INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN LOW-INCOME COUNTRIES—2025

April 2025

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its April 14, 2025, consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on March 19, 2025, for the Executive Board's consideration on April 14, 2025.
- A **Staff Supplement**.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 25/58

IMF Executive Board Discusses Macroeconomic Developments and Prospects in Low-Income Countries—2025

FOR IMMEDIATE RELEASE

Washington, DC – **April 14, 2025:** The Executive Board of the International Monetary Fund (IMF) discussed the IMF staff paper on Macroeconomic Developments and Prospects in Low-income Countries (LICs). The paper defines LICs as the 70 countries eligible for the Poverty Reduction and Growth Trust facilities

LICs experienced in 2024 another year of steady but modest growth of an average 4.4 percent, with marked divergence across countries. Disinflation advanced on the back of moderating international prices for energy and food staples. At the same time, many LICs continue to face significant external vulnerabilities. Aggregate data conceal significant divergence in economic outturns across countries. More than half of the world's fastest growing economies in 2024 were LICs, often frontier markets and diversified economies. At the other extreme, many of the poorest LICs, often affected by fragility and conflict, experienced very low growth rates, virtually no progress on per capita incomes, and large pockets of food insecurity.

Important policy and reform efforts are underway, but more progress is needed. LICs' gradual fiscal consolidation supported a modest decrease in public debt levels. However, liquidity conditions remain tight in many LICs, and high debt service burdens often constrain space for much needed development spending. Monetary policy has supported disinflation and structural reforms advanced, albeit at an often-slow pace.

LICs' growth is expected to accelerate over 2025-29. However, downside risks are significant. These reflect a subdued global economic outlook and elevated uncertainty from recent announcements on trade policies and aid flows, as well as tighter global financial conditions. The outlook is also conditional on strong policies, steadfast reform implementation, and the absence of new major shocks.

Efforts to reinvigorate growth are needed across all LICs and entail two priorities. The first priority involves implementing the necessary fiscal consolidations with as little negative impact on growth and vulnerable households as possible. Moreover, the mobilization of growth-enhancing external financial inflows and domestic financial market development can support consumption and investment. The second priority is to improve LICs' growth potential by increasing productivity, and especially total factor productivity (TFP), which has contributed negatively to growth in recent years.

The policy and reform agenda should be carefully calibrated to country-specific conditions and focus on enhancing spending efficiency and prioritization, mobilizing domestic revenue, and strengthening economic institutions. Staff analysis also suggests that improvements in governance would be instrumental in mobilizing growth-enhancing capital inflows and domestic financial market development. Improved governance would also help increase TFP, together with measures to enhance education and health, broaden labor force participation, and promote innovation.

The report also examines exchange rate and foreign exchange market operations in LICs and identifies a trend among LICs to move away from market-determined exchange rates towards exchange rate regimes driven to a greater extent by authorities' measures. This trend has resulted in a growing gap between LICs' declared exchange arrangements (de jure) and what the exchange arrangements are in practice (de facto) and has led to less clarity about nominal anchors in LICs. There has been steady progress in developing foreign exchange markets, with less reliance on central bank allocations but LICs impose more restrictions on capital flows than emerging market countries and continue to maintain exchange restrictions and multiple currency practices.

Executive Board Assessment[1]

Executive Directors welcomed the opportunity to discuss recent macroeconomic developments and prospects in low-income countries (LICs). They broadly supported staff's assessment and the identified policy priorities, in particular the need to reduce high debt burdens and reinvigorate growth through well-designed fiscal policies and measures to increase productivity.

Directors noted positively that LICs' average growth in 2024 remained steady at 4.4 percent, notwithstanding significant scarring from the COVID-19 pandemic and the shock-prone environment. They commended progress with disinflation, supported in many countries by monetary and fiscal tightening. While noting the modest decrease in LICs' public debt levels on the back of gradual fiscal consolidation, Directors raised concerns about elevated debt service burdens and the limited space to finance development spending in many countries.

Directors acknowledged the significant heterogeneity in macroeconomic outcomes across LICs. They were concerned that the poorest and most fragile countries have seen virtually no progress on per capita income convergence with advanced economies over the past 15 years. They highlighted the detrimental impact of fragility and conflicts on LICs and emphasized the need for careful tailoring of policy and structural reform agendas to country-specific conditions and coordinated international support. On the other hand, they welcomed that about half of the fastest growing economies in 2024 were LICs, mostly frontier markets and diversified economies.

Looking forward, Directors noted the relatively benign medium-term baseline growth outlook for LICs but were concerned about substantial downside risks which have intensified given recent global developments. These include elevated uncertainty from recent announcements on trade policies and aid flows, financial market volatility, and tighter global financial conditions which pose additional headwinds for the subdued global economic outlook.

Directors emphasized the need for strengthening growth-friendly fiscal consolidation in LICs, to help reduce the high debt burdens and to create space for growth-enhancing investment, education, and health spending, as well as targeted social protection for vulnerable populations. This would require sustained efforts to enhance domestic resource mobilization and strengthen spending efficiency and prioritization. Directors emphasized the importance of the Fund and World Bank's three-pillar approach to help LICs address debt service challenges

[1] At the conclusion of the discussion, the Managing Director, as Chair of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

and underscored the need for strengthening public financial and debt management practices and reforming SOEs.

Directors acknowledged that important structural reform efforts are underway but noted that the pace of reforms has been uneven and too gradual. They underscored that reinvigorating growth is critical to make progress on LICs' convergence with more advanced economies and to advance their development path. They noted with concern the negative contribution of total factor productivity to growth in recent years and stressed the critical importance of strengthening governance, institutions, education, health, capital formation, innovation, and female labor participation as key enablers of inclusive and sustainable growth. Sustained progress in these areas would also help stimulate external financial inflows. Directors supported efforts to develop domestic financial markets, which would create an enabling environment for investment.

Directors welcomed the analysis of exchange rate and foreign exchange market operations in LICs. While they positively noted the increased development of foreign exchange markets, Directors expressed concerns about the trend among LICs to move away from market-determined exchange rates towards more managed exchange rate regimes. They concurred that this trend is resulting in less clarity about nominal anchors in LICs, given the growing gap between LICs' declared exchange arrangements (*de jure*) and what the exchange arrangements are in practice (*de facto*), and encouraged deeper analyses of the drivers of this trend and policy implications.

Directors underscored the importance of strong sustained Fund engagement with LICs through targeted policy advice, capacity building, and financing. They underscored the important role played by the Fund in helping LICs maintain or restore macroeconomic and financial stability and implement growth-enhancing reforms. They encouraged proactive consideration of Fund financing support in light of heightened challenges and increased risks. Directors urged the Fund to continue to leverage its comparative advantage to support LICs, and to maintain close cooperation with the World Bank and other development partners and stakeholders in this effort.

Directors looked forward to further discussions on tailored Fund support for LICs and for fragile and conflict-affected states in the context of forthcoming reviews including the Comprehensive Surveillance Review, the Review of Program Design and Conditionality, and the LIC-DSF Review.

INTERNATIONAL MONETARY FUND

March 19, 2025

MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN LOW-INCOME COUNTRIES—2025

EXECUTIVE SUMMARY

Recent Developments and Outlook in LICs

The 70 low-income countries (LICs) in the IMF's membership experienced steady but modest growth in 2024, with marked divergence across countries. LICs' GDP-weighted average growth turned out at 4.4 percent, unchanged from 2023, and one point below the average growth experienced over the 2010s. Disinflation took hold, while significant external vulnerabilities persisted for many LICs. The aggregate statistics mask important divergence across countries. In 2024, 11 of the 20 fastest growing countries in the world were LICs. By contrast, growth remained very low in many of the poorest LICs that are also often fragile and conflict-affected states (FCS). And many of the poorer LICs saw virtually no progress on per capita incomes over the past 15 years, while the more advanced LICs realized significant gains.

Important policy and reform efforts are underway, but more progress is needed. Gradual fiscal consolidation proceeded in about half of the LICs, supporting further stabilization of public debt levels. The adjustment relied both on tax revenue increases and modest expenditure compression. A funding squeeze continues to constrain priority spending in support of sustainable development and growth in many countries. Monetary policy has supported disinflation; and growth-enhancing structural reforms proceeded, albeit at an often slow pace.

LICs' GDP growth is expected to accelerate over the medium term, amid downside risks reflecting the subdued global economic outlook and heightened uncertainty. Staff expects LICs' GDP-weighted growth over 2025-29 to reach an average 5.7 percent (4.5 percent for the median country). These relatively benign projections are underpinned by strong forecasts for 13 countries, including some LICs exiting conflicts and fragility as well as Frontier Markets, which would grow at an annual 6 percent or more. More broadly, this outlook is subject to significant downside risks, including on the evolution of global growth, international financial conditions, and exchange rate movements. It also depends critically on strong policy and steadfast reform implementation (including decisive fiscal adjustment in 2025), adequate external financing including aid flows, and the absence of major negative shocks.

Reinvigorating Inclusive Growth in LICs

Reinvigorating inclusive growth in LICs entails two priorities for policymakers. First, implementing the necessary fiscal consolidation with as little negative impact on growth and vulnerable households as possible, and supporting consumption and investment through the mobilization of growth-enhancing external financial inflows and

the development of domestic financial markets. Second, improving productivity to enhance LICs' growth potential. Without policy measures to support all factors of production, and especially TFP that has contributed negatively to growth since the COVID-19 pandemic, LICs will not be able to generate the levels of growth needed to improve durably the standards of living for their often fast-growing populations.

The analyses on aggregate demand and productivity in LICs suggest clear priorities for policymakers, as part of a broader policy and reform agenda. Acknowledging that country-specific conditions will require careful fine-tuning of the agenda, LICs and their external partners could focus on (1) enhancing spending efficiency and prioritization, and mobilizing domestic revenue where needed, (2) improving economic institutions, including through technology, in support of external capital inflows and domestic financial market development, (3) boosting TFP through measures to improve governance, education, and health, while supporting capital formation and innovation, and (4) facilitating broad labor force participation.

Exchange Rate and Foreign Exchange (FX) Market Operations in LICs

Developments and prospects in LICs include important evolutions since 2009 in exchange rate arrangements, FX markets, and restrictions to capital and current account transactions:

- There has been a clear trend among LICs to move away from market determined exchange rates toward regimes where the exchange rate is to a greater extent driven by authorities' measures. As a result, there are greater inconsistencies between what the authorities in LICs report as their exchange arrangement (de jure) and what the exchange arrangement is in practice (de facto).
- There has been a move towards less clarity regarding the economy's nominal anchor in LICs; also, the exchange rate remains the main nominal anchor in about 50 percent of LICs.
- There has been steady progress in developing FX markets in LICs. Overall, central banks are playing a lesser role in allocating foreign exchange including through greater reliance on FX auctions to facilitate price discovery.
- The balance of payments' financial accounts of LICs remain less open than those of Emerging Market and Developing Economies (EMDEs) and advanced economies and the average restrictiveness is lower on capital inflows than outflows. However, there is a large dispersion in the degree of restrictiveness among LICs.
- LICs have been easing capital controls at a significantly slower pace than EMDEs and tend to adjust their controls less frequently than EMDEs, perhaps due to less capacity to calibrate and enforce such changes.
- Many LICs continue to maintain exchange restrictions and multiple currency practices (MCPs) subject to IMF jurisdiction, including as a means to allocate and prioritize the distribution of scarce foreign exchange resources.

Approved By
Guillaume Chabert (SPR) and Miguel Savastano (MCM)

Prepared by the Strategy, Policy, and Review Department and the Monetary and Capital Markets Department, with helpful comments from other Departments and the World Bank, under the overall guidance of Guillaume Chabert (SPR) and Miguel Savastano (MCM) and the supervision of Bjoern Rother and Jung Yeon Kim (SPR) and of Jennifer Elliott and Thorvardur Tjoervi Olafsson (MCM). The team included Oana Luca and Marta Spinella (leads, SPR), Paula Arias, Yiran Chen, Rachidi Kotchoni, Maxwell Kushnir, Yinhao Sun, Maxwell Tuuli, Holt Williamson, Alexander Zaborovskiy, Yipei Zhang, Lavinia Zhao, and Ling Zhu (all SPR); and Salim M. Darbar (lead, MCM) and Michael Gottschalk (MCM). Linda Bisman, Tifany Lacroux, Emelie Stewart, and Katarina Varga (SPR) provided excellent administrative coordination.

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Glossary

AD	Aggregate demand
AE	Advanced Economies
AES	Alliance of Sahelian States
AI	Artificial Intelligence
AIPI	Artificial Intelligence Preparedness Index
AREAER	Annual Report on Exchange Arrangements and Exchange Restrictions
BCEAO	Banque Centrale des États de l'Afrique de l'Ouest
BEAC	Banque des Etats de l'Afrique Centrale
BOP	Balance of Payments
CA	Current Account
CEMAC	Central African Economic and Monetary Community
COVID	Coronavirus Disease 2019
CPI	Consumer Price Index
DRM	Domestic Revenue Mobilization
DSF	Debt Sustainability Framework
ECOWAS	Economic Community of West African States
EM	Emerging Markets
EMDE	Emerging market and developing economies
EM-DAT	International Disaster Database
FARI	Financial Account Restrictiveness Index
FCS	Fragile and Conflict-affected States
FDI	Foreign Direct Investment
FM	Frontier Markets
FRED	Federal Reserve Economic Data
FSIN	Food Security Information Network
FX	Foreign Exchange
FY	Fiscal Year
GDP	Gross Domestic Products
GFC	Global Financial Crisis
GNI	Gross National Income
ICRG	International Country Risk Guide
IDA	International Development Association
IDS	International Debt Statistics
IFS	International Financial Statistics
IMF	International Monetary Fund
IQR	Interquartile Range
LICs	Low-income Countries
MCM	Monetary and Capital Markets Department

MCP	Multiple currency practices
MONA	Monitoring of Fund Arrangements
MTRS	Medium-Term Revenue Strategy
OI	Other Investment
OTC	Over the Counter Markets
PFM	Public Financial Management
PI	Portfolio Investment
PIM	Public Investment Management
PRGT	Poverty Reduction and Growth Trust
SDG	Sustainable Development Goals
SDR	Special Drawing Rights
SDS	Small Developing States
SOEs	State-owned enterprises
SPR	Strategy, Policy and Review Department
SSA	Sub-Saharan Africa
STA	Statistics Department
TFP	Total factor productivity
UCT	Upper Credit Tranche
WAEMU	West African Economic and Monetary Union
WB	World Bank
WDI	World Development Indicators
WEO	World Economic Outlook
WGI	Worldwide Governance Indicators

RECENT DEVELOPMENTS AND OUTLOOK IN LICS[1]

This section provides an overview of recent economic developments in the 70 low-income member countries of the IMF. Based on this, the discussion moves to recent policy and reform efforts, and the medium-term outlook.

A. Another Year of Modest Growth but Increasing Cross-Country Divergence

The 70 low-income countries in the IMF's membership experienced another year of steady but modest growth in 2024, in a shock-prone environment and amid increasing divergence in macroeconomic outturns across countries. LICs' average GDP growth turned out at 4.4 percent, virtually unchanged from the year before. Gains on disinflation broadened, while significant external vulnerabilities persisted for many LICs. The aggregate statistics mask significant divergence in performance. On one side of the spectrum, 11 of the 20 fastest growing countries in the world in 2024 were LICs. On the other, growth remained weak in many of the poorest LICs that are also often fragile and conflict-affected states (FCS). Similar divergence can be observed in the evolution of per capita incomes: for the subsample of the 38 more advanced LICs, income convergence vis-à-vis advanced economy peers progressed during the 2010s and again since 2022, while the poorest 32 LICs saw virtually no improvement over the past 15 years.

Modest and Increasingly Divergent Growth Across Low-Income Countries

1. LICs experienced another year of modest growth amid a shock-prone environment.[2] Average (weighted) GDP growth for LICs remained virtually unchanged from 2023, at 4.4 percent (Figure 1). While exceeding outturns for both Emerging Markets (EMs) and Advanced Economies (AEs), growth remained 1 percentage point lower than the average rate achieved during the 2010s. Global economic conditions worked in LICs' favor with resilient growth throughout the disinflationary process, steady trade volumes, and the reversal of the upward trend in AEs' monetary policy rates (IMF 2025a). That said, LICs experienced more scarring from the Covid-19 pandemic than their higher-income peers and faced greater exposure to additional exogenous shocks. Many were susceptible to extreme climate events due to their unfavorable geographical location, high dependence on agriculture, and limited adaptation capacity (Figure 2).[3] Moreover, conflicts and

[1] Low-income countries are defined in this report as the 70 countries currently eligible to Poverty Reduction and Growth Trust (PRGT) facilities. This universe of 70 countries can be further segmented by income level, institutional characteristics, and export structure to highlight the significant heterogeneity across LICs regarding their economic conditions. See Annex I for details.

[2] The aggregate growth for LICs is calculated using a weighted average, following the WEO methodology. For all other macroeconomic variables, this report mainly relies on medians.

[3] Recent examples include cyclones in Bangladesh and Mozambique, droughts in Ethiopia, Ghana, Kenya, Malawi, Somalia, Tanzania, Zambia, and Zimbabwe, and floods in Chad, the Democratic Republic of Congo, Mali, Niger, and Sudan.

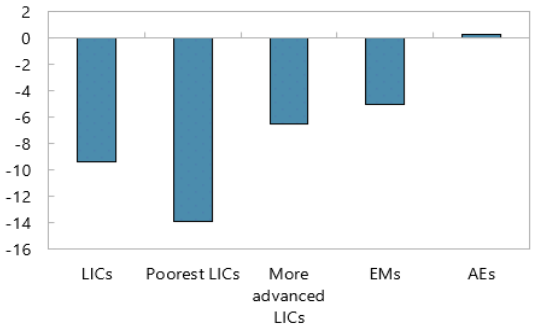
political instability[4] weighed on several countries, and policy slippages were amplified in many of the 21 LICs with parliamentary or presidential elections in 2024.[5]

Figure 1. Growth Performance 2022-24

Real GDP Growth by Income Group
(Weighted Average, in percent)

	2010-19 average	2022-23 average	2024
LICs	5.4	4.6	4.4
EMs	5.0	4.2	4.2
AEs	2.1	2.3	1.7

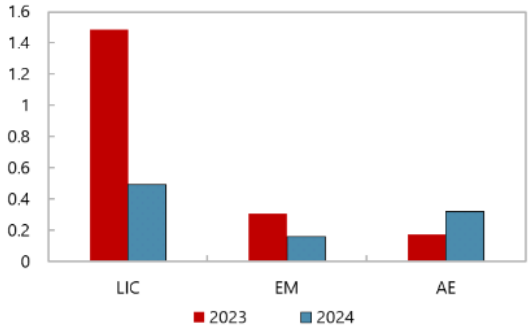
Scarring from the Covid Pandemic
(Gap between GDP level projected for 2024 in 2020 versus outcome (In percent))



Sources: WEO, IMF staff calculations.
Note: Scarring calculations are based on January 2020 WEO GDP projections for 2024 and January 2025 WEO GDP outcome for 2024.

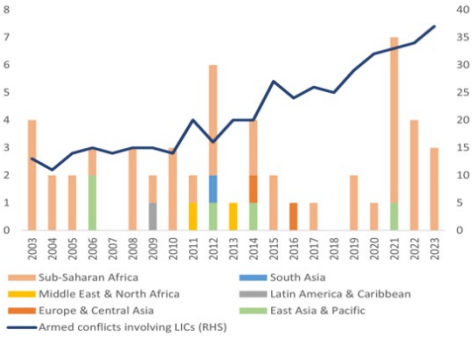
Figure 2. A Shock-Prone World for LICs

Average Damage from Climate Disasters
(Percent of GDP)



Sources: EM-DAT, IMF staff calculations.

Number of Coup Attempts and Armed Conflicts in LICs



Sources: Powell and Thyne (database on coups), Uppsala Conflict Data Program, IMF staff calculations.

Notes: EM-DAT data is subject to time, threshold, and geographical biases. Uninsured damages are underreported.

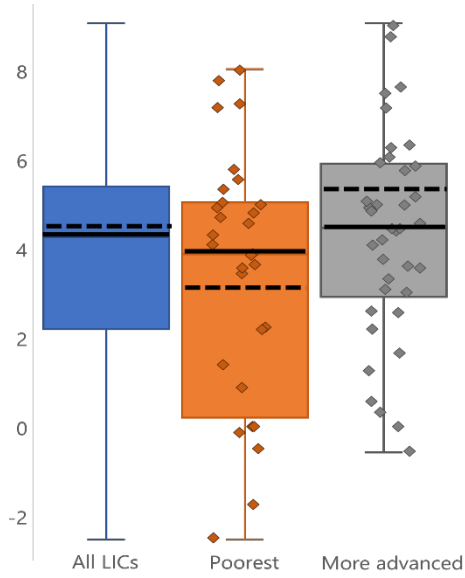
[4] Since the military seized power in Niger, Burkina Faso and Mali, relations between the Economic Community of West African States (ECOWAS) and the three Sahel countries became tense, including through the imposition of sanctions. The three countries formed the Alliance of Sahelian States (AES), and officially exited ECOWAS on January 28, 2025, but decided to remain in the West African Economic and Monetary Union (WAEMU).

[5] In the countries with elections, fiscal deficits exceeded October 2023 WEO forecasts by a median of 0.2 points of GDP, and important reform projects such as the fuel subsidy reform in Madagascar and anti-corruption regulations in Moldova took delays. Unlike the typical experience in EMs, there were no systematic movements in LICs' exchange rates in the months surrounding election episodes.

2. The aggregate statistics mask significant divergence in growth outturns across countries, highlighting the heterogenous nature of the LIC universe. Figure 3 visualizes the significant degree of divergence in growth among LICs during the post-COVID period (2022-24). Among the 70 LICs, 11 countries achieved average annual growth rates of 6.0 percent or more, while 10 countries recorded growth rates of 3.0 percent or less. It is noteworthy that LICs accounted for 11 of the world's 20 fastest growing economies in 2024, 7 of which from Sub-Saharan Africa. Meanwhile, Sudan and South Sudan are extreme cases in the poorest group: over the last three years, their GDP growth fell by an average 9 percent and 16 percent, respectively,[6] reflecting the impact of civil war and fragility.

3. The varied growth experience across LICs reflects their diversity in key structural and institutional characteristics. The countries' respective per capita income levels reveal important insights for the divergent growth experience over recent years (Figure 3).[7] Specifically, annual growth averaged 5.4 percent for the 38 ***more advanced LICs***, surpassing LICs' average growth during the 2010s. Meanwhile, the 32 ***poorest LICs*** recorded average growth of only 3.1 percent. Moreover, growth dispersion was higher among the poorest LICs than for the more advanced LICs. Structural and institutional characteristics, which are typically correlated with LICs' per capita income level, offer some clues to explain the growth divergence:

Figure 3. Real GDP Growth 2022-24
(Percentage)



Sources: WEO, IMF staff calculations.
Note: Straight horizontal lines are medians; dotted lines are average growth rates.

- ***Diversified export structures and access to international capital markets have typically been associated with stronger growth.***[8] LICs with diversified export structures and Frontier Markets (FM) have consistently recorded strong growth in recent years, averaging 5.4 percent and 5.3 percent over 2022-24, respectively.

- ***By contrast, fragility and conflicts, as well as undiversified export structures, were correlated with below-average growth rates.*** FCS achieved a mere 2.4 percent annual growth

[6] The sharpest decline in growth was recorded in 2024: -23.4 for Sudan and -26.4 for South Sudan.

[7] The ***poorest LICs*** include 29 countries with a GNI per capita below the FY25 International Development Association (IDA) cut-off (US$1,335) as well as Nepal, Guinea and Haiti that are included in this group for consistency with the Tier 1 ("the lowest income") countries as identified in IMF 2024a. The ***more advanced LICs*** are the remaining 38 PRGT-eligible countries with GNI per capita above the IDA cut-off. See also Annex I.

[8] Diversified economies include countries whose exports are dominated by manufactured goods or more than one category of exported products. See Annex I.

rate over 2022-24; and fuel exporters recorded the weakest performance of all LIC subgroups with average growth of only 0.8 percent.[9]

Income Convergence for Some, Risk of Decoupling for Others

4. About half of the LICs have made some progress on income convergence with EMs and AEs in recent years, mostly in the subgroups of diversified and more advanced countries. As shown in Figure 4, the median per capita income for LICs has hovered at 6.5 percent of the AE median for over two decades, while some EMs have managed to narrow their gap. At the same time, one can observe significant heterogeneity across LICs.

- **More advanced LICs are making progress.** Their median income per capita has risen from about 9 percent of the AE median in 2000 to 11 percent in 2024. Similar improvements can be observed across the interquartile range. Some fast-growing LICs are on track to achieve EM status, provided the positive trend continues.

- **The poorest LICs are falling increasingly behind.** Their median income per capita has hovered around 4 percent of the AE median. Interestingly, the poorest countries in the LIC universe today were also the poorest countries at the turn of the century.[10] Many of them failed to capitalize on the favorable global economic conditions prior to the 2008 Global Financial Crisis (GFC) and on the commodity price super-cycle of the 2010s. Rapid population growth (2.8 percent per year during 2000-2024 compared to 1.7 percent for more advanced LICs) has contributed to these countries' difficulties in progressing on their per capita incomes.

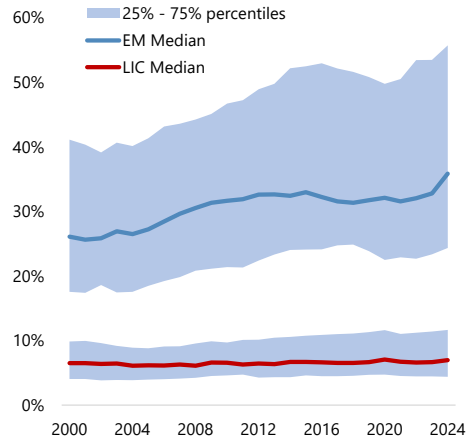
[9] The World Bank highlights the impact of fragility on progress with poverty reduction. The IMF discussed how export concentration has led to divergent growth paths for resource rich and non-resource rich countries (World Bank 2025, IMF 2024b).

[10] World Bank 2025, Chapter 4, presents similar conclusions based on a slightly narrower sample of countries.

Figure 4. PPP-Adjusted Real Per Capita Income Gap and Convergence with AEs

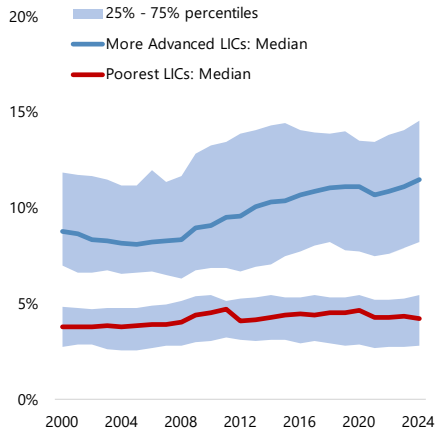
Per Capita Income: LICs Versus EMs

(Percent of AE median)



Per Capita Income: LIC Subgroups

(Percent of AE median)



Sources: WEO, IMF staff calculations.

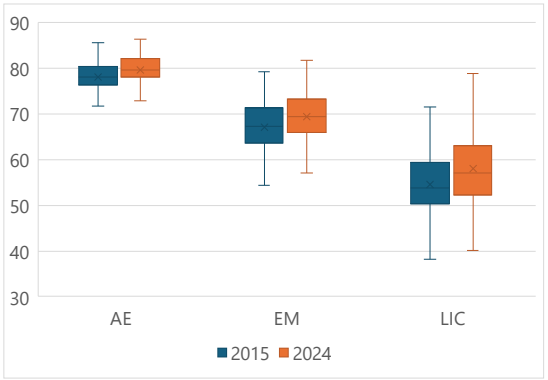
Note: The 2012 structural break in the poorest LICs' median reflects the inclusion of Somalia whose data was not available prior to 2012.

5. Progress on human development and poverty reduction remains challenging especially for the poorest LICs. Among the 135 assessable Sustainable Development Goals (SDG), only 17 percent are on track to be met by 2030. The remaining 83 percent show limited progress or a reversal of progress. Progress remains elusive especially for FCS and the poorest LICs (Figure 5).[11]

Figure 5. Sustainable Development Goals (SDG) Composite Index

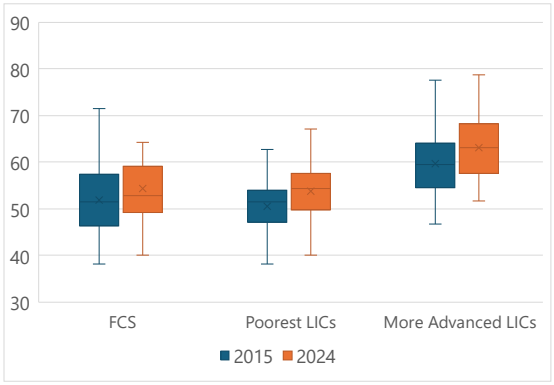
SDG Index across Country Groups

(Range 0-100)



SDG Index across LIC Subgroups

(Range 0-100)



Sources: 2024 SDG Database, IMF staff calculations.

Note: The SDG Index aggregates data on individual SDGs into a composite index. "X" in the figures denotes the mean of that country group.

[11] For 2024, more than half of the LICs exhibit moderate to severe deviations from the desired SDG trajectory and nearly 30 percent only show marginal progress (see Sachs, Lafortune and Fuller, 2024).

Progress on Disinflation Amid Tight Credit Conditions

6. Median inflation further decelerated in 2024, but price pressures and related food insecurity remain major problems for some LICs. On the back of falling world inflation, supported by stabilizing goods prices (including for energy and food staples) and monetary tightening in about a third of the countries, LICs' median CPI inflation declined to 4.6 percent in 2024. This reading signals significant progress since inflation peaked at 8.0 percent in 2022 (Figure 6). However, concerns about the increase in the cost-of-living remain pertinent: prices for key staples in the consumption baskets are now significantly higher than during the previous decade; and about 25 percent of LICs, most of them among the poorest and most fragile countries, continued to experience double-digit inflation in 2024. Higher prices, in combination with supply constraints and distribution challenges in areas plagued by security concerns, are also major factors driving food insecurity. In 2024, about 209 million people in 41 countries worldwide, many of which FCS, were classified as acutely food insecure (FSIN and Global Network Against Food Crises 2024).

Figure 6. Low-Income Countries: Macroeconomic Outturns and Prospects

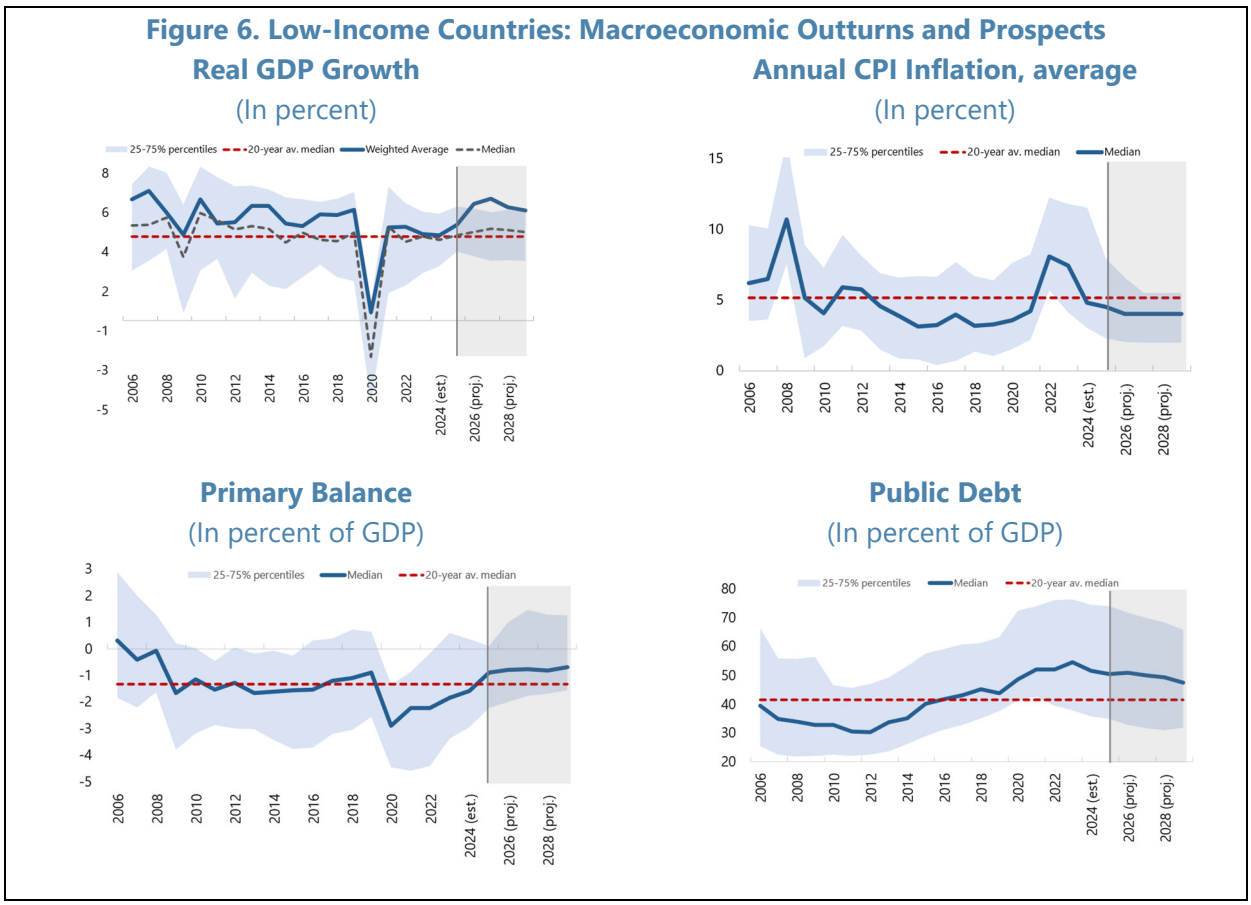
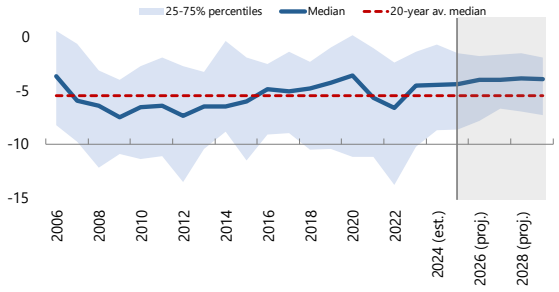
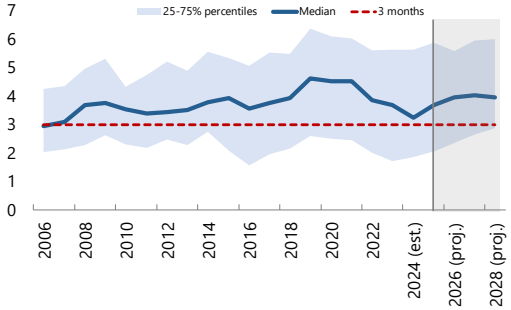


Figure 6. Low-Income Countries: Macroeconomic Outturns and Prospects (concluded)

Current Account
(In percent of GDP)



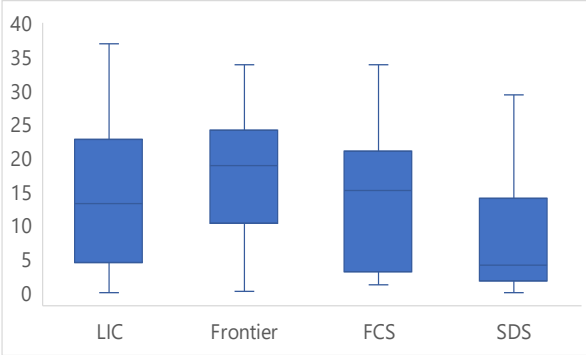
FX Reserves
(In months of imports)



Sources: WEO, IMF staff calculations.

7. Domestic financial sectors continued to show resilience in 2024, but tight liquidity conditions and a growing sovereign-bank nexus in some LICs point to increasing risks. Median credit to the private sector is projected to reach 24 percent of GDP in 2024, up from 22 percent of GDP in 2023. [12] At the same time, many LICs showed signs of elevated liquidity pressures, with liquid bank assets as a share of total assets declining sharply in 2024. Banks' median exposure to the sovereign remains relatively contained but has been growing significantly in some LICs (Figure 7).

Figure 7. Banking Sector's Claims on Central Government in LICs: 2024
(In percent of banking sector assets)



Sources: IFS, IMF staff calculations.
Note: The number reflects monthly averages between Jan-Jun 2024. The whiskers of the boxplot, being visually close to zero, indicate that banking sectors in some small and developing states (SDS) have a small exposure (less than 5 percent) to central government.

Stubborn External Vulnerabilities

8. LICs struggled in making progress with turning around often large external current account (CA) deficits.[13] The median (average) CA deficit for 2024 of 4.4 (6.1) percent of GDP remained almost unchanged from 2023's level of 4.5 (6.1) percent of GDP, despite softening international prices for energy and food as well as continued demand for LICs' exports. Indeed, these positive trends were overcompensated by the impact of highly negative public sector savings-investment balances (Box 1), and, in some cases, sizeable exchange rate depreciations. Divergences in CA trends across LICs can often be traced to differences in countries' export structures, while a majority of LICs experienced a rapid increase in

[12] LICs' median private credit of 24 percent of GDP still represents only a fraction of the levels typically found for EMs and AEs. For the 15 LICs with the least developed credit markets, private credit-to-GDP ratios range between 2 and 15 percent. On the other side of the distribution, some Asian LICs (Cambodia, Nepal, and Bhutan) report credit penetration comparable to AEs, although the depth of their credit markets remains well below that of AEs (and in the case of Nepal, the financial sector still faces structural challenges).

[13] In 2024, 23 out of 39 LICs assessed in IMF Article IV reports had external sector positions that were weaker, moderately weaker, or substantially weaker than their economic fundamentals suggested.

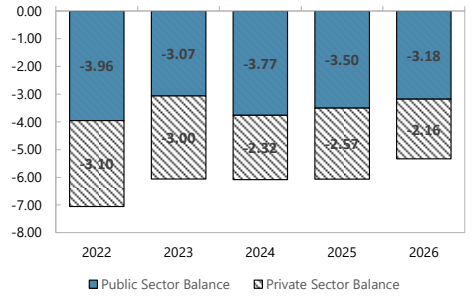
remittance inflows in recent years (total flows almost tripled between 2010 and 2023 to US$117 billion).[14]

Box 1. Twin Deficits in LICs

In many LICs, public sector deficits and current account deficits are closely intertwined, giving rise to twin deficits. LICs' average CA deficit of 6.1 percent of GDP in 2024 can be decomposed into a public sector deficit of 3.8 percent of GDP, driven by a large gap between public investment and public savings (the difference between domestic revenues and current spending), and a smaller private sector deficit of 2.3 percent of GDP. Fuel exporters exhibit a particularly strong nexus between fiscal and external accounts. Staff analysis shows that, on average across all LICs, a one percentage point improvement in fiscal balances translates into a reduction in CA deficits of half a percentage point. This correlation increases to almost one for fuel exports (correlation coefficient of 0.90).

Decomposition of Current Account Deficits

(Percent of GDP, average of components across LICs)



Sources: WEO, IMF staff calculations.

9. While several frontier markets returned to the market in 2024 and FDI inflows increased slightly in nominal terms, overall capital account inflows to LICs remained subdued.

- ***Between January and July 2024, several Frontier Markets issued Eurobonds, ending a temporary absence from international markets.*** Collectively, Benin, Cote d'Ivoire, Senegal, Kenya, Cameroon, and Uzbekistan raised US$7.7 billion with new issuances. In parallel, sovereign spreads declined significantly. That said, it remains to be seen whether these welcome events will continue in the current international environment that has become more challenging, and whether these issuances will lead the way towards a broader trend for LICs to (re-)gain access to international capital markets.[15] Other than sovereign Eurobond issuances, portfolio inflows were largely absent from LICs due to underdeveloped financial markets.

- ***Gross FDI inflows grew slightly in nominal terms but remained unchanged in real terms, at about 2 percent of LICs' GDP.***[16] FDI inflows have historically been the largest contributor to LICs' total capital inflows. However, since the pandemic, around three quarters of LICs have

[14] With still elevated global energy prices, fuel exporters reported the lowest median CA deficit of 1.7 percent of GDP. By contrast, tourism dependent LICs fared the worst in 2024 with a median deficit of 7.4 percent of GDP, reflecting a (downward) normalization of travel patterns.

[15] Even before the pandemic, access to international capital markets was selective. Based on BIS's International Debt Security (IDS) data, only 16 LICs (Ghana, Cote d'Ivoire, Kenya, Senegal, Zambia, Lao PDR, Honduras, Ethiopia, Uzbekistan, Cameroon, Bangladesh, Benin, Papua New Guinea, Tajikistan, Rwanda, Maldives) issued Eurobonds with face value exceeding US$100 million during the 2010s.

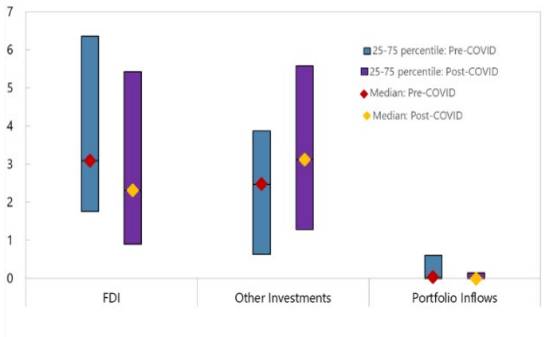
[16] Gross FDI inflows to LICs averaged an annual 3.1 percent of GDP during the 2010s.

experienced a decline in these flows as a share of GDP. The remaining quarter recorded an increase in FDI mostly in sectors related to natural resource exploration.

- ***Taken together, the new market financing and FDI were not strong enough to boost overall capital account flows to LICs.*** This partly reflects changes in the Other Investment (OI) inflows category that includes official bilateral and multilateral assistance loans and other bank flows. OI rose during the Covid period, overtaking FDI as the largest source of inflows, but have declined since 2022 (Figure 8).[17]

10. With little improvement in CA deficits and declining capital inflows, foreign exchange (FX) reserves remained under pressure in many LICs. Median FX reserves dropped to 3.2 months of imports in 2024 from 3.7 months in 2023. Exchange rate interventions in support of LICs' domestic currencies contributed to this negative trend. A more disaggregated view shows a worrisome picture: 30 LICs, often among the poorest and most fragile, had reserve cover of less than 3 months of imports at the end of 2024 (unchanged from 2023). Meanwhile, international reserves for the more advanced LICs stood at 4.5 months of imports.

Figure 8. Gross Capital Inflows to LICs: Before and After Covid
(In percent of GDP)



Sources: Official data, BOP statistics, WEO, IMF staff calculations.
Note: Pre-Covid (Post-Covid) medians and 25-75 percentiles are computed from 2010-19 (2021-23) period average.

B. Policy and Reform Efforts are Underway, but More Progress is Needed

Gradual fiscal consolidation proceeded in about half of the LICs, supporting further stabilization of public debt levels. For the median country, this adjustment relied on tax revenue increases and modest expenditure compression in broadly equal measure. While risks of a systemic debt crisis seem contained, pockets of vulnerabilities remain, and debt service challenges are elevated in many countries. Monetary policy supported disinflation and gradual growth-enhancing structural reforms proceeded, albeit at an often slow pace.

Broadening Gains on Fiscal Consolidation in Support of Further Public Debt Stabilization

11. Fiscal balances improved in about half of the LICs in 2024, but the pace of underlying consolidation efforts often remained very gradual. The median overall (primary) fiscal deficit decreased to -3.1 (-1.6) percent of GDP in 2024 from -3.6 (-1.8) percent in 2023. 33 countries out of the total 70 LICs strengthened their fiscal positions. Consolidation typically proceeded in a gradual

[17] The median for Other Inflows (OI) to LICs surged to an average 3.1 percent of GDP during the COVID-19 pandemic (2021-23), up from 2.5 percent of GDP during the preceding decade. However, OI subsequently fell sharply as donor priorities shifted, including due to the impact of the war in Ukraine.

way: only 18 countries reduced their deficits by more than one percent of GDP. Adjustment was most pronounced among the poorest LICs, reflecting a scarcity of available financing.

12. Consolidation efforts yielded early successes with Domestic Revenue Mobilization (DRM) in more than half of the LICs. LICs' median fiscal (tax) revenue increased by about 0.9 (0.4) points of GDP in 2024 to reach 21.3 (13.9) percent of GDP.[18] These results reflect efforts often centered on taking greater control over VAT and sales taxes (closing exemptions, broadening the VAT base), as well as tax administration measures expected to bear fruit more gradually. Looking at LIC subgroups reveals large divergences in tax revenue between the more advanced LICs with a median tax take of 15.4 percent of GDP, and the poorest group with a median of 10.8 percent of GDP. Even as DRM has gained increased attention as a policy tool, tax revenues remained below pre-pandemic levels in more than a third of LICs and, in particular, in many small and developing states (SDS) and FCS. Meanwhile, the recent popular discontent against certain tax policy measures in some countries highlights the need for careful design of the measures, including with regard to their distributional impact, and effective communication and consultation to build consensus (IMF 2024c).

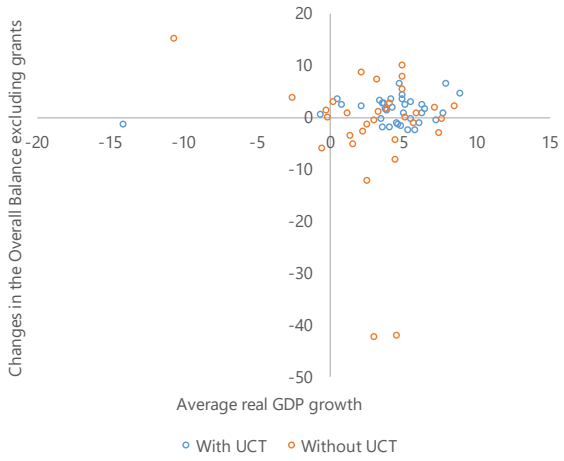
13. At the aggregate level, fiscal adjustments in LICs did not lead to significant expenditure compression in 2024. LICs' median expenditure in 2024 declined modestly to 24.0 percent of GDP, from 24.4 percent of GDP in 2023. Most of the decline was on account of current expenditure, while median capital expenditure remained almost unchanged at 6.2 percent of GDP (6.1 percent of GDP in 2023). The usual divide between poorer and more advanced LICs was observable again: median current and capital expenditures for the poorest LICs represented only 14 percent and 5.7 percent of GDP respectively, underscoring their limited fiscal space and elusive access to financing. Conversely, median current and capital expenditure for higher-income LICs was 22 percent and 6.5 percent of GDP, respectively. In terms of quality of adjustment, most LICs continued to struggle with reducing distortionary energy subsidies, which consumed a large share of overall spending. That said, some progress was made in countries with Fund-supported programs (Figure 9). Median spending on social benefits in LICs rose to a record high of 3.8 percent of GDP in 2024, up from 3.3 percent of GDP in 2023, with sharp increases observed in LICs that held elections. However, LICs' median social benefits level remained at about one-quarter of that of AEs.[19]

[18] The difference is explained by non-tax revenue, which typically includes royalties and fees from natural resource exploitation, fees and charges for services, aid and grants, and profits from state-owned enterprises.

[19] Based on WEO data. The definition of social benefits should be distinguished from that of social spending. The former includes social assistance but does not include social insurance or health and education spending.

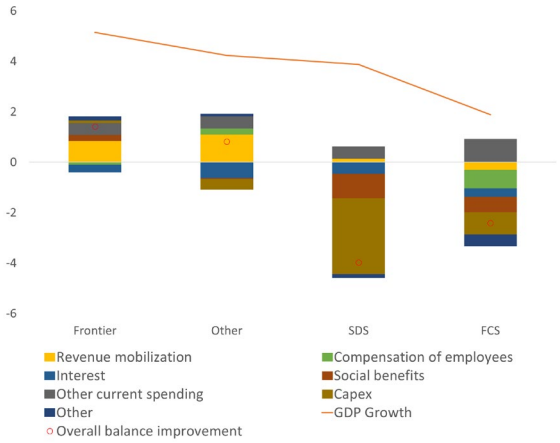
Figure 9. Fiscal Consolidation and Growth in LICs, 2021-24

LICs With/Without UCT Arrangements
(In percent)



Source: WEO, MONA, IMF staff calculations.
Note: Data for 2024 is preliminary. The sample covers 67 LICs without Afghanistan, Eritrea, and Syria due to data constraints. LICs under a Fund-supported program are defined as those that have concluded at least one successful review.

Decomposition of Fiscal Consolidation
(In percent, percent of GDP)



Source: WEO, IMF staff calculations.
Note: The sample covers 67 LICs without Afghanistan, Eritrea, and Syria due to data constraints. *GDP Growth* is the average real GDP growth between 2021-2024. *Overall balance improvement* is the improvement in the non-grant overall balance between 2021-2024.

14. Public debt levels saw another year of moderate decrease. The median debt-to-GDP ratio for LICs declined to 52.8 percent in 2024 from 54.7 percent in 2023, supported by fiscal consolidation efforts and steady GDP growth. While the median debt level fell, reliance on domestic public debt (proxied as total public debt less external public debt) in LICs remains at levels significantly higher than in the 2010s.[20] This trend accelerated in the wake of the Covid-19 pandemic, given the unanticipated need for funding and limited access to international markets.

15. Debt vulnerabilities remain high and, while the risk of a systemic debt crisis seems broadly contained under baseline assumptions, it still exists. The number of LICs at high risk or already in debt distress has fallen since 2021 (see Figure 10) and, even if remaining high compared to a decade ago, has almost returned to pre-pandemic levels. Most countries currently at high risk or already in debt distress are among the poorest and most fragile LICs.[21] That said, uncertainty around baseline assumptions has increased in recent months, and the risk of a broad-based debt crisis still exists.

Elevated Debt Service Challenges

16. While debt levels have stabilized, most LICs have been facing significant challenges from elevated debt service burdens. Interest payments on total public debt (external and

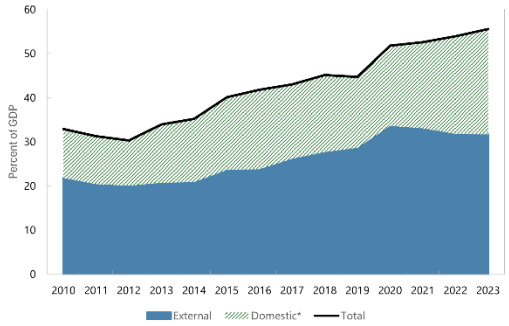
[20] For a comprehensive analysis of debt issues in LICs and EMs, please see IMF 2025b.

[21] Eritrea, and Yemen have not been assessed under the debt sustainability analysis (LIC-DSF) in 2024. Syria only entered the PRGT-eligibility list in the last quarter of 2024 and was also not assessed.

domestic) in LICs have increased by over two and a half times compared to a decade ago, with a significant acceleration since 2021 (Figure 10). Some LICs with increased reliance on domestic debt have been particularly affected by rapidly rising interest rates.[22] LICs' external debt service (interest and principal) pressures have also intensified, with obligations rising about two and a half times as a share of revenues (excluding grants) between 2014 and 2024 for the median LIC (from 6 percent of revenue to 15 percent). Proactively addressing these debt service challenges is becoming pressing, and Fund and Bank staff are working on implementing the conceptual framework provided by the "three-pillar approach" presented last Fall.[23]

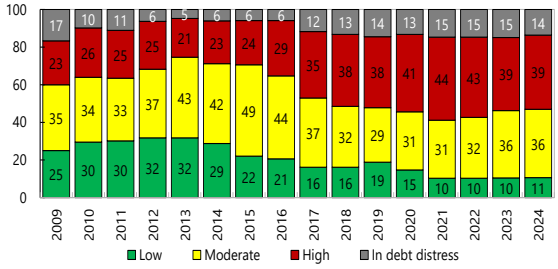
Figure 10. LIC Debt Indicators

Public and Publicly Guaranteed Debt in LICs
(Percent of GDP)



Sources: WEO, WB IDS, IMF staff calculations.

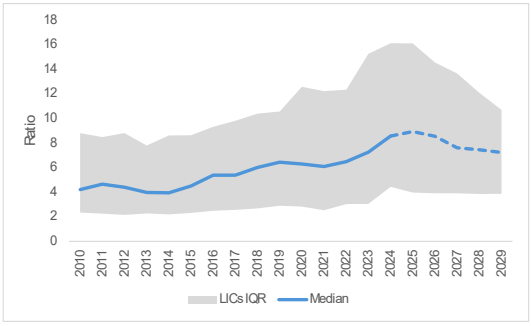
Evolution of Risk of Debt Distress
(In percent of LICs with LIC-DSF)



Sources: IMF-World Bank LIC-DSF database.

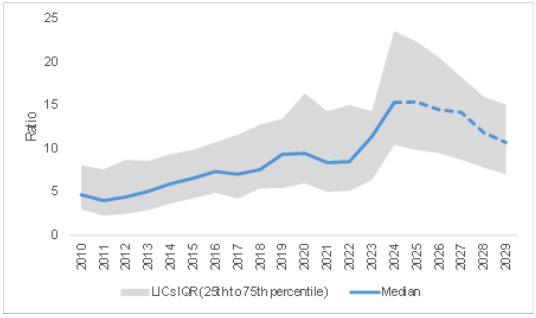
Note: *Domestic debt is calculated as the difference between total (general government) debt and external public debt.

LICs Overall Interest to Revenue
(Excluding Grants)



Sources: WEO, World Bank IDS, IMF staff calculations.

External Debt Service to Revenue in LICs
(Excluding grants)



Sources: WEO, IMF staff calculations.

Note: 2024 values are estimates. IQR is the interquartile range

[22] 23 percent of LICs used more than 40 percent of their fiscal revenue to cover domestic debt service, compared with a LIC median of 14.7 percent.

[23] For details, see June 2024 G-20 Note on Alternative Options for Revenue Mobilization.

Challenging Times for Monetary and Exchange Rate Policies

17. Many LICs achieved progress with disinflation, but weaknesses in policy frameworks often affected the effectiveness of monetary and exchange rate policies. While monetary tightening occurred through policy interest rate increases and/or quantitative measures, the effectiveness of these tools in the disinflation process was mixed. In many countries, key interest rates remained in negative territory at the end of 2024 when adjusted for inflation. Moreover, monetary and exchange rate policy frameworks often suffer from inconsistencies, such as having multiple objectives without a clear hierarchy.[24] This weighed on central banks' capacity to signal policy intentions and implement monetary policy. In addition, *de facto* exchange rate regimes have become less market-based, with a shift away from flexible exchange rates, likely reflecting, inter alia, low institutional capacity and weak monetary policy transmission mechanisms in many LICs (IMF 2025c, forthcoming). The result is a growing divide between *de jure* and *de facto* exchange rate regimes, with most LICs now implementing hard and soft pegs and only 6 LICs operating floating exchange rates (see Paragraphs 43-50).

Some Progress with Structural Reforms in a Difficult Socio-Political Context

18. Many LICs progressed with ambitious structural reform agendas, but often at a gradual pace. Fiscal sector reforms were a key focus, with attention placed on measures to increase revenues, improve the efficiency and effectiveness of public spending, enhance transparency, and adopt accountability mechanisms. Other reform efforts sought to address state-owned enterprises' (SOEs) inefficiencies, corruption and governance challenges, as well as to enhance the business climate, improve central banking structures and operations, and strengthen oversight and regulation of the financial sector. Recent experience from countries with Fund-supported programs fostering home-grown structural reforms indicates a positive relationship between such efforts on the one hand and growth outturns on the other, even if at times with significant lags.[25]

C. An Improving Outlook Conditional on Strong Policy and Reform Efforts

Macroeconomic projections based on the January 2025 WEO update indicate that LICs' GDP growth would accelerate over the medium term, notwithstanding subdued global growth.[26] LICs' GDP-weighted average growth over 2025-29 would accelerate to 5.7 percent, while median growth would increase less forcefully to 4.5 percent. 13 LICs, often among the larger countries in the LIC universe, are

[24] Only 7 percent of LICs are currently operating under an inflation targeting framework. Most LICs are in transition from monetary aggregate or exchange rate targeting to an interest-based monetary policy framework as a stepping-stone toward full-fledged inflation targeting (see Paragraphs 43 - 50).

[25] For example, Benin was successful in developing a Medium-Term Revenue Strategy (MTRS), improving public management of procurement and investment, and enhancing transparency. Cote d'Ivoire adopted measures to improve tax administration and MTRS as well as the management of public debt. Guinea-Bissau and the Comoros experienced delays in adopting fiscal reforms to improve the transparency and efficiency of their public sector, mostly due to their fragility and low capacity.

[26] There is significant uncertainty regarding economic projections due to various factors, including tariff measures and aid cuts. In turn, these uncertainties could affect financial markets and global supply chains, and hence have an important impact on LIC's economic prospects.

forecast to grow at an annual 6 percent or more. That said, the relatively benign projections come with significant downside risks amid elevated uncertainty, as they depend on strong policy and steadfast reform implementation (including decisive fiscal adjustment in 2025), adequate external financing, and the absence of major shocks.

An Improving Outlook

19. LICs' GDP growth is expected to accelerate over the medium term, with the average reaching 5.7 percent annually over 2025-29 and the median improving to 4.5 percent. This outlook stands in contrast with the more modest forecasts for AEs and EMs, which would only grow at an average 1.8 percent and 4.1 percent, respectively.[27] The outlook for LICs signals continuous improvement over time, relative to the average 4.5 percent (median 4.1 percent) realized over 2022-24 and the average 5.4 percent (median 4.0 percent) during the 2010s.

20. The variance in GDP growth across LIC subgroups would become less pronounced. The strongest growth of an average 6 percent or more is expected for 13—often relatively large—countries[28] that together account for 60 percent of LICs' overall growth forecast. This explains why the GDP-weighted average growth forecast significantly exceeds the projection for the median country (Figure 6). For these countries, the divergence in growth along the IDA eligibility cut-off and institutional structures would almost disappear. However, one significant divide that holds firmly also for the outlook relates to export structure. All but one (South Sudan) of the countries expected to experience strong growth are diversified exporters. On the other side of the spectrum, there is more homogeneity among the 13 LICs with the lowest average growth forecasts (below 3.3 percent) over 2025-29: 9 are SDS and 7 are FCS.[29]

21. The disinflation process in LICs would be completed over the medium term, at varying speeds depending on country-specific conditions. Median inflation is expected to fall to 4.2 percent in 2025 and then stabilize around that level. It will likely remain higher in diversified and frontier LICs at levels closer to 5 percent, as development gains lead to higher prices and wages in the tradables sector that would then spread to the broader economy. By contrast, in FCS and fuel exporters, median inflation would fall to some 3 percent by 2029.

22. LICs' external positions would proceed further on a path of gradual improvement, but international reserves would remain too low in a number of LICs. LICs' median current account deficit would stabilize at 4.3 percent of GDP in 2025 and decline to 3.9 percent of GDP by 2029

[27] Global growth would remain subdued at about 3.0 percent throughout 2029, compared with an average growth rate of 3.7 percent in the decade before the pandemic. Persistent structural headwinds—such as population aging and weak productivity—are holding back potential growth in many economies (IMF 2025a).

[28] Bangladesh, Benin, Bhutan, Cote d'Ivoire, Ethiopia, Mozambique, Nepal, Niger, Rwanda, Sudan, South Sudan, Tanzania, and Uganda. Growth prospects have been revised significantly downward for Bangladesh due to recent domestic developments. The projected recovery in Sudan hinges on the assumption that the conflict would end by end-2025, and re-engagement and reconstruction would commence shortly thereafter.

[29] The 9 SDS comprise Kiribati, Marshall Islands, Micronesia, Samoa, Solomon Islands, St. Lucia, Tonga, Tuvalu, and Vanuatu. The 7 FCS include Haiti, Myanmar, Kiribati, Marshall Islands, Micronesia, Solomon Islands, Tuvalu. Only Lesotho and Lao P.D.R. are not part of at least one of these groups.

supported by fiscal consolidation efforts and broadly favorable trends in the terms of trade. Median reserve coverage would increase slightly to 4.0 months of imports by the end of the medium term, compared with 3.6 months in 2025. That said, while diversified exporters and frontier markets are projected to build up their reserves to levels above 4 and 5 months of imports, respectively, reserve cover for the median FCS would remain far below its pre-pandemic level. Fuel exporters would be unable to increase reserves even to cover 2 months of imports by 2028, given pressures from declining oil prices and high debt service burdens.[30] On current projections, a total of 16 LICs would still have reserves of less than 3 months of imports by 2028.

A Continued Need for Strong Policy and Reform Efforts

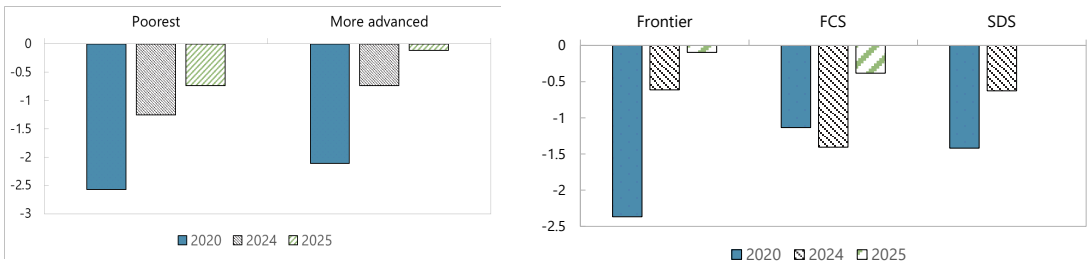
23. This relatively benign outlook depends on strong policy and steadfast reform efforts, evolution of external support, improved security, and the absence of major shocks. Risks to the outlook are important, and include insufficient implementation of policy and reform efforts, as well as the impact of reduced levels of financing including in the form of official bilateral assistance that has come under increasing pressure in recent months. Moreover, for several LICs, stronger growth will only materialize if security conditions improve—a point that was also made prominently by the World Bank and the IMF in earlier publications (World Bank 2025, IMF 2024b). One example involves South Sudan, where an end to the disruptions to oil exports would generate growth of some 25 percent of GDP over 2025-26. Finally, the outlook assumes the absence of further major external shocks affecting LICs' economies.

24. Further fiscal consolidation in 2025 will continue to support gradual reduction of public debt. The median primary deficit is expected to fall to 0.9 percent of GDP in 2025 from 1.6 percent of GDP in 2024, before ending the decade at 0.7 percent of GDP in 2029. On its back, and supported by stable GDP growth, the median debt-to-GDP ratio would fall to 48.4 percent by 2029 from 50.8 percent in 2025. The most substantial consolidation effort is programmed for tourism-dependent countries. But many LICs with severe liquidity constraints, which are often among the poorest and most fragile, would also need to proceed swiftly with fiscal adjustment (IMF 2024d; IMF 2024e).

25. The pace of adjustment will depend on fiscal sustainability, the availability of financing, and the cyclical position of the economies. The larger the concerns about the viability of a country's fiscal deficits and public debt, the faster the pace of adjustment would have to be. Moreover, a persistent funding squeeze may force LICs without access to sufficient financing to undertake significant adjustments. At the same time, in countries with large negative output gaps, including many of the poorest LICs (Figure 11), growth and employment will inevitably be affected by the needed fiscal consolidation. By contrast, many frontier markets and SDS have nearly closed their output gaps and could move more quickly to tighten the fiscal stance to address sustainability concerns and/or in case their economies risk overheating.

[30] Reserves are expressed in terms of months of imports of goods and services of the country in prospective year. WEO data projection is available through 2029, therefore the reserve projection is available until 2028.

Figure 11. Output Gaps in LICs
(Median, in percent of potential GDP)



Sources: WEO, IMF staff calculations.
Note: Sample excludes Afghanistan and Eritrea. The output gap is calculated using a standard Hodrick-Prescott (HP) filter method, which may not fully capture country-specific supply shocks or structural changes. Therefore, the results should be interpreted with caution, considering the unique economic conditions and potential supply-side factors affecting each country.

26. Regarding the composition of adjustment, LICs' fiscal plans signal some further rebalancing towards DRM. This strengthened focus on DRM, coupled with strong emphasis on higher-quality public spending to tackle the elevated level of inefficiency observed in particular in many infrastructure projects, can help achieve the necessary fiscal adjustment while prioritizing expenditures necessary to foster development. DRM potential in LICs is significant (IMF 2024f; World Bank 2024a).

27. For many LICs, debt service bills are projected to remain high, against a backdrop of declining financing flows and high financing needs for much-needed development spending. Access to financing—both public and private—will remain elusive for many countries given tight purse strings, especially among official bilateral creditors, and uncertainty surrounding private sector risk appetite. At the same time, needs will continue to be elevated: an exercise with updated WEO data to estimate LICs' external financing needs over 2025-29, using the same methodology as in IMF 2024f, yields the amount of US$658 billion (Figure 8). This large figure reflects only current account deficits and projected debt amortization, and does not account for additional needs emanating, for example, from efforts to replenish reserve buffers or more ambitious efforts on development. Ensuring sufficient levels of financing calls for a multi-pronged approach. The Fourth Financing for Development (FfD4) conference planned for June 30-July 3, 2025, will present an opportunity for LICs and their development partners to discuss this topic as part of a broader development agenda.

28. While further fiscal consolidation will be important for most LICs, the future direction of monetary policy should be data dependent and will likely be less uniform across countries. This reflects projected differences in the pace of the disinflation process. As discussed above, many LICs tightened their monetary stance. However, inflation is expected to remain in the double digits in about a quarter of LICs in 2025, many of which among the poorest LICs and FCS. For countries where inflation significantly exceeds the central bank's target, maintaining a tighter monetary policy for longer will be necessary until evidence is clearer that underlying inflation is sustainably returning to target. Conversely, in economies where activity is cooling fast and inflation is on track to durably return to target, a less restrictive stance would be justified.

29. Ensuring consistency in the macroeconomic policy mix, including in the interplay between monetary and exchange rate policies, will be important (IMF 2023b; IMF 2023c). A key insight from this report's section on exchange rate arrangements and foreign exchange markets in LICs is that for many countries where the main nominal anchor is not the exchange rate, there is a lack of clarity on such an anchor. Evidence suggests that flexible exchange rate regimes, in which the exchange rate is allowed to adjust to market fundamentals, requires a clear monetary framework, with an effective anchor in place (IMF 2015a). Where conditions are not in place to anchor expectations—due to, e.g., low reserves, weak internal capacity, underdeveloped transmission mechanisms—the exchange rate may *de facto* serve as the monetary anchor and will therefore not be allowed to float freely and the two frameworks can become muddled. By contrast, in fixed exchange rate regimes, monetary policy should align with that of the anchor country to preserve external stability and prevent reserve losses. The absence of conditions to set an effective monetary anchor may go a long way in explaining the shift away from more flexible exchange rate regimes in LICs over the past decade (see Paragraphs 43-50).[31]

30. Growth-enhancing structural reforms will also remain a priority and should be pursued decisively, especially in LICs were growth remains subdued. The next section discusses the respective policy agenda in some detail.

Significant Downside Risks

31. Risks are tilted to the downside amid elevated uncertainty. On a global level, an intensification of trade tensions, as well as adverse trends in global growth, international financial conditions, or/and exchange rates, could impact LICs' trade and capital flows, and weigh on investment and growth, especially in countries with large financing needs. Further disruptions to the disinflation process, potentially triggered by new spikes in commodity prices amid persistent geopolitical tensions, could prevent central banks from easing monetary policy. In turn, this would pose significant challenges to fiscal policy and financial stability. The already announced, or likely to come, reductions in international aid flows, including from the US and several European countries, also adds to the challenges. Regionally and on the domestic front, LICs will continue to be strongly exposed to economic risks from negative climate events, conflicts, political instability, as well as backlash against unpopular measures and, partially as a result, weaker-than-expected reform implementation. Given the dependence of the relatively benign 5.7 percent (weighted) average growth forecast on the strong performance of a number of relatively large countries, any materialization of significant risks for these could have a significant impact on the overall growth outlook for the entire LIC universe.

[31] The IMF provides capacity development support to help its members strengthen monetary and exchange rate frameworks, enhance domestic financial markets, and improve the effectiveness of monetary policy tools.

REINVIGORATING INCLUSIVE GROWTH

This section establishes two priorities for policymakers to support inclusive growth in LICs: designing fiscal consolidation in a manner that limits its impact on aggregate demand (AD), also taking into account distributional aspects; and enhancing productivity to increase LICs' growth potential. It concludes with a set of policy recommendations.

A. Designing Fiscal Adjustment Mindful of Growth and Distributional Impacts

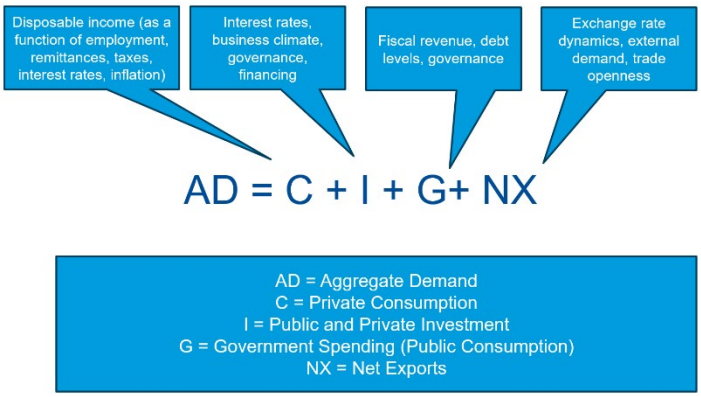
Growth over the short and medium term is mostly determined by aggregate demand (AD) for a countries' output.[32] A decomposition exercise shows that private consumption is a larger component of AD for LICs than for higher-income countries, public consumption typically plays a smaller role, and investment relies more on the public sector that highlights the need for structural reforms in support of private-sector development. The main challenges for LICs' policymakers are to implement the often-necessary fiscal consolidation with as little negative impact on growth as possible, mobilize growth-enhancing external financial inflows, and develop domestic financial markets in support of consumption and investment.

Understanding the Drivers of Aggregate Demand in LICs

32. AD in LICs followed a distinct pattern over the past decade, reflecting the countries' relatively early stage of development. Several stylized facts emerge from a decomposition of AD into its main components (Figure 12-13) and an analysis of how these contributed to growth over 2015-2024:

- ***Private consumption was the dominant component of aggregate demand, with its contribution to growth strongest in more advanced LICs.*** Over the past decade, private consumption represented an average 73 percent of LIC's AD, a significantly higher share than that for EMs and AEs. It was also by far the most important driver of growth: on average, private consumption explained some 69

Figure 12. Stylized Aggregate Demand Equation



Sources: IMF Staff.

[32] Measures to increase aggregate demand can be particularly effective in LICs with economic slack (see e.g. Goldberg and Reed (2023), and Walker et al. (2024)). They can reach their limits when capacity constraints become binding and inflation pressures mount.

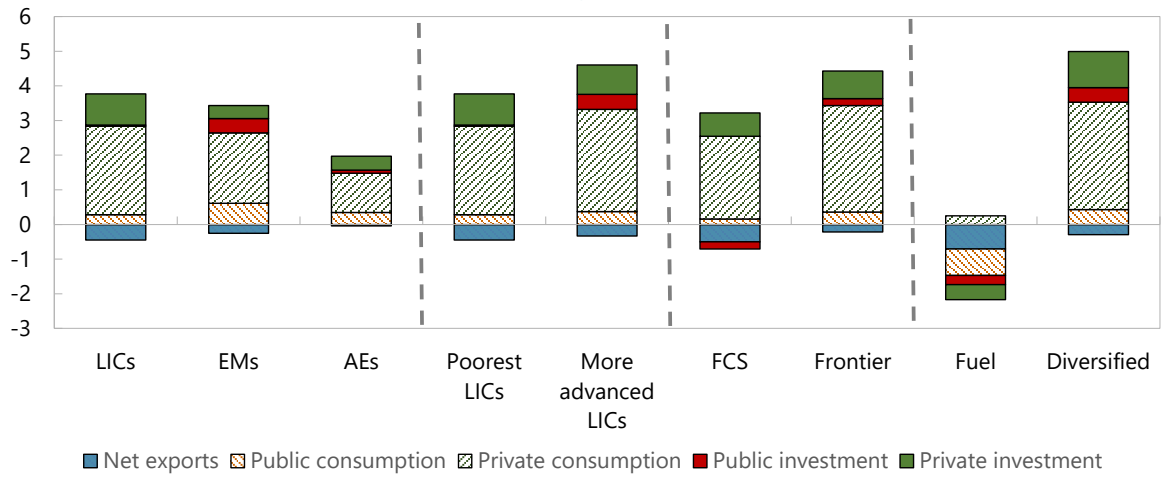
percent of growth, with its role being most important in more advanced LICs and FMs.

- ***By contrast, public consumption, which saw a marked decline over recent years, played only a small role in AD and as a contributor to GDP growth.*** On average, public consumption accounted for 13 percent of aggregate demand over 2015-24. Tight fiscal positions and resource constraints led to a fall in its average share after the pandemic; and, in turn, to a fall in its contribution to GDP growth from 9 percent before the pandemic to 6 percent after 2020. Growth in more advanced LICs typically benefitted from public consumption almost twice as much as growth in the poorest LICs.

- ***LICs' share of investment in AD was comparable to that of EMs, but its composition was more biased towards public investment and its impact on growth was relatively weak.*** For the median LIC, investment accounted for 25 percent of output over the past decade. The share of public investment in total investment was larger in LICs than in EMs (28 percent v. 20 percent, respectively). However, the contribution of public investment to growth was lower than in EMs (7 percent v. 12 percent, respectively), suggesting weaker growth multipliers in LICs (see Paragraph 35).

- ***Net exports typically contributed negatively to LICs' AD due to their sizeable import needs and often relatively small export sectors.*** Over the past decade, net exports reduced growth by 10 percent for the median LIC. The largest negative impact was observed for FCS (20 percent) and fuel exporters (30 percent). In diversified and frontier LICs, while still negative, the impact was smaller and similar to that in EMs (5 and 6 percent, respectively, compared to 7 percent in EMs). This contrasts with the median AE, where net exports added to overall AD.

Figure 13. AD Growth Decomposition
(Period averages, 2015-24)



Sources: WEO, IMF staff calculations.
Note: The growth contributions of AD components are calculated as weighted averages for country groups and years, and then averaged over the period.

33. The AD analysis points to the critical role of fiscal policy, external financing, and domestic financial markets for LICs' growth in the short and medium term. Fiscal policy choices affect AD directly through their impact on public consumption and public investment. But fiscal policies also affect the other components of demand: private sector activity (consumption, investment, and net exports) responds to taxation and other revenue policies, transfers such as social safety net payouts and subsidies, and incentives in the form of tax expenditures or subsidies. Moreover, consumption and investment depend on adequate financing from external and domestic sources. For policymakers, it is important to encourage the types of financing that have been proven to be most conducive to LICs' GDP growth.

Minimizing the Impact of Fiscal Adjustment on Growth

34. An analysis of LICs' fiscal multipliers highlights significant differences in how the various areas of budget activity affect GDP growth (Annex III). In addition, output effects depend on the cyclical position and structural characteristics of an economy.[33] Thus, the estimated results of fiscal multipliers should be interpreted with some caveats in mind:

- ***(Tax) revenue.*** The analysis finds that, for the full group of LICs, an increase in tax revenue has a negative impact on growth, with the results remaining, however, outside standard thresholds of statistical significance. For the subgroups of the poorest LICs and the more advanced LICs, the effects are positive, but also outside the significance band.These findings are consistent with other studies that often show a weak coefficient for LICs[34] and suggest scope for further revenue mobilization without sizeable effects on growth.

- ***Public consumption.*** An increase in public consumption expenditure has no statistically significant growth impact for the entire group of LICs. However, it has a strong multiplier effect on the poorest LICs, where increasing current spending by 1 percentage point of GDP boosts output by a statistically significant 0.14 percent in the year of the shock and by almost three times that level three years after. This suggests that for the poorest LICs, transfers and programs to support vulnerable households can have an important impact on growth. By contrast, the coefficient for the more advanced LICs becomes negative and significant two and three years after the shock.

- ***Public investment.*** The multiplier for public investment is larger than the one for public consumption. On average, increasing public investment in LICs by 1 percentage point of GDP boosts output by 0.2 percent in the year of the shock and 0.3 percent in the year after, increasing only marginally and loosing statistical significance thereafter. Among the LIC subgroups, public investment has a statistically significant growth impact in FCS (a cumulative

[33] For example, Honda et al. (2020) find that in LICs, the output effects are larger during recessions, under a fixed exchange rate regime, and in countries with higher quality of institutions.

[34] For example, Arizala et al. (2021) and IMF 2017 find for a sample of SSA countries that increasing government revenues has a small and statistically insignificant impact on output. In contrast, increasing public investment by 1 percentage point of GDP boosts output by about 0.1 percent in the first year and 0.7 percent after three years, while a similar increase in public consumption results in a 0.5 percent output increase after three years.

54 basis points three years after the shock). This could reflect FCS' infrastructure gaps. Investment is especially powerful in driving growth in the case of the more advanced LICs and frontier LICs (a cumulative increase of 74 basis points three years after the shock), which could reflect higher efficiency of their public investment programs. On the other side of the spectrum, the multiplier for the poorest LICs has only one third of the strength of that for the more advanced LICs, showing statistical significance only for the first year.

Mobilizing External Financing and Developing Domestic Financial Markets

35. With LICs' often significant foreign exchange constraints and tight liquidity, macroeconomic demand responds strongly to the volume and type of capital inflows. If offered at affordable terms and managed well, external capital inflows can help cover LICs' public and private spending needs and play an important role in supporting and stabilizing GDP growth.

36. Staff's analysis suggests a positive link between external financial inflows and growth, the strength of which varies across the different types of financing (Figure 14 and Section 2 of Annex IV):

- ***Remittances.*** This relatively stable and increasingly important source of inflows to LICs helps alleviate financial constraints for households and firms, and especially for those in the informal sector (Chatterjee and Turnovsky 2018). Staff's analysis finds that each U.S. dollar received translates into an average increase of 36 cents in consumption and 24 cents in investment. Remittances also have countercyclical properties in many LICs, supporting demand during global downturns.

- ***FDI.*** If managed prudently, FDI inflows play a critical role in supporting investment and capital accumulation in LICs, as well as knowledge transfer and market access.[35] Staff's analysis is consistent with these priors: the impact of FDI on investment is the strongest of all flow types. By contrast, the impact on consumption is much smaller and statistically insignificant. As is the case for remittances, FDI can play a stabilizing role in the economic cycle: the long-term nature of these inflows, together with their risk sharing characteristics if entailing equity investments rather than loans, make these flows attractive for development without typically giving rise to risks of sudden capital outflows.

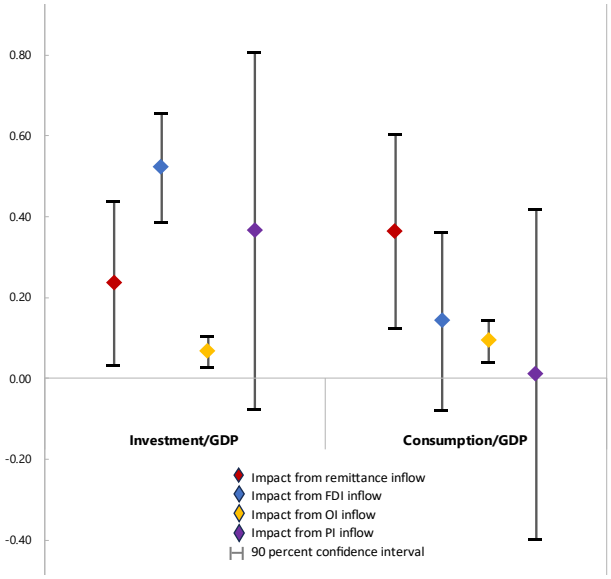
- ***Other Investment (OI).*** OI inflows, which include financing from official bilateral creditors and international financial institutions (including the 2021 SDR allocation), were found to have small positive, statistically significant effects on consumption and investment. Notwithstanding their relatively small impact, these flows can be critical during economic crisis when other inflows become less available.

[35] Although for the largest part beneficial, foreign investment can lead to significant debt accumulation when poorly managed, increasing LICs financial burdens if returns are insufficient to service that debt. For more discussion, see Saurav and Kuo (2020).

- ***Portfolio Investment (PI).*** Staff's analysis finds a positive but statistically insignificant impact of PI on both investment and consumption. The weak statistical signal may derive from the low relevance of these flows for most LICs, with the exception of some FMs.

37. Domestic pull factors such as corruption control and fiscal discipline are important to attract FDI, while global push factors and domestic financial market development are key determinants of portfolio flows (Annex IV). Staff's analysis based on a panel regression finds a positive correlation between effective corruption control and FDI inflows, and a negative association of FDI with fiscal deficits. Efforts to improve corruption control and fiscal deficits to levels on par with those in the median EM are estimated to raise LICs' FDI by an average 0.5 percent of GDP.[36] By contrast, portfolio inflows are more sensitive to global factors beyond the control of LIC governments, especially global financial market volatility. That said, the underdevelopment of domestic bond and equity markets in many LICs has been a hindrance to attracting international portfolio investors and building a domestic investor base. Finally, the study confirms that OI inflows (encompassing official loans) are reacting in a countercyclical pattern to domestic GDP growth and fiscal balances.

Figure 14. Financial Inflows and Aggregate Demand: Impact from a One Percentage Point Increase in Financial Inflows
(All in percent of GDP)



Sources: IMF staff estimates.
Note: The chart shows the coefficients and confidence intervals on lagged inflow variables estimated from a balanced panel consisting of 44 LIC countries between 2000-23. All regressions control for time and country fixed effects (see Annex IV for details).

B. Raising Productivity

When approaching LICs' growth challenge from a longer-term perspective, the attention needs to shift to improving productivity. This is an urgent agenda especially as the contribution of total factor productivity (TFP) to growth has been declining significantly for the median LIC for some time and has become negative since the pandemic. Without policy measures to support all factors of production, and in particular TFP, potential growth in LICs will remain far below the levels needed to offer the promise of improving standards of living for their often fast-growing populations.

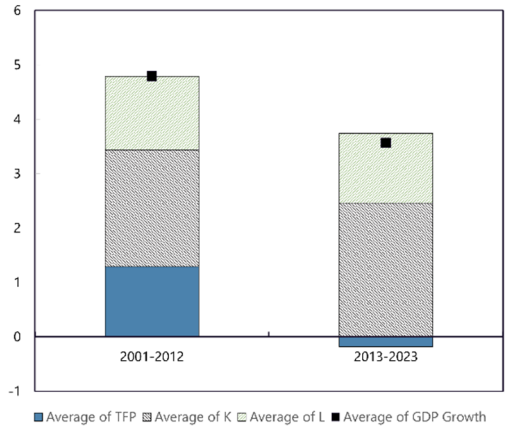
[36] Relatedly, Lee and Sami (2019) have also found investors' perception of regulatory quality, including policies for taxes, trade, starting business, price controls, competition, and labor markets to be important drivers in attracting FDI inflows, particularly in resource-poor countries.

Dissecting LICs' Productivity Challenge

38. A decomposition of growth based on a standard production function indicates that LICs face significant challenges in unlocking their growth potential (Box 2 and Annex V). Staff's analysis for a sample of 50 LICs over 2001-23 attributes changes in GDP growth to variations in capital stock, labor, and TFP,[37] using the methodology outlined in Chapter 3 of the April 2024 WEO (IMF 2024k). It shows that, on average, LICs' factors of production are insufficiently strong to unlock the levels of growth that would be needed for faster economic development, but also that there are examples of countries within the LIC universe from which others can learn:

- ***Declining and negative contribution to growth from TFP.*** A steep decline in the TFP's contribution to growth was the primary cause of the recent slowdown of GDP growth in LICs. Over the past 20 years, TFP's contribution has declined worldwide, but the drop has been particularly severe for LICs since the GFC in 2008. This trend further worsened during the COVID-19 pandemic and subsequent crises. Specifically, LICs' TFP contribution to growth, measured as a 5-year rolling average for the median country, fell from about 1 percent in the early 2000s to 0.8 percent following the GFC. Post-pandemic, it entered negative territory. The poorest LICs, FCS, and fuel exporters experienced the steepest declines in TFP. This underscores the ongoing challenges of leveraging production factors and optimizing resource allocation, especially in fragile and undiversified economies.

Figure 15. Contribution of Components to GDP Growth of LICs
(In percentage points)



Sources: WEO, Penn World Table, IMF staff calculations.
Note: The period 2013-2023 excludes year 2020, which was an outlier due to the Covid pandemic. Contribution of TFP becomes positive, albeit low, if 2021-2022 are also treated as pandemic period.

- ***Plateauing and weak contribution from labor, despite strong population growth.*** In sharp contrast to TFP, the contribution of labor to growth has remained broadly stable within 1.5-2.0 percent of GDP over the sample period. These outturns may seem low in light of LICs' often large demographic potential: conceptually, a higher rate of population growth should be associated with strong GDP growth as it boosts the young workforce. Weaker-than-expected contributions from labor may signal challenges in transforming a growing population into an adequately skilled labor force and a key driver of higher productivity.

- ***Relatively stable contribution from capital, with large differences in its strength across LICs.*** Capital has contributed 2.1 percent of the growth for the median LIC, a level that has

[37] The TFP measures an economy's efficiency in using its inputs (labor and capital) to generate income. It is measured as the portion of output that cannot be directly explained by the quantity of labor and capital inputs.

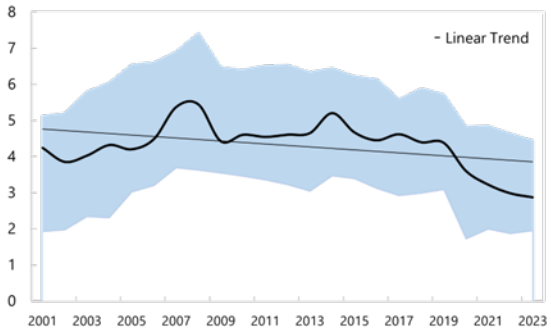
remained relatively stable.[38] Domestic and external financing constraints limit the ability of many LICs to boost this contribution further, a challenge compounded by exposure to frequent and intense shocks, fast depreciation, and/or physical destruction of assets. These constraints coupled with public financial management (PFM) weaknesses affect not only the quantity but also the quality of public investment (Devadas and Pennings, 2018). Country-specific shocks and structural factors contribute to substantial variation across LICs (World Bank 2024b). For example, fuel-exporting LICs saw a major increase in investment over the past 15 years, while FCS often struggled to increase their capital stock as reflected in their large infrastructure gaps.

Box 2. Decomposition of Growth Along the Production Function in LICs

The total output of an economy is determined by the combination of capital (K), labor (L), and total factor productivity (TFP), that is, **Output = TFP * f(K,L)**.

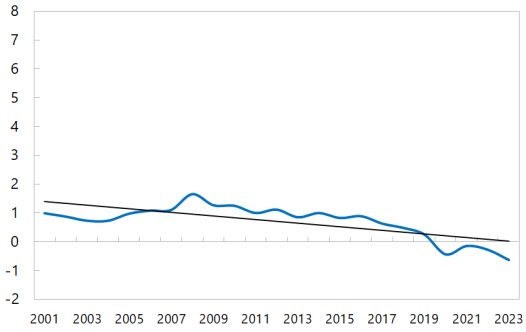
Annual GDP Growth

(5-year moving average, percentage points: median within 25th-75th percentiles band)



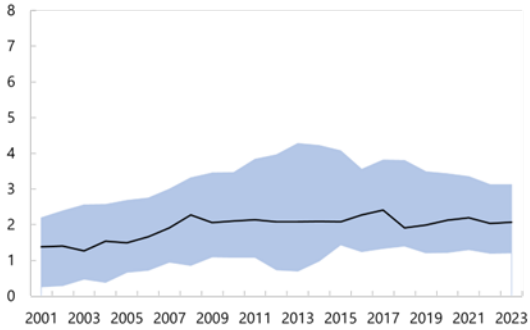
TFP Contribution to Median LIC Growth

(5-year moving average, percentage points, median and linear trend)



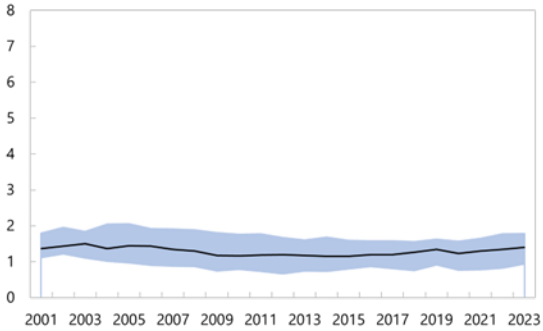
Capital Contribution to LIC Growth

(5-year moving average, percentage points: median within 25th-75th percentiles band)



Labor Contribution to LIC Growth

(5-year moving average, percentage points: median within 25th-75th percentiles band)



Sources: WEO, Penn World Table, IMF staff Calculations.

Note: Data on labor, employment, GDP or capital output ratio is missing for some island economies and conflict-affected countries LICs, limiting the sample size to 50 LICs.

[38] In 2023, the contribution of the capital stock to growth in the median LIC was 2.1 percentage points, and thus higher than the 1.5 percentage point for EMs and the 0.7 percentage points for AEs.

39. A host of structural impediments to growth underlie the observed challenges to improve LICs' production functions. Structural impediments are country-specific, and there is no one-size-fits-all diagnosis (Figure 16). Nevertheless, the literature points to the following:

- ***Weaknesses in economic institutions.*** Weak economic institutions have frequently been identified as an obstacle to faster growth in LICs (Acemoglu, Johnson, Robinson, 2004; Edwards, Johnson, and Weil 2016; Ivanyna and Salerno 2021). Despite efforts to improve institutional quality, large gaps remain between LICs and their higher income peers (World Bank 2025).

- ***Informality.*** Informality accounts for more than a third of total output in approximately half of the LICs. The informal sector is typically much less productive than the formal sector and is less efficient in accumulating physical and human capital, as informal firms are often smaller and slower to adapt to new technologies.[39]

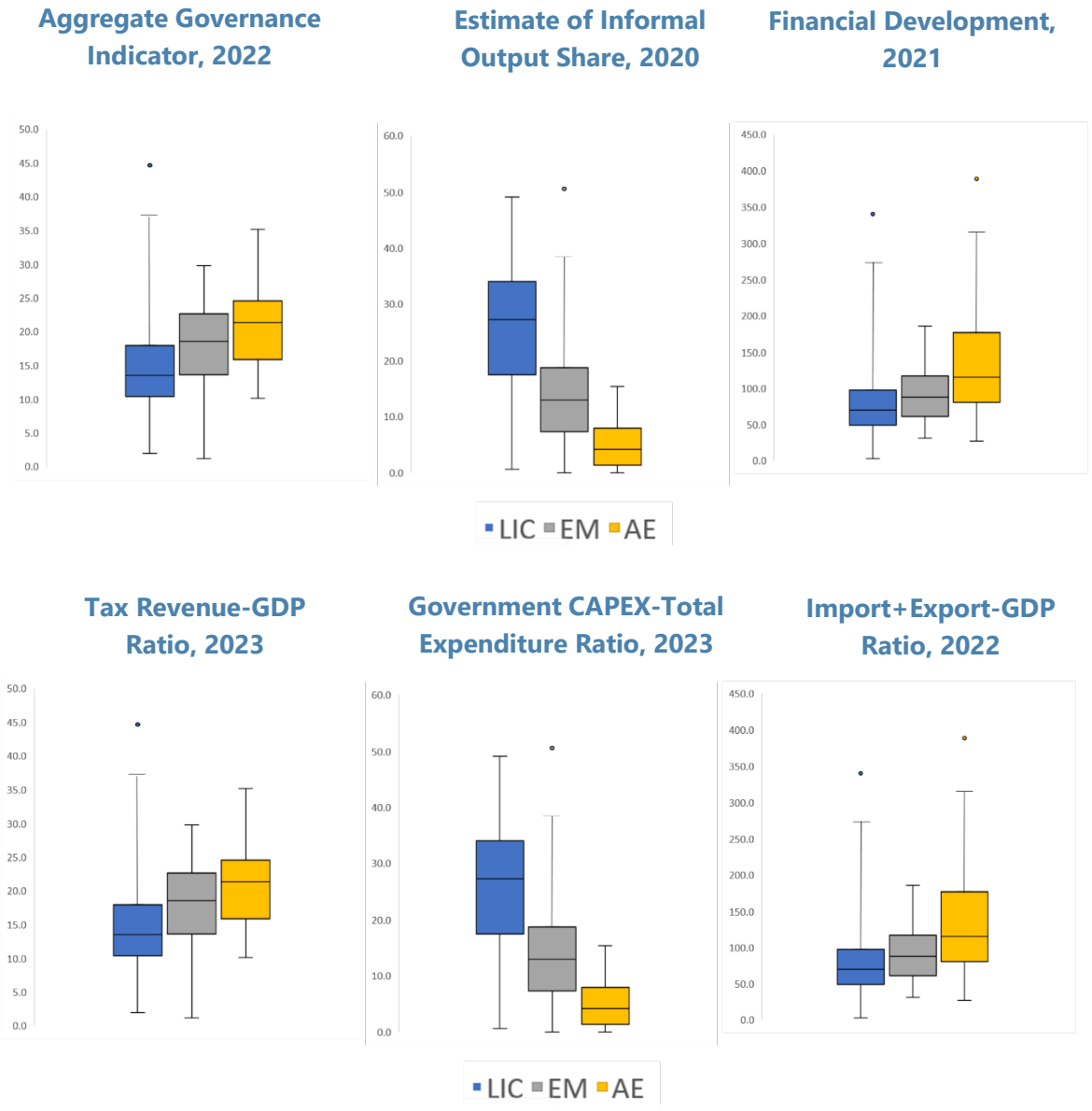
- ***Underdeveloped financial sectors.*** Financial systems in LICs are often under-developed, leaving many households and firms (mostly small-scaled businesses) with self-financing as the only option to satisfy their financial needs (Khan and Senhadji 2000).

- ***Narrow export base and few trade partners.*** While median imports and exports for LICs nearly doubled as a percentage of GDP since 1990, trade openness still lags that of their higher-income peers, typically reflecting a narrower export base and a limited number of trading partners.

- ***Weaknesses in Artificial Intelligence (AI) preparedness.*** AI can be a catalyst for technological and productivity advancement. However, weaknesses in skills and education, technological infrastructure, and legal frameworks negatively impact AI preparedness in LICs.

[39] For details related to informality and its impact on the economy, see Ohnsorge, F., & Yu, S. (2022).

Figure 16. Structural Characteristics of LIC Economies



Sources: WEO, Worldwide Governance Indicator, 2024 Update, World Bank (www.govindicators.org); World Bank Informality data; IMF Financial Development data; IMF staff calculations.
Note: Boxes indicate group interquartile; horizontal bars indicate median; whiskers indicate range. Aggregate governance indicator is computed as a simple average across all six Worldwide Governance Indicator estimates.

C. A Policy and Reform Agenda in Support of Inclusive Growth

The preceding analyses on aggregate demand and productivity in LICs suggest clear priorities for policymakers. Country-specific conditions will require careful finetuning and sequencing of the agenda. LICs should emphasize spending efficiency and DRM while prioritizing social spending and public investment during fiscal adjustment. Enhancing economic institutions and technology is crucial for attracting external capital and developing domestic financial markets. Boosting TFP through measures to improve governance, education, and health, and support capital formation and innovation is also an important priority, together with increasing social spending coverage and promoting broad labor force

participation. As structural measures typically take time to develop their impact, there is a strong case for acting quickly.

40. To support growth over the medium term, policy and reform efforts could focus on the design of fiscal adjustment, external capital flows, and financial market development.

- ***Enhancing spending efficiency, and mobilizing domestic revenue where needed, while prioritizing social spending and public investment when implementing fiscal adjustment.*** With large development needs amid tight financing constraints, many LICs will have to address current inefficiencies[40] and mobilize domestic resources to balance their budgets,[41] while ensuring at the same time adequate levels of public spending in priority areas. Priorities should include shifting spending to priority areas such as health, education and targeted support for vulnerable households and away from untargeted energy subsidies.[42] Moreover, growth-enhancing investment, including by factoring climate risks into PFM and public investment management (PIM) processes, should be prioritized, embedded in medium-term fiscal frameworks and supported by efficient investment processes (Eltokhy et al. 2024). On the revenue side, where needed, DRM measures could aim at broadening the VAT base and reducing informality, improving personal income taxes and property taxes, rationalizing corporate income tax incentives and modernizing the fiscal regime for extractive industries, and leveraging excise taxes. In addition, implementing revenue administration measures and progress with digitalization can help ensure better compliance with tax obligations.[43] The finding of generally weak GDP multipliers for fiscal revenue, as well as the need to protect growth-enhancing expenditures reinforces the case for this agenda. Moreover, PFM reforms are instrumental to strengthen budget processes and enhance transparency and efficiency. In FCS, a gradual approach to improving fiscal institutions aligned with local absorption and implementation capacity is critical.[44]

- ***Improving economic institutions and governance, as well as technology, in support of external capital inflows and domestic financial market development.*** Overall official inflows to LICs are unlikely to increase significantly over the medium term. This reinforces the need for

[40] Close to 40 percent of resources allocated by LICs to creating and maintaining public infrastructure are lost due to inefficiencies (Schwartz and others, 2020).

[41] There is significant potential to increase tax revenue in LICs: a recent joint World Bank/IMF paper estimated that up to 7 percent of GDP in additional tax revenue could be raised if all LICs followed best practices from within the LIC universe of countries (IMF 2024h).

[42] For example, Zambia removed untargeted energy subsidies and redirected the freed-up resources towards social programs. In Bangladesh, there have been efforts to target subsidies more effectively and reduce the burden on the national budget.

[43] Many LICs are pursuing this agenda. For example, Tajikistan improved the tax system by reducing the number of taxes and simplifying tax procedures (IMF 2021a), while Guyana focused on curbing tax exemptions by reducing statutory and discretionary exemptions. Burkina Faso ended tax holidays; Mauritania replaced corporate income tax exemptions with a reduced rate in its new investment code adopted in 2025; and Uganda eliminated VAT exemptions (Benitez et al. 2023).

[44] Reforms should thus be carefully tailored and sequenced to address key fragility drivers (i.e., weak governance, corruption, and food insecurity).

LICs to mobilize other external financing, including FDI. In addition to maintaining macroeconomic stability through policies and reforms aimed at addressing domestic and external sector vulnerabilities, this objective calls for enhancing transparency and accountability, and for enforcing strong legal frameworks to protect property rights. Technical innovation can also play an important role. For example, Fintech could lower the cost of remittances and portfolio inflows to LICs (currently, the average cost of money transfers to LICs is 6.3 cents on each dollar and much higher in some cases, see World Bank 2024c). Efforts to develop deeper domestic financial markets can reduce informality and support higher private consumption and investment through the efficient channeling of resources, as well as more effective monetary policy transmission.

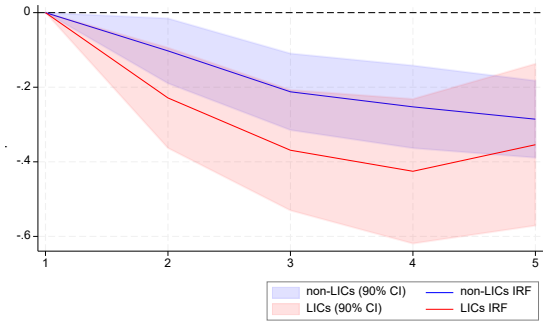
41. To boost their growth potential, LICs could give priority to reforms aimed at increasing TFP and enhancing the inclusiveness of the labor force.

- ***Boosting TFP through improved governance, education, health, capital formation, and innovation.*** TFP is affected by many factors, which calls for appropriate prioritization in designing and sequencing reform agendas. The results of an impulse response analysis (Figure 17) can provide some guidance. It finds that improvements in governance (e.g., to protect intellectual property and ensure adequate regulatory and quality standards), expansion of compulsory education, and increased gross capital formation and innovation are particularly important to strengthen TFP in LICs. In this context, staff analysis highlights the strong complementarity between FDI and AI preparedness (as a proxy of preparedness for advanced technology more broadly) in fostering TFP growth (Box 3). These findings are broadly consistent with other studies that also highlight the role of tech-based industries and/or deep engagement in global value chains for knowledge transfer and technology diffusion. Moreover, improving health could play a major role, as malnutrition, waterborne diseases and malaria have been proven to negatively affect TFP (Cole & Neumayer 2006). Finally, industrial policy can potentially help address market failures, but the respective measures should be designed to be well-targeted, time-bound, cost-effective, and transparent while preserving macroeconomic stability (IMF 2024i).

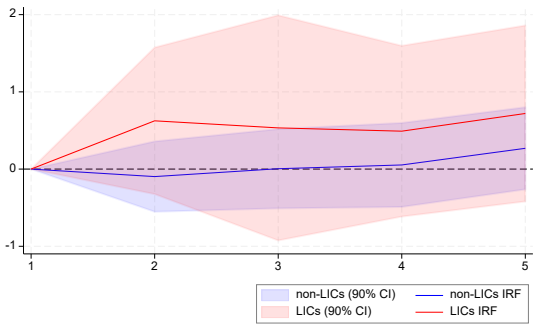
- ***Facilitating broad labor force participation to increase potential growth and ensure that the growth dividend is shared across LICs' populations.*** This entails efforts to enhance the quality and accessibility of education and vocational training to ensure an adequate matching of skills with the needs of employers; help firms transition into formality; and support productivity growth also in the informal sector. Moreover, increased coverage and more efficient allocation of social spending, including targeted efforts to support vulnerable groups such as the youth, women, and the disabled, could facilitate their access to the labor market and thus boost potential growth through a larger labor force (Annex V).

Figure 17. TFP Response to Growth Determinants in LICs and non-LICs, 2000-19[1] *

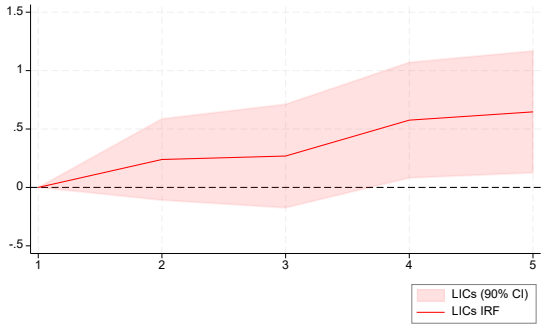
ICRG Composite Risk Rating[2]



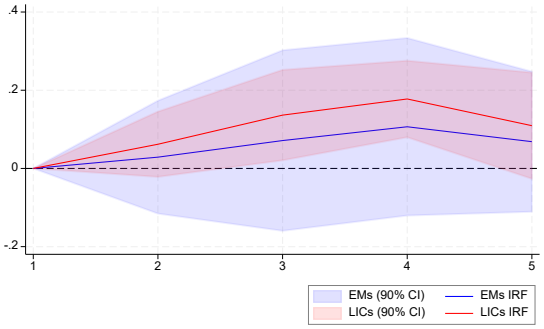
ICRG Law and Order Component[3]



Duration of Compulsory Education[4]



Gross Capital Formation[5]



Sources: WEO, International Country Risk Guide (ICRG), World Development Indicators (WDI), IMF staff calculations.

[1] The charts show Impulse Response Functions (IRF) to one-unit increases in variables of interest, controlling for lagged GDP per capita, economic openness, two TFP lags, and country- and time-specific fixed effects, using the Local Projection method (Jordà, 2005). The Y axis measures percentage points, the X axis years. The impulse response estimates become progressively less precise at longer horizons, A coefficient of -0.5 (+0.5) corresponds to a 0.5 percentage points decrease (increase) in TFP's contribution to real GDP growth. The TFP data includes 90-110 countries, half of which are LICs.

[2] The ICRG Composite Risk Rating includes political, economic, and financial risk indicators. The Index is inverted to a 100-Index, where an increase indicates higher risk.

[3] The ICRG Law and Order Component.

[4] The duration of compulsory education in years as from WDI.

[5] Gross capital formation as a percentage of GDP, from the WEO Database.

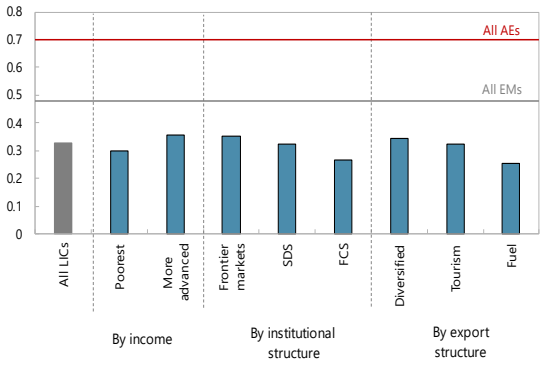
* While the IRFs demonstrate statistical relationships between the variables of interest and TFP, these results should be interpreted as correlational rather than causal. Despite controlling for various factors as explained in Footnote 1, including both country and time fixed effects, endogeneity and reverse causality may still be present. The identification method traces dynamic relationships but does not fully address all sources of endogeneity.

Box 3. Low-income Countries and Artificial Intelligence (AI)

AI presents both challenges and opportunities for LICs. The IMF's Artificial Intelligence Preparedness Index (AIPI) reveals significant disparities in AI readiness between LICs and higher-income peers (Figure 1). Among LICs, those with above-median FDI and AIPI values which typically include more advanced LICs and diversified exporters, have had more sustained TFP contributions to growth during and after the Covid-19 pandemic (Figure 2) than others. Conversely, LICs with above-median FDI but below-median AIPI, mainly commodity exporters, recorded lower TFP contributions to growth. This implies that FDI can contribute to higher growth when backed by knowledge and a skilled labor force.

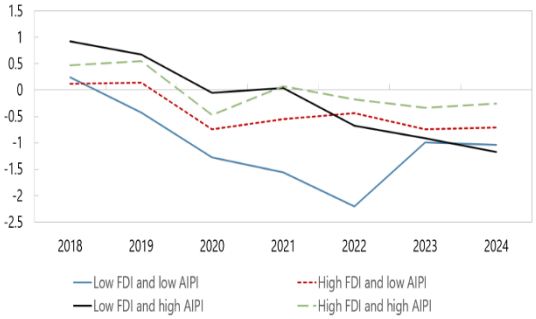
Box 3. Figure 1. AI Preparedness Index

(Median)



Box 3. Figure 2. TFP Contribution to Growth by FDI and AIPI

(5-year moving average, percent)



Sources: WEO, IMF AI Preparedness Index (AIPI), IMF staff calculations.
Note: LICs are categorized based on their average FDI/GDP (2019-2023) and their 2023 AIPI as follows: overall low resources (lower than median FDI/GDP and AIPI), higher funding but low tech (higher than median FDI/GDP, lower than median AIPI), higher tech but low funding (lower than median FDI/GDP, higher than median AIPI), and overall higher resources (higher than median FDI/GDP and AIPI).

EXCHANGE RATE ARRANGEMENTS AND FOREIGN EXCHANGE MARKETS IN LICS[45]

This chapter looks at the evolution of exchange rate arrangements and foreign exchange markets in LICs from 2009 to 2023.[46, 47] Concretely the chapter reviews (i) the exchange rate arrangements and (ii) their monetary policy frameworks in LICs, (iii) the characteristics of their foreign exchange markets, (iv) the existence and use of capital controls, and (v) the exchange restrictions and multiple currency

[45] Prepared by Salim M. Darbar (MCM). Research assistance provided by Michael Gottschalk (MCM).

[46] The bulk of the discussion relies on information reported in country chapters of the various publications of the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions* (AREAER) database available online. Each edition of the AREAER covers data over two years: development through part of the year in which data was collected and for the full previous year. The latest edition, the 2023 AREAER contains data at least through end June 2023 for most countries and for 2022. In line with the AREAER compilation guide, the 2023 AREAER contains data on the de facto exchange rate arrangement as of end April 2023 and information on exchange restrictions and multiple currency practices as specified in the latest IMF staff reports issued as of end 2022.

[47] The list of LICs in this section total 69 countries and excludes Syria since the analysis was done prior to it being included in the PRGT-eligibility list (see Annex I for list of LICs).

practices (MCPs) subject to IMF jurisdiction under Article VIII and XIV of the IMF's Articles of Agreement. The last section offers some concluding remarks.

A. Exchange Rate Arrangements

42. Surveillance of member's exchange rate policies is a core mandate under the IMF's Articles of Agreement. Through such surveillance the Fund carries out its mandate to promote orderly exchange arrangements and a stable system of exchange rates. In that context every IMF member country must notify the Fund of the exchange arrangement it intends to apply (*de jure* exchange arrangement) and also notify promptly of any changes to its de jure exchange arrangement (IMF 2012a). In undertaking this surveillance Fund staff reviews the actual behavior of the member's bilateral exchange rate to determine the *de facto* exchange rate arrangement classification. The current methodology allows for consistency and objectivity of classifications across countries, expediting the classification process, and improving transparency, with benefits for the IMF's bilateral and multilateral surveillance. The methodology to assess the de facto classification is backward looking, and the determination does not imply statements or views on future or intended policies. The methodology breaks up exchange rate arrangements into 10 categories (Table 1).[48]

Table 1. De facto Classification of Exchange Rate Arrangements

Type	Categories				
Hard pegs	Exchange arrangement with no separate legal tender	Currency board arrangement			
Soft pegs	Conventional pegged arrangement	Pegged exchange rate within horizontal bands	Stabilized arrangement	Crawling peg	Crawl-like arrangement
Floating regimes (market-determined rates)	Floating	Free floating			
Residual	Other managed arrangement				

Note: This methodology became effective February 2, 2009, and reflected an attempt to provide greater consistency and objectivity of exchange rate classifications across countries and to improve the transparency of the IMF's bilateral and multilateral surveillance in this area. For further details, see IMF Working Paper 09/211 (Veyrune et al, 2009).

43. The majority of LICs have, de facto, exchange arrangements that fall under a soft peg classification (Figure 18). As of April 2023, 43 of the 69 countries in the LICs group had a de facto classification corresponding to a soft peg arrangement (Table 2). Almost half (20) of soft peg arrangements were conventional peg arrangements, for which a slight majority comprise countries in the two currency unions in Africa, whose currencies are pegged to the Euro. In most cases, LICs

[48] See Compilation Guide in IMF 2024g and IMF Working Paper 09/211 (Veyrune et al, 2009) for definition and characteristics of the various categories and the methodology used for de facto exchange rate classifications.

peg their currency to a single convertible currency reflecting trading patterns or to the currency of a large neighboring state (for example, the Bhutanese ngultrum which is pegged to the Indian rupee and the Lesotho loti which is pegged to the South African rand). In one case the peg is defined in terms of a basket of currencies (as in Samoa where the tala is pegged to a trade and payments weighted basket that includes currencies of major trading partners). Crawl-like arrangements reflect the second largest share of de facto classification (12), followed by stabilized and other managed. Five countries each are classified as either currency boards or having no separate legal tender, most of them small island states (Table 2). Another five are classified as floating arrangement, with only one (Somalia) categorized as having a de facto free-floating classification.

44. In contrast, de facto exchange rate arrangements in advanced economies are mostly market determined (floating and free-floating regimes), while the overall picture in Emerging Market and Developing Economies (EMDEs) is more mixed (Figure 19).[49] That said, EMDEs are characterized by a markedly smaller share of countries with soft pegs and a significantly larger share of floating regimes compared to LICs.

[49] In this section the term EMDEs refers to Emerging and Developing Economies as classified in the WEO minus the 69 LICs. Thus, there is no overlap between the countries included in EMDEs and LICs.

Table 2. LICs: De Facto Classification of Exchange Rate Arrangements, as of April 30, 2023, and Monetary Policy Frameworks

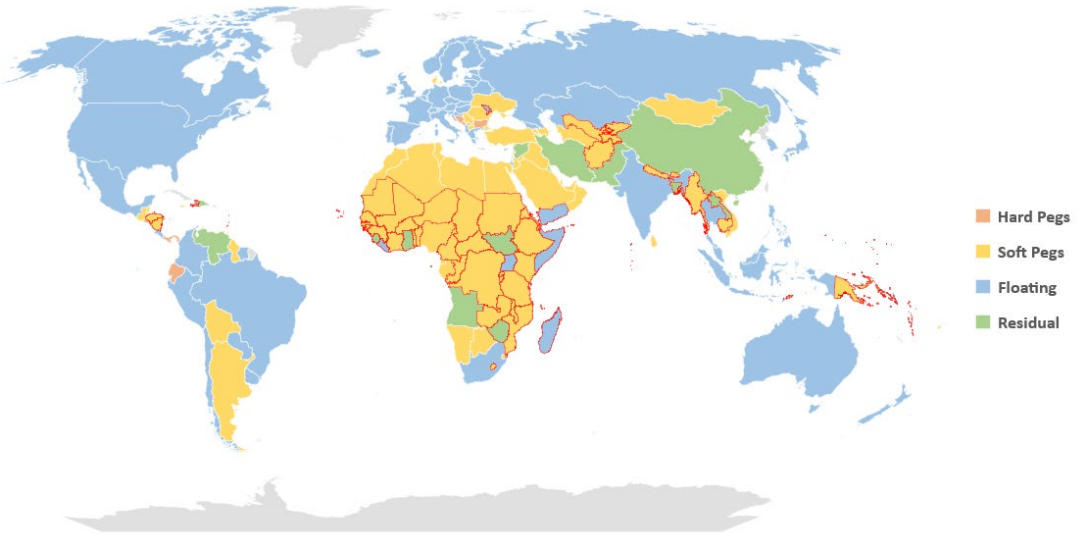
Exchange Rate Arrangement (Number of Countries)	Monetary Policy Framework							
	Exchange Rate Anchor				Monetary Aggregate Target (18)	Inflation-Targeting Framework (5)	Other[1] (13)
	US Dollar (13)	Euro (15)	Composite (0)	Other (5)			
No separate legal tender (5)	Marshall Islands Micronesia Timor-Leste			Kiribati Tuvalu			
Currency board (5)	Djibouti **ECCU** Dominica Grenada St. Lucia St. Vincent and the Grenadines						
Conventional peg (20)	Eritrea	Cabo Verde Comoros São Tomé and Príncipe **WAEMU** Benin Burkina Faso Côte d'Ivoire Guinea-Bissau Mali Niger Senegal Togo **CEMAC** Cameroon Central African Rep. Chad Rep. of Congo Equatorial Guinea	Fiji Libya	Bhutan Lesotho Nepal	Samoa[2]		
Stabilized arrangement (10)	Honduras Maldives				Guinea[3] Myanmar[3] Papua New Guinea[3] Tajikistan[3,4] Tanzania[3]		Malawi[3] Mozambique[3,4] Sudan[3]
Crawling peg (1)	Nicaragua						
Crawl-like arrangement (12)	Cambodia				Afghanistan[3,5] Burundi[3] Democratic Rep. of the Congo[3] Ethiopia[3] The Gambia[3] Rwanda[3]	Kenya[3] Uzbekistan[3]	Kyrgyz Rep[3] Mauritania[3] Zambia[3]
Pegged exchange rate within horizontal bands (0)							

Table 2. LICs: De Facto Classification of Exchange Rate Arrangements, as of April 30, 2023, and Monetary Policy Frameworks (concluded)

Exchange Rate Arrangement (Number of Countries)	Monetary Policy Framework						
	Exchange Rate Anchor				Monetary Aggregate Target (18)	Inflation-Targeting Framework (5)	Other[1] (13)
	US Dollar (13)	Euro (15)	Composite (0)	Other (5)			
Other managed arrangement (10)					Bangladesh Sierra Leone Zimbabwe	Ghana	Haiti Lao P.D.R. Solomon Islands South Sudan Tonga Vanuatu
Floating (5)					Liberia Madagascar Yemen	Moldova Uganda	
Free floating (1)							Somalia[6]

Source: IMF, AREAER database.
Note: CEMAC = Central African Economic and Monetary Community; ECCU = Eastern Caribbean Currency Union; EMU = European Economic and Monetary Union; WAEMU = West African Economic and Monetary Union.
[1] Includes countries that have no explicitly stated nominal anchor, but rather monitor various indicators in conducting monetary policy.
[2] The country maintains a de facto exchange rate anchor to a composite.
[3] The country maintains a de facto exchange rate anchor to the US dollar.
[4] The central bank is in transition toward inflation targeting.
[5] The classification of the de facto exchange rate arrangement for Afghanistan is as of April 30, 2021.
[6] Currently, the Central Bank of Somalia does not have a monetary policy framework.

Figure 18. LICs: De Facto Exchange Rate Classification, April 2023



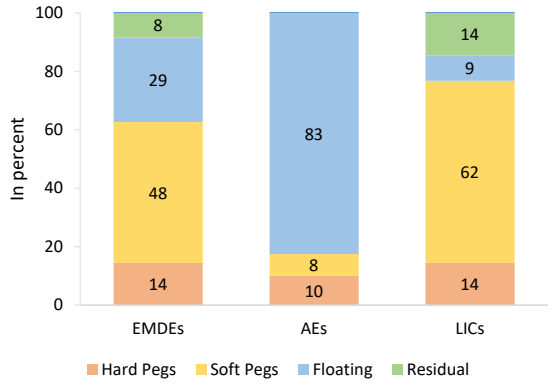
Source: IMF AREAER database.
Note: Countries with red outline are those in the LICs sample. Floating arrangements include free floating and floating classifications.

45. In the last 15 years there has been a clear trend among LICs to move away from market determined exchange rates to more tightly controlled exchange rate arrangements. The share of LICs with floating and free-floating regimes dropped from about 30 percent (19 countries) to about 9 percent (6 countries) of LICs between 2009 and 2023 (Figure 20). During 2010-11, six countries moved away from floating regimes to either soft pegs (Burundi, Cambodia, Congo DR) or other managed (Guinea, Haiti; Sudan). The global financial crisis (GFC) seems to have played a role in the observed switch to more managed exchange rate arrangements, including to mitigate the risk of large depreciations (IMF 2009; IMF 2010a; IMF 2010b; IMF 2011). Four countries moved from floating in 2017 to stabilized (Kenya, Tanzania, Malawi,) and other managed (Sierra Leone) exchange rates. External shocks related to the volatile global market conditions, commodity price shocks, the Ebola epidemic, and weather events influenced those changes in arrangements (IMF 2016a; IMF 2016b; IMF 2018a). Three countries switched from floating to crawl-like arrangement (Ghana; Mozambique; Zambia) in 2021. One main reason was the impact of COVID-19, which lowered growth and increased fiscal deficits (IMF 2022a). As of April 2023, the number of soft peg regimes in LICs is above the historic average, while the number of floating regimes is below average (Figure 21).

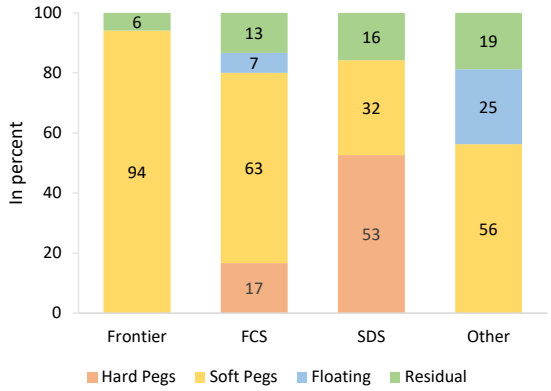
Figure 19. De Facto Classification Across Income Country Groups, April 2023

(Number inside the bars indicate the share of the group)

AEs and EMs have a larger share of market determined exchange rate regime compared to LICs



Within different LICs, soft pegs dominate except in the small state group

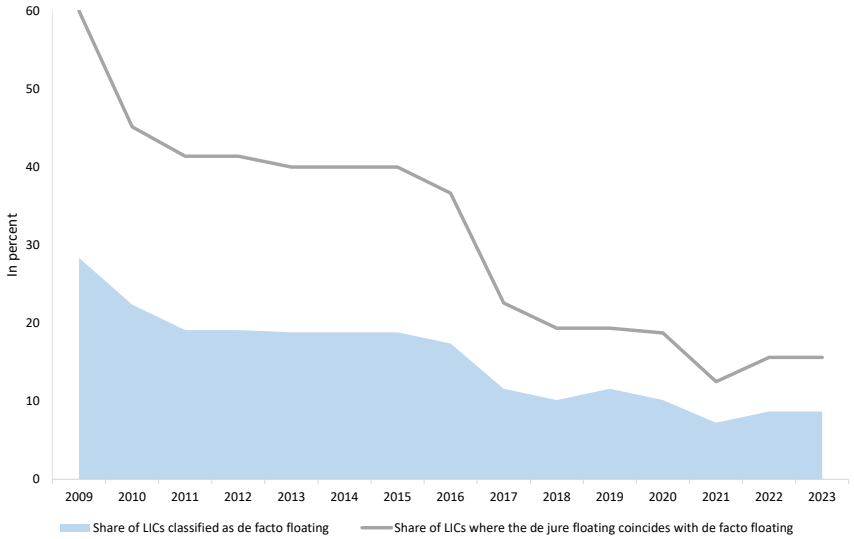


Sources: IMF AREAER database.

Note: AEs = advanced economies (39 countries); EMDEs = emerging market and developing economies (86 countries); LICs = low income countries (69 countries); Frontier (17 countries); FCS = fragile and conflict-affected situations (30 countries); SDS (19 countries) and Other (16 countries). There exists 13 countries that are classified as FCS as well as either Frontier (five countries) or SDS (eight countries). They are as follows: FCS and Frontier - Cameroon, Republic of Congo, Ethiopia, Mozambique, and Papua New Guinea; FCS and SDS - Comoros, Kiribati, Marshall Islands, Federated States of Micronesia, Solomon Islands, São Tomé and Príncipe, Timor-Leste, and Tuvalu. Floating arrangements include free floating and floating classifications.

Figure 20. LICs: Share of Floating Arrangements, 2009–23

Clear move away from floating arrangements and towards greater inconsistency between de jure and de facto floating arrangements



Sources: IMF AREAER database and IMF staff calculations.
Note: Data is as of April of each year. Floating arrangements include free floating and floating classifications.

Figure 21. LICs: Share in De Facto Classification Categories, 2009–23

LICs share in the soft peg regime is above the historical average, while its share in floating regime is below the average.

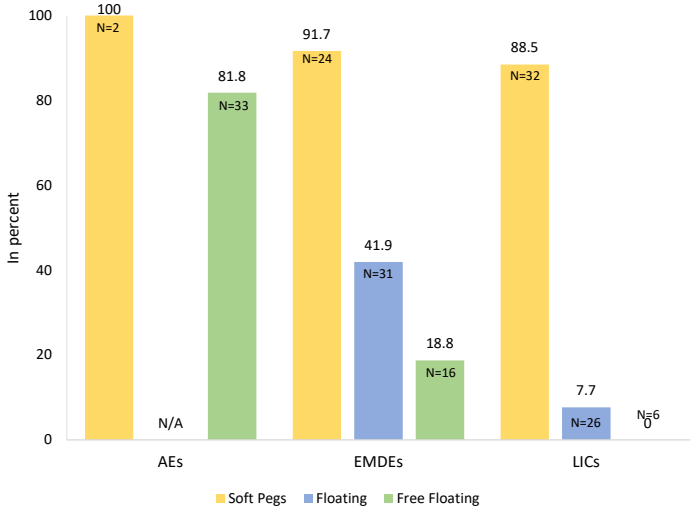
Sources: IMF AREAER database; and IMF staff calculations.
Note: Data is as of April of each year. The bars represent the range and mean of LICs share in the de facto classification categories from 2009 to 2023. Minimum = the lowest share; Maximum = the highest share; Mean = the average share; 2023 = the share as of April 2023. Floating arrangements include free floating and floating classifications.

46. As a consequence of this shift toward managed exchange rate arrangements the inconsistencies between what the LICs report as the country's exchange arrangement (de jure) and the de facto exchange rate arrangements have increased. As of end April 2023, only

8 percent of the LICs that classify their country's exchange rate arrangement as "floating" have de facto a floating exchange rate (the comparable share in EMDEs is about 40 percent). None of the LICs that report having a free-floating regime do so in practice.[50] In contrast, 19 percent of EMDEs and 82 percent of advanced economies that report having a free-floating regime do so in practice (Figure 22).

Figure 22. De Jure vs. De Facto Classifications, April 2023

LICs show a greater mismatch between de jure and de facto regimes



Sources: IMF AREAER database and IMF staff calculations.
Note: N=the number of countries that have the specified de jure arrangement (soft pegs, floating or free floating). The number on top of each bar represents the percentage of countries whose de jure matches the de facto arrangement. All AEs, EMs, and LICs classified as de jure hard pegs are also de facto hard pegs. Of the 33 AEs with de jure market-determined exchange rate arrangements, all are classified as de jure free floating. Hence, there is no data to report for mismatch for de jure floating for AEs. AEs = advanced economies; EMDEs = emerging market and developing economies; LICs = low income countries.

B. Monetary Policy Frameworks[51]

47. Monetary policy frameworks can be classified in terms of the main variables that serve as nominal anchor for the economy and generally have key desirable features such as clear objective, credibility and transparency (IMF 2015a)**.** LICs with de jure and de facto hard pegs, or members of a currency union have a clear nominal anchor. However, when there are large discrepancies between the de jure and de facto exchange rate arrangements the monetary policy frameworks tend to be opaque and less effective.

48. In recent years it has become increasingly difficult to clearly identify the nominal anchor based on the de jure monetary policy framework reported by LICs (Figure 23, left

[50] While Somalia has a de facto free-floating arrangement its de jure exchange rate arrangement is undetermined because of the absence of administrative measures controlling the foreign exchange market, and hence excluded from the comparison between de jure with de facto classification.

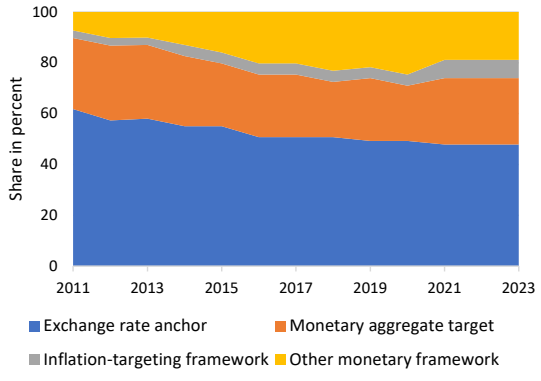
[51] The AREAER considers four types of de jure monetary policy frameworks: (1) Exchange rate anchor; (2) Monetary aggregate target; (3) Inflation-targeting framework; and (4) Other monetary framework. See Compilation Guide in IMF 2024g.

panel). While exchange rate anchor remains the most common monetary policy framework its share in LICs declined from about 62 percent to about 48 percent from 2010 to 2023. Countries that moved away from a de jure exchange rate anchor were: Lao P.D.R., Malawi, Sudan (all 2011); Ethiopia, Vanuatu (both 2013); Samoa, Tonga (both 2015), Zimbabwe (2018); and Liberia (2020). Also, South Sudan, which adopted a conventional peg in 2012 abandoned it in 2015. One half of the LICs that ceased de jure to have the exchange rate as main nominal anchor are now reported as having "Other monetary framework." In 2023, the currency used the most as an anchor was the Euro (15), followed by the US dollar (13).

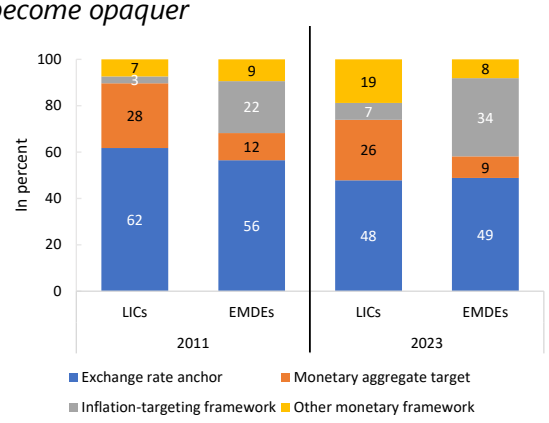
49. While both LICs and EMDEs have de jure moved away from exchange rate anchors, only EMDEs have tended to move towards inflation targeting (Figure 23, right panel). The share of LICs currently operating under inflation targeting framework (7 percent) is significantly below that in EMDEs (34 percent). Recently, Kenya and Uzbekistan (both in 2020) adopted an inflation targeting framework and joined Ghana, Moldova, and Uganda, which have been the few LICs implementing inflation targeting for the past many years. Three of these are frontier economies. Many of the LICs moved away from monetary aggregate or exchange rate as their nominal anchor to an interest rate based monetary policy framework with the aim to adopt a full-fledged inflation targeting regime but continue to monitor other indicators to conduct monetary policy and are therefore reported as having in place de jure "Other monetary policy framework." Most of these countries continue to have a de facto exchange rate regime that is either a soft peg or the residual other managed, reflecting that they are yet to adopt a market determined exchange rate that is generally required by an inflation targeting framework (Table 2). In part, because these LICs continue to face challenges in establishing the key elements for an effective monetary policy framework that would allow them to adopt full-fledged inflation targeting framework (IMF 2015a).

Figure 23. De Jure Monetary Policy Framework, 2011-23

LICs have moved away from monetary policy frameworks based on exchange rate anchor, to the other monetary framework category.



More EMDEs have moved to inflation targeting while monetary policy frameworks in LICs have become opaquer



Sources: IMF, AREAER database and IMF staff calculations.
Note: AEs = advanced economies; EMDEs = emerging market and developing economies; LICs = low income countries. The years in this chart represent the year of the AREAER publication and cover development during the previous year and through part of the publication year (for example, the 2023 report has full-year data for 2022 with data at least until June 2023 for most countries).

C. Foreign Exchange (FX) Market Features

Standing Facility, Allocations, Auctions, and Fixing

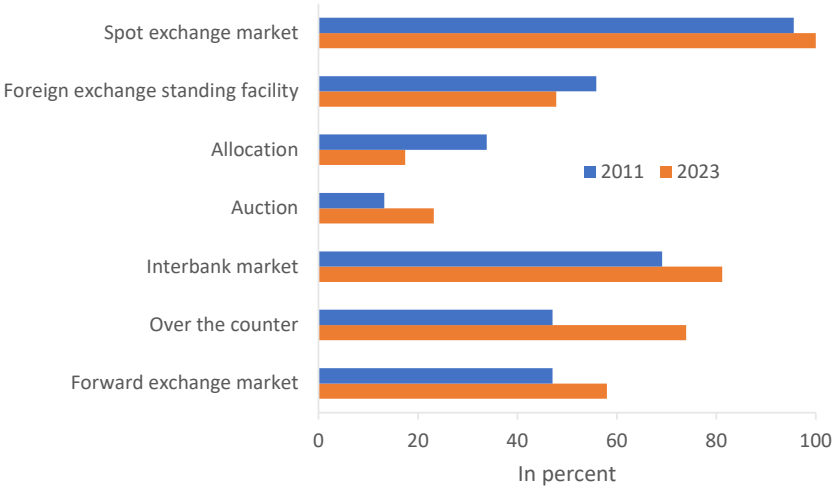
50. A well-functioning foreign exchange market can help support economic growth by facilitating cross border payments for trade and investments. The development of the foreign exchange market depends on the regulatory framework and institutional arrangements. Regulation and administrative controls are key factors in the development of FX markets. They affect who can participate, the sources and uses of foreign exchange, and the sophistication of the market (e.g., forward market). Critically, price discovery, or the efficiency of the FX market depends on the role the central bank plays in intermediating foreign exchange flows. Central banks that do not play a leading role in allocating FX flows incentivize the development of the interbank market. Regulatory and administrative measures to limit access to foreign exchange and the ability to conduct foreign exchange transactions often lead to existence of parallel foreign exchange markets, and/or exchange restrictions and multiple currency practices under Article VIII of the IMF's Articles of Agreement (see below).

51. Since 2010, foreign exchange markets in LICs have developed and increased their depth. There has been a sharp decline in the use of central bank facilities, such as an allocation mechanism, to provide foreign exchange and a greater reliance on market forces in the interbank market (Figure 24). A few LICs have also undertaken foreign exchange auctions to facilitate price discovery. Developments in different segments of the FX market are discussed below.

- *Foreign exchange standing facilities*—A total of 33 of 69 LICs reported standing FX facilities in their jurisdictions. When a country has a foreign exchange standing facility, the central bank typically stands ready to buy or sell foreign exchange to banks, thus providing a maximum and minimum exchange rate for their currency in a given day. Such facilities help regulate both money supply and liquidity and are usually instrumental in maintaining a hard or soft peg arrangement. Standing facilities are utilized mostly in LICs with currency boards conventional pegs, crawling pegs, and other managed arrangement. The credibility of such arrangements depends largely on the availability of foreign exchange reserves backing the facility. Over the past decade there has been relatively few changes in the number of countries reporting the use of standing facilities: six LICs (Burundi [2011], Guinea [2015], Malawi [2013], Rwanda [2015], São Tomé and Príncipe [2018], and Yemen [2020]) stopped using them, while Cambodia (2015) introduced one.

Figure 24. LICs: Foreign Exchange Market Segments, 2011 and 2023

FX markets in LICs are developing gradually



Sources: IMF AREAER database and IMF staff calculations.
Note: The years in this chart represent the year of the AREAER publication and cover development during the previous year and through part of the publication year (for example, the 2023 report has full-year data for 2022 with data at least until June 2023 for most countries).

- *Foreign exchange allocation systems*—Foreign exchange allocation is often used by central banks to provide foreign exchange for strategic imports, such as oil or food, when foreign exchange reserves are scarce. For instance, it has at times been used to finance priority sector projects (Ethiopia), essential imports (Eritrea), oil imports (São Tomé and Príncipe) and strategic imports (Sudan). In addition, it may also be used to facilitate financing in foreign currency for input procurements by manufacturer-exporters (Bangladesh). Less than 20 percent of LICs (12 of 69) currently report the use of allocation mechanism. This number has declined significantly since 2010 when it was almost twice as high. The biggest drop was in 2018 when 8 LICs comprising the BCEAO (WAEMU) reported that they had discontinued use of the allocation mechanism. Prior to that in 2013 the 4 LICs of the BEAC (CEMAC) had taken a similar decision. Other LICs that abandoned this practice include Myanmar (2012), Malawi (2012), and Ghana (2020); South Sudan reported introducing it in 2012 only to drop it in 2015. During the same period LICs that reported adopting allocation mechanism were Sudan (2012), Nepal (2013), Papua New Guinea (2019), and Mozambique (2020).[52]

- *Foreign exchange auctions*—Auctions are a useful mechanism to facilitate price discovery, particularly in markets that are still developing and do not as of yet have a deep and well-functioning interbank FX market. Auctions can also be used by central banks to influence the exchange rate as well as supply foreign exchange to the market. Overall, the number of LICs reporting the use of foreign exchange auctions have increased to 16 in 2023 compared with 9 in 2011. Since 2011, Burundi (2012), Mozambique (2012), Liberia (2019), and Kenya (2020) stopped conducting FX auctions. At the same time Myanmar (2011), Uganda (2011), Moldova (2012),

[52] Yemen reported the use of allocation facility only in 2020.

Guinea (2013), The Gambia (2014), South Sudan (2015), Tajikistan (2015), Zimbabwe (2019) and Yemen (2021) reported conducting FX auctions. Honduras discontinued FX auctions in 2020 but reinstated them in 2023, while Sudan temporarily conducted FX auctions in 2021-22 (IMF 2021b).

- *Fixing sessions*— Fixing sessions allow the central bank to organize sessions in which market participants can submit buying and selling bids for FX. This feature is characteristic of an early stage of foreign exchange market development when price discovery may be difficult. The central bank uses these bids to gauge the market clearing exchange rate. Only 3 LICs report having used fixing sessions since 2010 and in 2023 only Mozambique reported its use. Mauritania stopped the use of fixing session in 2022 and relies only on auctions to intervene in the foreign exchange market. Uzbekistan reported the use of fixing session during 2017 – 19. This mechanism is mostly utilized in countries where exchange rates are not market determined.

Interbank and Retail Foreign Exchange Markets

52. Since 2010 there has been a gradual increase in the number of LICs that report the existence of an interbank market. The AREAER reports information on three main types of interbank markets: over the counter markets (OTC), brokerage arrangements and market-making arrangements. Fifty-five of the LICs report some type of an interbank market as discussed below.[53]

- *Over-the-counter operations*—The majority of LICs report the existence of an OTC market in 2023 (51 of 69 or about 74 percent). This is only slightly lower than the ratio of EMDEs that report the existence of OTC interbank market (about 78 percent). The majority, 43 LICs, exclusively operate OTC interbank market and do not have brokerage or market making arrangements. The number of LICs reporting an active OTC interbank market in their jurisdiction grew from 32 in 2010 to 51 by 2020; a net increase of 19, with 20 LICs implementing an OTC FX market and one LIC discontinuing its use. Since 2010, the following 20 LICs reported the existence of OTC FX interbank market (Afghanistan, Myanmar, Tanzania, Uzbekistan, Comoros, Kenya, Democratic Republic of the Congo, Malawi, Tajikistan, The Gambia, Maldives, Djibouti, Mauritania, Uganda, Zimbabwe, Grenada, St. Lucia, St. Vincent and the Grenadines, Liberia, and Mozambique), while São Tomé and Príncipe, which initially reported an existence of an OTC stopped doing so in 2014.[54] As of end June 2023, 18 LICs reported that they do not engage in over-the-counter operations: of which over half are LICs with fragile and conflict-affected situations, while a few are frontier economies.

- *Brokerage arrangements*—In general, a brokerage arrangement involves an intermediary (broker) between buyers and sellers who does not deal on its own account. Such systems are typically found in countries with deeper financial markets. Only two LICs (Kenya and Papua New Guinea)

[53] São Tomé and Príncipe report the existence of an interbank market but do not provide information on the type of market.

[54] Somalia reported the existence of an OTC FX market during 2015 –17.

report the existence of brokers in the foreign exchange market, with this number having remained constant since 2010.

- *Market-making agreements*—Market making agreements create a standing relationship between the central bank and banks, who agree to provide a two-way market in specific financial instruments. Examples of market making agreements can be found in both developed and developing countries. Twelve LICs (or about 17 percent) report the existence of market making agreements in the foreign exchange market compared with about 41 percent of EMDEs in 2023.

Other Features

- *Forward market*—Forward markets can provide additional liquidity to markets by allowing market participants to lock in future prices. The number of LICs with a forward market increased gradually from 34 countries in 2009 to 40 in 2023. However, compared to EMDEs the share of LICs with forward markets is relatively low (about 60 percent, compared to 75 percent for EMDEs). Within LICs the depth and scope of the forward market is quite varied. For example, forward contracts are limited to select underlying transactions such as those related to current transactions or the imports and exports of goods (countries in the WAEMU, Comoros, Madagascar, Nepal, Papua New Guinea, Sierra Leone [only if below a threshold value], Tanzania). In some countries there is a threshold value over which forward contracts require central bank approval (BEAC/CEMAC), while in others central bank approval is required to conduct such transactions (Mozambique [for certain financial derivatives], Solomon Islands). The forward market is still insignificant or at a very early stage of development in a few countries (Moldova, Mauritania, Malawi, Rwanda). To encourage the development of the forward market central banks have undertaken swaps with authorized dealers (Ghana). On the other hand, a few countries do not report any specific limitations on the ability of banks to carry out forward market operations (Cabo Verde, Kenya, Uganda).

- *Taxes and subsidies on foreign exchange transactions*—The number of LICs levying a tax on foreign exchange transactions remained fairly stable during 2009-23, increasing only slightly from 18 to 20. Compared to EMDEs the share of LICs with such taxes is almost double, about 29 percent versus about 14 percent. Taxes on foreign exchange transactions are generally introduced because they are relatively easy to adopt and collect by the central bank. FX taxes in LICs range from 0.02 percent to 2.5 percent of the value of transaction. In most cases the tax is applied to both purchases and sales of foreign exchange and could be at different rates. Countries may also subsidize foreign exchange transactions by using separate, nonmarket exchange rates. Only one LIC in 2023 reported subsidizing foreign exchange transactions compared to three EMDEs. In order to make inward remittances more attractive through official channels, Bangladesh subsidized such remittances at 2.5 percent. Previously, Sudan provided an exchange subsidy to incentivize exports and Yemen utilized nonmarket exchange rates for food imports.

D. Capital Controls[55]

Level of Restrictiveness

53. Capital flows typically bring benefits for countries but carry risks (IMF 2012b)**.** Capital inflows can facilitate economic growth including by enhancing efficiencies, encouraging financial sector competitiveness, enabling productive investment, and helping smooth consumption over time. However, capital inflows and outflows also carry risks, particularly in countries with weak financial and institutional infrastructure. Free capital movements are generally more beneficial and less risky in countries that have reached a certain level of financial and institutional development. Countries with long standing capital controls are likely to benefit from liberalization under the right circumstances but as recognized by the IMF's Institutional View there is no presumption that full liberalization is appropriate for all countries at all times.

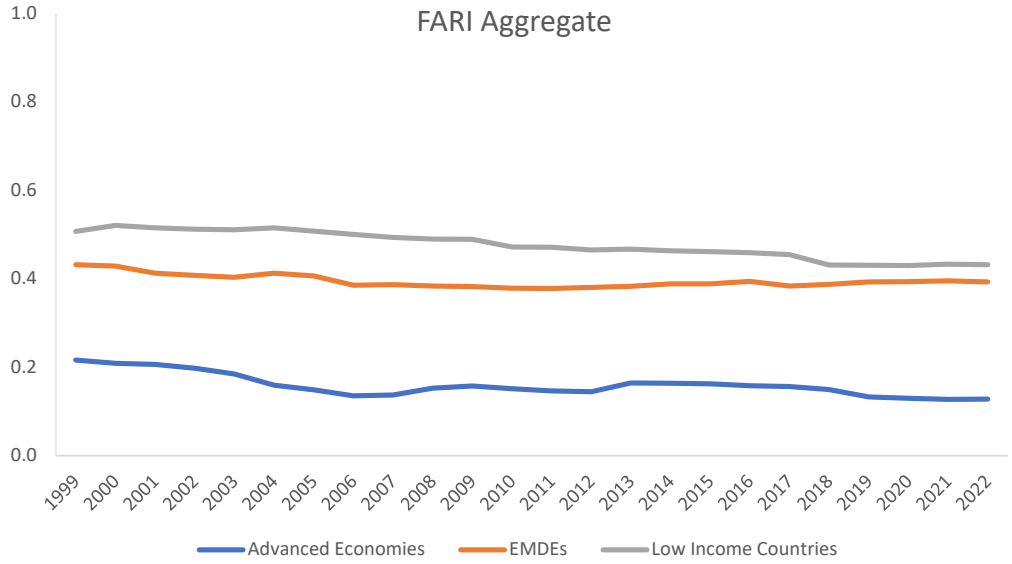
54. The balance of payments' financial accounts of LICs are less open than those of EMDEs and advanced economies, but the gap relative to EMDEs is narrowing (Figure 25). Since the early 2000, there has been a gradual decline in the overall restrictiveness of capital account controls in LICs as measured by the Financial Account Restrictiveness Index (FARI) (Baba et al forthcoming).[56] Among LICs the degree of restrictiveness is quite heterogenous (Figure 26). For 2022, the FARI value ranges from a couple of countries that register no controls (aggregate FARI equal to zero; Cabo Verde and Zambia) to levels of 0.8 indicating a highly restrictive or closed financial account. Figure 27 shows how the FARI in LICs has changed from 1999 to 2022, where for the most part there has been a tendency toward less restrictiveness.

[55] The measures discussed here are those that affect international capital flows as reported in the AREAER and are not limited to capital flow management measures (CFMs) identified since 2012 under the Institutional View (IMF 2012b). The concept of capital controls in the AREAER is residency-based: it includes various measures that regulate the execution of transactions and transfers and the holding of assets in the reporting jurisdiction by nonresidents and abroad by residents. Such measures may also be considered to be CFMs as defined by the IMF's institutional view on the liberalization and management of capital flows. However, the AREAER does not use this terminology because classifying a measure as a CFM requires substantial background information and considerable judgment, which is beyond the scope of the analysis conducted in compiling the AREAER database.

[56] A FARI value of 0 indicates least restrictiveness and 1 implies the most restrictiveness of capital controls. Based on the binary response regarding controls as reported in the AREAER, the paper calculates an aggregate index plus separate indices that measures restrictiveness on inflows and outflows. The indices include not only the standard portfolio and direct investment categories but also categories that cover nonresidents' foreign currency accounts in the country and domestic residents' accounts abroad as well as repatriation and surrender requirements. The broad coverage of transactions provides a more representative measure of the degree of restrictiveness of a country's financial account.

Figure 25. Capital Controls, 1999-2022

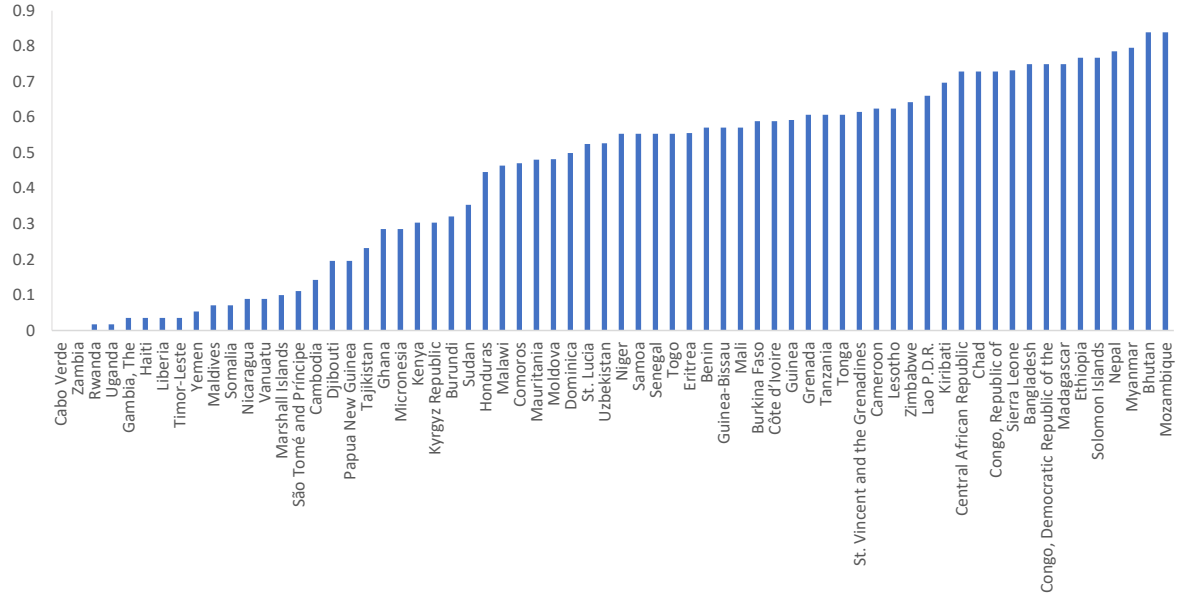
Financial accounts in LICs are the least open



Source: Baba et al., (forthcoming).
Note: EMDEs = emerging market and developing economies.

Figure 26. LICs: Financial Account Restrictiveness Index, 2022

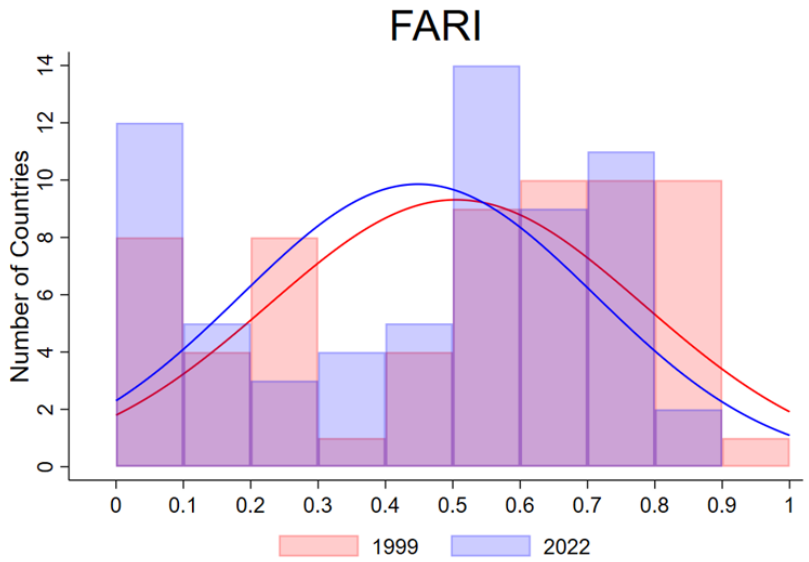
LICs exhibit a wide dispersion in the degree of restrictiveness of their financial account



Source: Baba et al., (forthcoming).

Figure 27. LICs: Distribution of Restrictiveness Index, 1999 and 2022

Financial account restrictiveness in LICs has eased somewhat from 1999 to 2022



Sources: Baba et al., (forthcoming) and IMF staff calculations.

55. LICs are relatively more open to capital inflows than to capital outflows, and have reached the same level of inflow openness as EMDEs (Figure 28). The difference between inflow and outflow openness is similar to the pattern seen across EMDEs and advanced economies. The tendency for less restrictions on inflows probably reflect LICs willingness to receive funding from abroad to finance domestic investments and/or the external current account. As shown in the lower panel of Figure 28, there is a clear shift in the distribution of inflow controls, indicating liberalization since 1999, while the shift in outflow controls is less prominent; fifty four of 66 LICs have a lower FARI for inflows than outflows in 2022 compared to 41 in 1999.

Figure 28. Restrictiveness: Capital Inflows vs. Outflows, 1999-2022

LICs have gradually relaxed controls on inflows and are as open as EMDEs in this category

LICs continue to be the most restrictive group on outflows

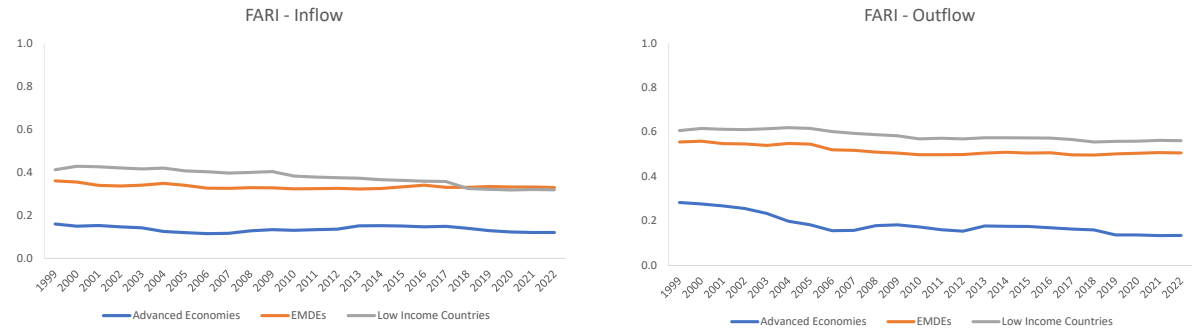
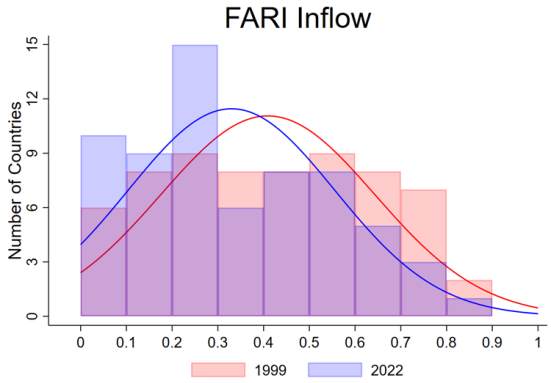
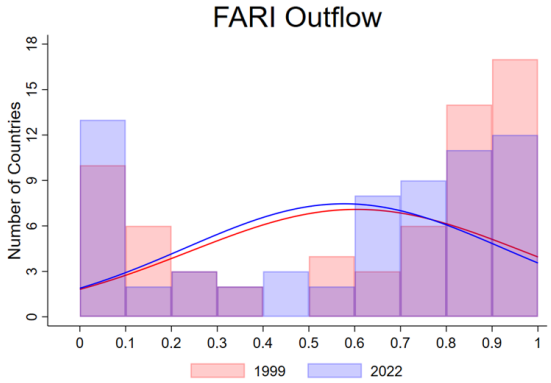


Figure 28. Restrictiveness: Capital Inflows vs. Outflows, 1999-2022 (concluded)

The distribution of inflow controls has clearly shifted to easing…



Whereas the distribution of controls on outflows has remained stable.



Sources: Baba et al., (forthcoming) and IMF staff calculations.
Note: EMDEs = emerging market and developing economies.

56. Most LICs report some form of controls on portfolio and direct investments, both in terms of inflows and outflows. Just over half of LICs report some form of control on nonresidents investment in shares of domestic companies. A slightly smaller number of LICs report some form of restrictions on nonresidents' investment in the local bond and/or money markets compared to equity markets. In contrast, about 70 percent of LICs report some controls on residents' portfolio investments abroad. About 64 percent report some form of restrictions on inward FDI, of which a third indicate controls on liquidation of invested capital. Slightly over 50 percent of LICs report restrictions on nonresidents' investment into real estate and residents' real estate investment abroad.

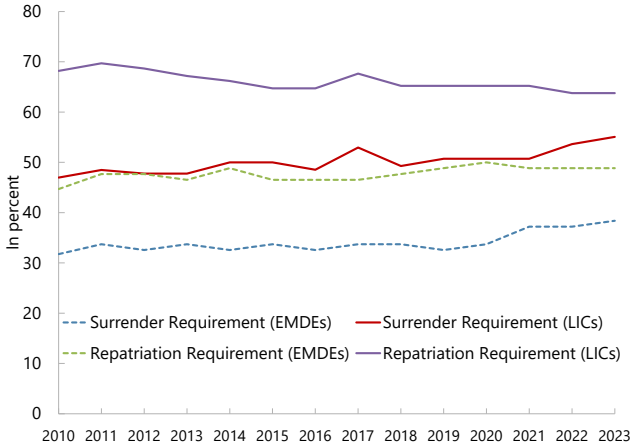
57. Most LICs also report some form of repatriation requirement and/or surrender requirement for cross border transactions. The overall share of LICs reporting repatriation and surrender requirements is notably higher than in EMDEs (Figure 29). As of end June 2023, the most common repatriation requirements are those related to proceeds from export of goods (44 LICs), followed by those on proceeds from export of services (37) and finally on proceeds from capital investments (33). The share of LICs reporting the use of repatriation requirements is relatively higher than those reported by EMDEs: 64 percent, 54 percent, and 48 percent compared to 45 percent, 37 percent, and 30 percent, respectively, for the three types of transactions. In conjunction with repatriation requirements, a larger share of LICs report the use of some form of surrender requirements compared to EMDEs, although lower than that for repatriation requirements. The share of countries with surrender requirements for proceeds related to export of goods, export of services, and investment are respectively, 46 percent vs 30 percent, 45 percent vs 28 percent, and 33 percent vs 26 percent, for LICs vs EMDEs.[57] Foreign exchange proceeds have to be surrendered to the banking system, to the central bank or to both. As of end June 2023, 23 LICs report some form of surrender requirement to the central bank; about 60 percent of those countries have a

[57] Note that no advance economies report any type of repatriation or surrender requirement.

conventional peg arrangement (12 belonging to one of the currency unions). The remainder are split across crawl-like, stabilized, other managed, with one classified as floating arrangement.

Figure 29. Share of Repatriation and Surrender Requirements: LICs vs EMDEs, 2010–23

Share of LICs with repatriation and surrender requirements are higher than in EMDEs



Sources: IMF AREAER database and IMF staff calculations.
Note: The years in this chart represent the year of the AREAER publication and cover development during the previous year and through part of the publication year (for example, the 2023 report has full-year data for 2022 with data at least until June 2023 for most countries). EMDEs = emerging market and developing economies; LICs = low income countries.

58. Restrictions on nonresidents' accounts in the country and residents' accounts abroad are somewhat less prevalent. Virtually almost all LICs (97 percent) permit nonresidents to hold bank accounts in foreign exchange in the country, which is comparable to the share of EMDEs that do so. About 80 percent of those LICs do not require nonresidents to get approval to open such accounts. At the same time, residents of 90 percent of LICs are permitted to have bank accounts in foreign exchange abroad, with just over half of them permitting this without requiring approval from the authorities. The share is somewhat lower than in EMDEs.

Changes to Controls Affecting Capital Flows

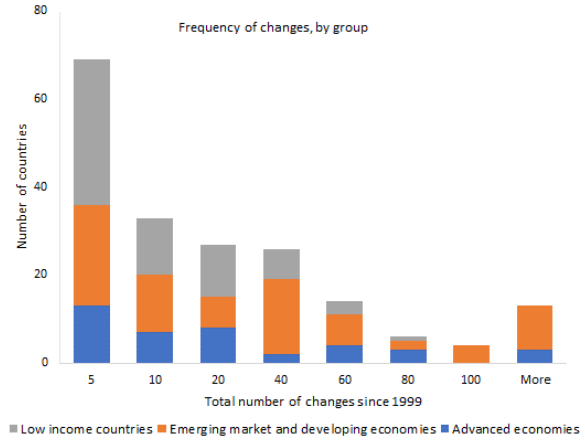
59. Besides having more closed financial accounts than EMDEs', LICs also have changed regulations affecting capital flows much less frequently than EMDEs since 1999. As shown in Figure 30 (left panel), LICs with 5 or less changes are the largest group, whereas several EMDEs reported over 100 changes.[58] These changes may reflect a tightening or easing of controls. While the FARI shows a gradual decline in the level of restrictiveness (Figure 30, right panel), the ACI complements the picture by illustrating that countries continue to take policy measures that can affect capital flows in response to shocks or as part of a financial account liberalization plan (Figure

[58] Baba et al., (forthcoming) have identified changes to regulations reported in the AREAER database as affecting capital inflow or outflows and whether they represent a tightening or easing action for the set of categories that mostly overlap with those in FARI. A count of such actions results in four main indices (AREAER Change Index or ACI) representing: inflow easing, inflow tightening, outflow easing, and outflow tightening; hence, they vary—from 0 to a positive number—for any period for each country.

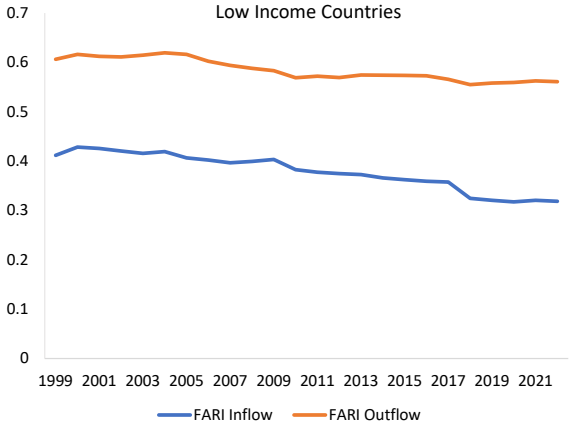
31, panel 1).[59] Nevertheless, the frequency of policy actions concerning capital flows taken by EMDEs is almost 5 times higher than LICs (Figure 31, panel 2): the cumulative number of easing actions taken by EMDEs was about 3,000, compared to about 500 in LICs. Although a small group of countries account for close to two-thirds of the sum of easing and tightening measures taken by EMDEs, the much lower number of measures taken by LICs may reflect a lower capacity in those countries to calibrate and effectively enforce changes to capital controls.

Figure 30. Changes Affecting Capital Flows, 1999-2022

LICs made relatively few changes to capital control measures since 1999



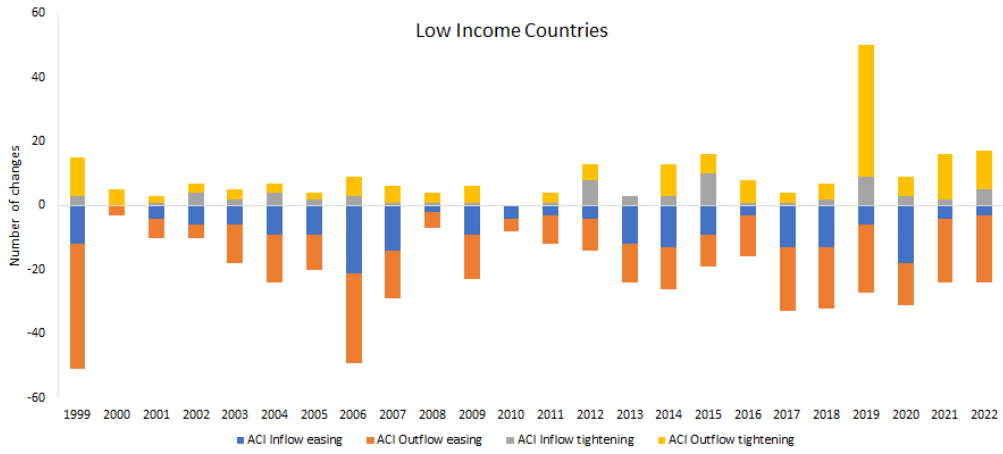
There is gradual change in outflow and inflow restrictiveness



Sources: Baba et al., (forthcoming); and IMF staff calculations.

Figure 31. Measures Affecting Inflows and Outflows, 1999-2022

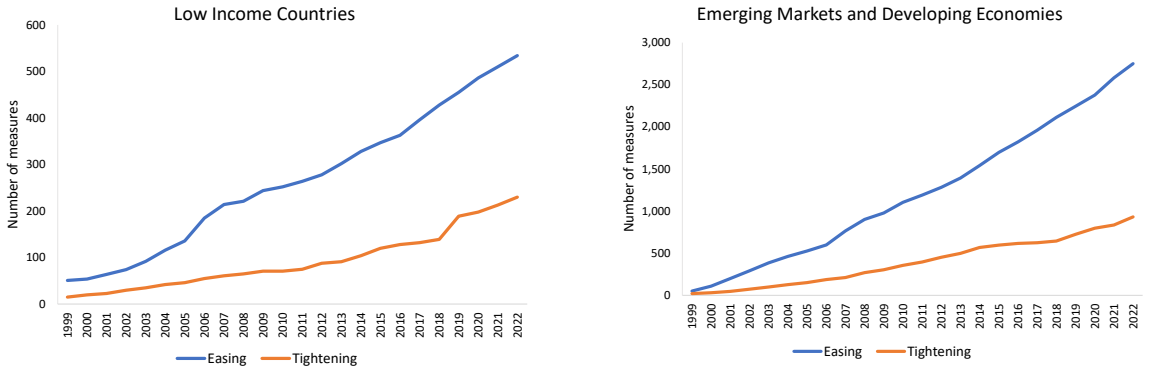
1. Easing actions dominate over tightening ones



[59] Given that the FARI is based on a bivariate input, the index will only change if all controls are eliminated in a category reflected in the FARI, or if there were no controls in that category and some form of control was introduced. However, if a country tightens or eases an existing control in a category covered by the indices, it will be reflected in the ACI, but not in the FARI.

Figure 31. Measures Affecting Inflows and Outflows, 1999-2022 (concluded)

2.The cumulative number of measures taken by LICs to affect capital flows is significantly less than those taken by EMDEs.



Sources: Baba et al., (forthcoming) and IMF staff calculations.
Note: Easing = ACI Inflow easing plus ACI Outflow easing; and Tightening = ACI Inflow tightening plus ACI Outflow tightening.

E. Exchange Restrictions and Multiple Currency Practices

60. Since its creation in 1944 the Fund has promoted international monetary cooperation including through the elimination of restrictive exchange measures on payments and transfers for current international transactions that hamper international trade. For that reason, Article VIII, Sections 2(a) and 3 of the IMF's Articles of Agreement establish certain obligations that members must observe with respect to exchange restrictions and multiple currency practices. Under Article VIII Sections 2(a) and 3 members may not impose restrictions on the making of payments and transfers for current international transactions and members are prohibited from engaging in any discriminatory arrangement or multiple currency practices without the (prior) approval of the IMF. When joining the Fund, a member may opt to avail itself of transitional arrangements under Article XIV, which allows a member to maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member. However, such members are also subject to obligation under Article VIII for any new exchange measures that they implement after joining the Fund.

61. The share of LICs that have accepted Article VIII at end 2022 is about 85 percent, slightly below the EMDE share (93 percent). Fifty-nine LICs have accepted Article VIII obligations as of end 2022, of which four accepted them since 2010 (Lao PDR [2010], Mozambique [2011], Tuvalu [2016], and Myanmar [2020]). The following LICs have yet to accept the obligations under Article VIII, Sections 2 and 3, and thus avail themselves of the transitional arrangements under Article XIV as of end 2022: Afghanistan, Bhutan, Burundi, Eritrea, Ethiopia, Liberia, Maldives, São Tomé and Príncipe, Somalia, and South Sudan. The discussion below does not specify whether the restrictive exchange measures are maintained under Article VIII or Article XIV.

62. LICs' share of the restrictive exchange measures maintained by member countries in 2022 is below 50 percent. The number of LICs maintaining restrictive exchange measures (exchange restrictions and/or multiple currency practices (MCPs)) have increased from 19 countries

in 2009 to 23 in 2022.[60] During the same period the number of EMDEs with restrictive exchange measures dropped from 25 to 23 countries. The number of LICs with MCP's increased from 11 in 2009 to 12 in 2022, and those with exchange restrictions from 15 in 2009 to 19 in 2022 (Figure 32). During the same period, the number of EMDE with MCPs also increased by one to 14 and those with exchange restrictions remained at 19.

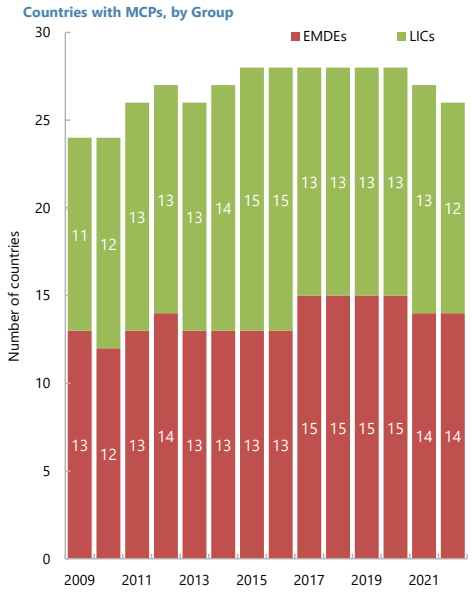
63. The number of restrictive exchange measures in LICs increased steadily since 2010 but dipped in 2022, largely because of a fall in the number of exchange restrictions.[61] In some cases such measures are a consequence of balance of payments pressures and foreign exchange shortages while in other cases they reflect a move to more liberalized FX markets (for example those that arose owing to foreign exchange auctions) (IMF 2019). Restrictive exchange measures peaked in 2018 in EMDEs and started a downward trend but increased sharply in 2022, in part because of a rise in the number of exchange restrictions (Figure 33, left panel). The number of MCPs maintained by LICs has increased steadily since 2009, and EMDEs show roughly a similar pattern. MCPs were a common feature of exchange systems when the Fund was established but their use dropped significantly in the ensuing decades; they reappeared in the early 1980s with many countries experiencing balance of payment difficulties (IMF 2019). The use of exchange restrictions in LICs has fluctuated more compared to MCPs, while in EMDEs the difference is not as pronounced. Many countries maintain both an exchange restriction and/or MCP and in many cases they also have more than one type of exchange restriction and/or MCP, thus resulting in a much larger count of restrictive exchange measures compared to number of countries with restrictions. The average number of MCPs maintained by LICs are between 1 and 2 per country and slightly over 2 per country for exchange restrictions (Figure 33, right panel). For the most part LICs maintained on average a higher number of exchange restrictions compared to EMDEs, and vice versa for MCPs. The broad trend has been for these averages to increase gradually over time for both groups.

[60] The IMF adopted a new MCP policy on July 1, 2022. The main changes in the new policy are: (1) an MCP will arise due to an official action that segments foreign exchange markets or increases or subsidizes the cost of certain foreign exchange transactions (for example, exchange taxes), (2) MCPs will be identified on the basis of a new country-specific market-based rule, and (3) the new policy ensures better alignment of the MCP policy with other relevant IMF policies. The new policy became effective on February 1, 2024, after a transitional period (July 1, 2022, until February 1, 2024) to allow members to adjust their policies. However, since July 1, 2022, under the new policy, no MCPs are to be found where (1) official action takes the form of (a) an one-day lagged official exchange rate computed and used as specified in the new policy, (b) broken cross-rates, or (c) a foreign exchange auction consistent with specified criteria under the new policy; and (2) an MCP results from exchange rate spreads arising in an illegal parallel market. Effective July 1, 2022, existing MCPs based on the types of official action that are no longer covered under the MCP policy were considered eliminated. In addition, all remaining pre-existing MCPs were considered eliminated effective February 1, 2024, when the new policy came into effect. See IMF 2022b.

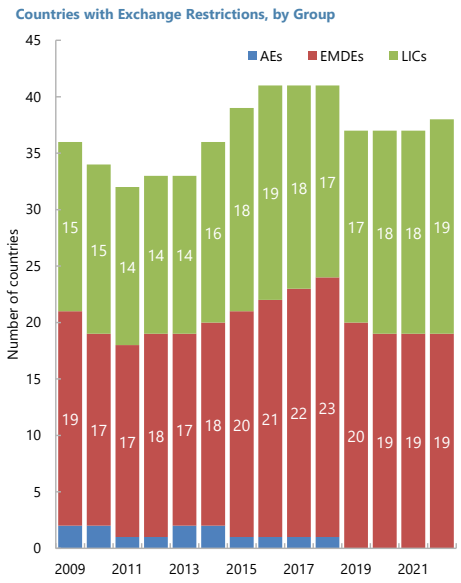
[61] The number of restrictive exchange measures discussed in this section is based on those reported in IMF staff reports issued as of December 31, 2022. Any changes to restrictive measures, either new measures or removal of existing measures that are reported in IMF staff reports issued after December 31, 2022, are not reflected.

Figure 32. Number of Countries with Restrictive Exchange Measures, 2009–22

Number of LICs with MCPs increases slightly in line with EMDEs



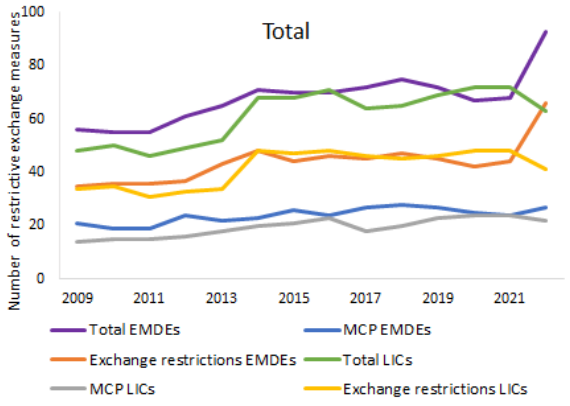
Number of LICs with exchange restrictions increased while the number of EMDEs have remained steady



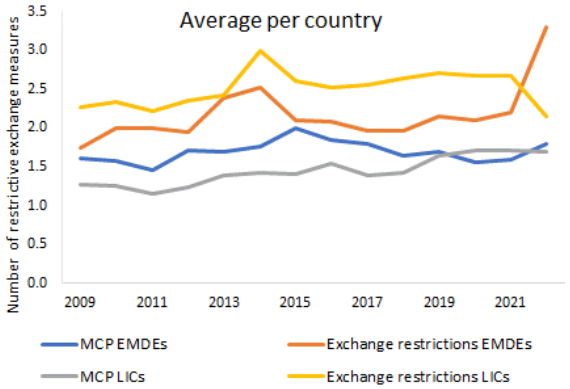
Sources: IMF staff reports, IMF staff calculations.
Note: Countries that have both MCPs and exchange restrictions are represented in both panels.

Figure 33. Number of Exchange Restrictions and MCPs, 2009-22

Overall number of exchange restrictions and MCPs have increased since 2009



For most of the period the average number of MCPs in LICs was lower than in EMDEs, while the average number of exchange restrictions was higher in LICs compared to EMDEs



Sources: IMF staff reports, IMF staff calculations.
Note: EMDEs = emerging market and developing economies; LICs = low income countries.

Multiple Currency Practices

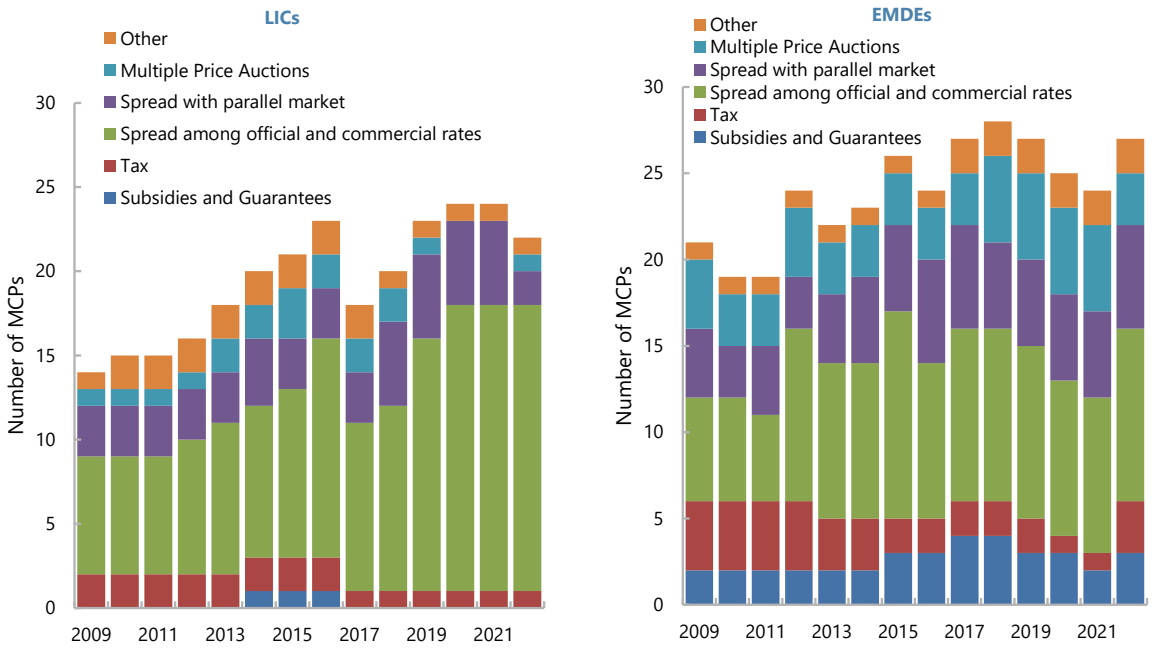
64. The most common form of MCPs in LICs is the use of mandated exchange rates for specific transactions (Figure 34). This is also the case in EMDEs though they are less common in

that group. An MCP may arise when the authorities use a mandated or official rate for certain transactions, because the official rate is calculated based on previous day's transactions, thus creating the potential deviation of two percent or more between official and market exchange rates on the day of the transaction.[62] This often reflects the lack of capacity to calculate the market exchange rate on a real-time basis (IMF 2019). Since 2009, 20 LICs have had such an MCP with the following LICs maintaining them in 2022: Burundi, Eritrea, Ghana, Guinea, Honduras, Kyrgyz Republic, Maldives, Papua New Guinea, Sierra Leone, Sudan, Tajikistan, and Zimbabwe.

Figure 34. Types of MCPs, 2009-22

The most common types of MCPs in LICs are also found in EMDEs…

but EMDEs use other types of MCPs more frequently



Sources: IMF staff reports, IMF staff calculations.
Note: EMDEs = emerging market and developing economies; LICs = low income countries.

65. Another common MCP is related to multiple price foreign exchange auctions. This type of MCP is more common among EMDEs than LICs (Figure 34). As discussed earlier, multiple price FX auctions are often used to facilitate price discovery where interbank markets are shallow. An official multiple price FX auction, under the old MCP policy, would give rise to an MCP unless there was a mechanism to ensure that exchange rates of accepted bids did not deviate by more than two percent (IMF 2019). Only one LIC (Zimbabwe) compared to three EMDEs had an MCP in 2022 owing to multiple price FX auctions. Since 2009 four other LICs were identified to have had an MCP related

[62] Prior to the new MCP policy, an MCP could be found based on potentiality, i.e., if there was no mechanism to prevent a spread of more than two percent between the official and market exchange rates. Under the new policy an MCP is found if a rate mandated by official action is not within the country specific market-based permissible spread (see IMF 2022b). Under the new policy a one-day lagged official exchange rate computed and used as specified in the new policy would not give rise to an MCP.

to multiple price FX auctions (Honduras, 2016 (IMF 2016c); Myanmar, 2013 (IMF 2013); Sierra Leone, 2009 (IMF 2010c); and Uganda, 2015 (IMF 2015d)).

66. MCPs arising from the spread between official and parallel market rates in LICs are only slightly less frequent than in EMDEs (Figure 34).[63] These MCPs generally arise due to exchange restrictions imposed in the official market such as foreign exchange rationing or prioritization. In 2022 only two LICs (Eritrea and Sudan) had such an MCP, but since 2009 other LICs (Maldives, São Tomé and Príncipe, South Sudan, Malawi, Myanmar) have had this type of MCPs.

67. Other types of MCPs have been less common among LICs in recent years. MCPs related to the use of taxes on foreign exchange transactions has been rare in LICs since 2009.[64] In 2022 only Eritrea has such an MCP, and Somalia had one during 2009-16. Subsidies and guarantees are still used by EMDEs but have been uncommon in LICs since 2009. South Sudan had an MCP due to an exchange rate guarantee arrangement during 2014-16.

Exchange Restrictions

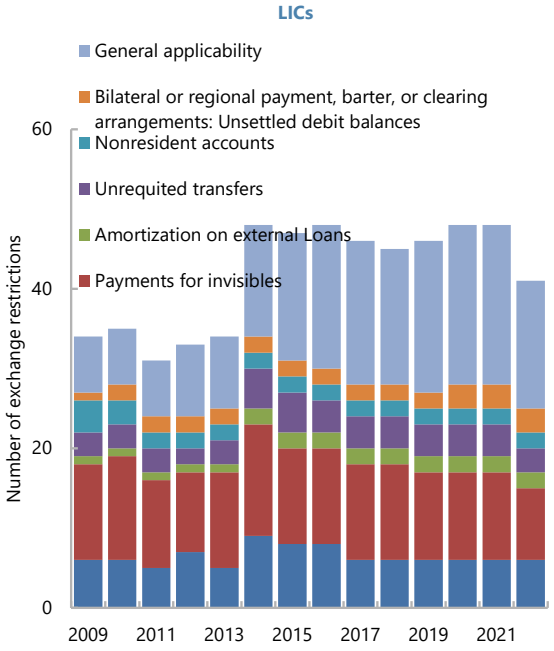
68. General limitation on access to foreign exchange was the most common type of exchange restriction identified in LICs and these have increased since 2009 (Figure 35). This form of exchange restriction was also common in EMDEs. These restrictions typically include prioritization and rationing of foreign exchange, or limiting amounts at foreign exchange auctions. In such cases, the excess demand for FX may be satisfied through access to the parallel market. South Sudan which became an IMF member in 2012 was found to have three such exchange restrictions, while Bhutan and Maldives were identified with two and one exchange restrictions respectively (IMF 2015b). In 2022, 14 LICs maintained general exchange restrictions for the most part attributed to prioritization, rationing and not allocating enough foreign exchange to meet demand for current transactions.

[63] Illegal parallel markets are excluded from the scope of the new MCP policy but would continue to be captured under the Fund's policy on exchange restrictions, where relevant (IMF 2022b). Parallel markets would be considered "illegal" if transactions conducted in such markets are prohibited under national law.

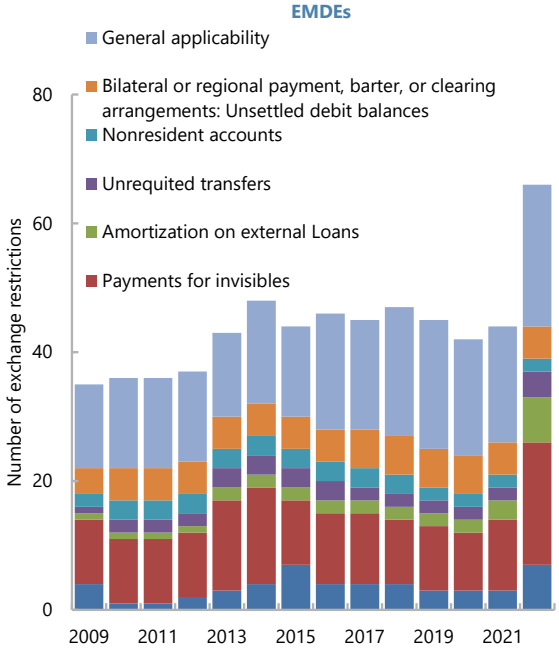
[64] Under the MCP policy effective prior to February 1, 2024, tax payable on exchange transactions would result in an MCP if the tax rate was greater than 2 percent. The new MCP policy broadly provides continuity for the treatment of exchange taxes. In the case of exchange taxes that do not exceed 2 percent imposed by official action on exchange transactions where the exchange rate is not determined by official action it would not result in MCPs. An MCP could result where a tax is imposed on an exchange transaction with an exchange rate arising from an official action, if the effective exchange rate (the nominal exchange rate plus any additional cost, such as taxes) falls outside the country specific permissible spread (IMF 2022b).

Figure 35. Types of Exchange Restrictions, 2009-22

Composition of exchange restrictions have remained steady in LICs



In EMDEs the two most common types of exchange restrictions are similar to LICs



Sources: IMF staff reports, IMF staff calculations.
Note: EMDEs = emerging market and developing economies; LICs = low-income countries.

69. Another common type of exchange restriction in LICs relates to limitations on access to foreign exchange for invisible transactions (Figure 35). The number of such exchange restrictions has remained steady, attributed to a few LIC who have maintained them for a number of years, and some have more than one such exchange restrictions. EMDEs also maintain a similar number of this type of exchange restriction but saw a jump in 2022.[65] Examples of LICs that maintained such exchange restrictions in 2022 include: Bhutan (3; including requiring FDI companies to pay for their operational expenses, IMF 2022c); Ethiopia (1; a tax certification requirement for repatriation of dividend and other investment income, IMF 2020d); São Tomé and Príncipe (1; requirement that taxes and other obligations to the government have to be paid/fulfilled as a condition for transfer of net income from investment, IMF 2022d); and South Sudan (1; an exchange restriction arises from imposing absolute ceilings on the availability of foreign exchange for certain invisible transactions, IMF 2022e).

70. Other types of exchange restrictions are not as prevalent (Figure 35). Of the remaining the most common relates to payments for imports. Examples include restrictions on the availability of foreign exchange for importers who have not provided evidence of past imports that are unrelated to the underlying transaction (Bhutan, Ghana); requirement for a clearance certificate

[65] Mostly because of Argentina (IMF 2024g).

(Ethiopia); the imposition by the government of a cash margin requirement for most imports (Sudan). Generally, EMDEs had less instances of such exchange restrictions during this period.

F. Concluding Observations

71. The evolution of exchange rate arrangements, foreign exchange markets and restrictions to capital and current account transactions in LICs since 2009 shows the following:

- There has been a clear trend among LICs to move away from market determined exchange rates toward regimes where the exchange rate is to a greater extent driven by authorities' measures. As a result, there are greater inconsistencies between what the authorities in LICs report as their exchange arrangement (de jure) and what the exchange arrangement is in practice (de facto).
- There has been a move towards less clarity regarding the economy's nominal anchor in LICs; also, the exchange rate remains as the main nominal anchor in about 50 percent of LICs.
- There has been steady progress in developing foreign exchange markets in LICs. Overall, central banks are playing a lesser role in allocating foreign exchange including through greater reliance on FX auctions to facilitate price discovery.
- The balance of payments' financial account of LICs remain less open than those of EMDEs and advanced economies and the restrictiveness is lower on capital inflows than outflows. However, there is a large dispersion in the degree of restrictiveness among LICs.
- LICs have been easing capital controls at a significantly slower pace than EMDEs and tend to adjust their controls less frequently than EMDEs, perhaps due to less capacity to calibrate and enforce such changes.
- Many LICs continue to maintain exchange restrictions and MCPs subject to IMF jurisdiction, including as a means to allocate and prioritize the distribution of scarce foreign exchange resources.

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Annex I. LIC Classification and Aggregation Methodology

For the purposes of this report, LICs are defined as all IMF members that are eligible for borrowing under the Poverty Reduction and Growth Trust (PRGT). This list, updated regularly following a PRGT-eligibility review approved by the IMF Board, currently includes 70 LICs.[1] This LIC classification is different from the definition of Low-Income Developing Countries (LIDC) used in the World Economic Outlook (WEO) and from the LIC classification used by the World Bank.

Throughout this report, the LIC group is further segmented across three dimensions:

1. By income level. LICs are categorized into two groups, mutually exclusive, based on their GNI per capita: (1) at or below the IDA cutoff threshold (US$ 1,335 in FY25, =100 percent), referred to as poorest LICs throughout the report; and (2) countries above the IDA cutoff threshold, referred to as more advanced LICs. For analytical consistency with the 2024 Review of PRGT Finances and Facilities, Haiti, Nepal, and Guinea are included in the first group despite having GNI per capita above the IDA cutoff threshold.[2] This grouping differs from the WB definition of poorest LICs, which is composed of those countries with more than half of their populations below the extreme poverty line (Mawejie 2024).

2. By institutional characteristics. LICs are divided into four institutional groups: (1) fragile and conflict-affected states (FCS) that experience political instability, flows of displaced people, or are in an open conflict; (2) small and developing states (SDS) with populations lower than 1.5 million[3]; (3) frontier markets (FM) with access to international financial markets; and (4) all other LICs. There are overlaps between some of these categories, that is, some LICs are classified, for example, as both FCS and FM, or FCS and SDS.

3. By export structure. Five mutually exclusive groups can be distinguished, following the World Economic Outlook Country Group classification:

- *Fuel exporters* are countries where net fuel exports make up 30 percent or more of total exports.
- *Non-fuel commodity exporters* are resource-intensive countries, other than fuel exporters, whose nonrenewable natural resources represent at least 25 percent of total exports.

[1] Since 2008, 83 countries have been classified as PRGT-Eligible (LICs) over time; 65 of the initial PRGT-eligible members remain on the list to this day. Only 6 countries entered the list since it was established, while 13 graduated to EM status (Table 3). See the IMF (2024a), approved by the Board on October 15, 2024, Annex IX.

[2] This classification reflects the status of these countries under the comprehensive assessment framework established in the 2024 PRGT Review for determining access to concessional financing.

[3] This country group (LIC-SDS) is a sub-group of SDS as defined in the 2024 SDS Guidance Note, as it does not include 7 advanced economies that are part of the WEO classification (Andorra, Cyprus, Estonia, Iceland, Luxembourg, Malta, and San Marino) and 3 high-income fuel-exporting countries as defined by the World Bank (Bahrain, Brunei Darussalam, and Equatorial Guinea).

- *Diversified countries* are non-resource-intensive countries (i.e. those not classified as either fuel or non-fuel commodity exporters), identified in the original WEO classification as having Diversified and Manufacturing export sectors. Countries are included in this category if their dominant categories of exports are manufactured goods or if they have more than one category of exported products.
- *Tourism dependent countries* are those whose export earnings are small, but revenue generated from travel and passenger transport services make up 10 percent or more of total export revenue.
- *Other services countries* are classified as those whose main source of exports are services (including income, transfers) in the original WEO Country Groupings.

Annex I. Table 1. LIC 2025 Classification by Income Level, Export Structure, and Institutional Structure[1]

Income Level[2] / Institutional Characteristics[3]	Most vulnerable LICs <=100	Threshold LICs >100=<150	Wealthier LICs >150<=300	Wealthy LICs >300
FCS	Afghanistan (Non -Fuel), Burkina Faso (Non -Fuel), Burundi (Non -Fuel), Central African Republic (Non-Fuel), Chad (Fuel), Democratic Republic of the Congo (Non-Fuel), Eritrea (Non-Fuel), Guinea -Bissau (Non-Fuel), Niger (Diversified), Mali (Non-Fuel), Myanmar (Diversified), Somalia (Non-Fuel), Sudan (Non -Fuel), South Sudan (Fuel), Syria (Diversified), Yemen (Fuel)	Haiti (Diversified), Zimbabwe (Non-Fuel)		
Frontier	Rwanda (Diversified), Tanzania (Diversified), Togo (Diversified), Zambia (Non-Fuel)	Tajikistan (Non -Fuel), Benin (Non-Fuel), Senegal (Diversified)	Cote d'Ivoire (Diversified), Ghana (Non-Fuel), Honduras (Diversified), Kenya (Diversified), Uzbekistan (Diversified)	
SDS			Bhutan (Diversified), Djibouti (Services), Vanuatu (Tourism)	Cabo Verde (Tourism), Dominica (Tourism), Grenada (Tourism), St. Lucia (Tourism), St. Vincent and the Grenadines (Tourism), Tonga (Services), Samoa (Tourism), Maldives (Tourism)
Other	The Gambia (Services), Lesotho (Diversified), Liberia (Non-Fuel), Madagascar (Diversified), Malawi (Non-Fuel), Sierra Leone (Non-Fuel), Uganda (Diversified)	Cambodia (Diversified), Kyrgyz Republic (Services), Nepal (Services), Guinea (Non -Fuel)	Bangladesh (Diversified), Lao P.D.R. (Diversified), Mauritania (Non-Fuel), Nicaragua (Diversified)	Moldova (Services)
FCS and Frontier	Mozambique (Services), Ethiopia (Diversified)	Cameroon (Diversified)	Congo, *Republic of* (Fuel), Papua New Guinea (Non -Fuel)	
FCS and SDS		Comoros (Services)	Sao Tome (Tourism), Kiribati (Non-Fuel), Solomon Islands (Non-Fuel), Timor-Leste (Fuel)	Marshall Islands (Non -Fuel), Micronesia, Fed. States of (Diversified), Tuvalu (Non -Fuel)

1/ The country colors refer to the LIC export structure classifications: Fuel (Red), Non-Fuel (Green), Diversified & Manufacturing (Blue), Tourism (Yellow) and Services (Black). Fuel and Non-Fuel countries are resource-rich countries.
2/ The four income columns correspond with the percent of the GNI per capita cutoff for FY2025 of $1335. GNI per capita data for 2023 is used except for Eritrea and South Sudan.
3/ FCS and Frontier, and FCS and SDS refer to institutional characteristics and their overlaps.

Annex I. Table 2. Complete Classification Lists

All PRGT Countries (70)	By Export Structure	By Institutional Structure	
Afghanistan			
Bangladesh	**Fuel (5)**	**FCS (31)**	**Others (16)**
Benin	Chad	Afghanistan	Bangladesh
Bhutan	Congo, Republic of	Burkina Faso	Cambodia
Burkina Faso	Timor-Leste	Burundi	Gambia, The
Burundi	Yemen	Cameroon	Guinea
Cabo Verde	South Sudan	Central African Republic	Kyrgyz Republic
Cambodia		Chad	Lao P.D.R.
Cameroon	**Non-fuel (25)**	Comoros	Lesotho
Central African Republic	Afghanistan	Congo, Republic of	Liberia
Chad	Benin	Democratic Republic of Congo	Madagascar
Comoros	Burkina Faso	Eritrea	Malawi
Congo, Republic of	Burundi	Ethiopia	Mauritania
Cote d'Ivoire	Central African Republic	Guinea-Bissau	Moldova
Democratic Republic of Congo	Democratic Republic of Congo	Haiti	Nepal
Djibouti	Eritrea	Kiribati	Nicaragua
Dominica	Ghana	Mali	Sierra Leone
Eritrea	Guinea	Marshall Islands	Uganda
Ethiopia	Guinea-Bissau	Micronesia, Fed. States of	
Gambia, The	Kiribati	Mozambique	
Ghana	Liberia	Myanmar	
Grenada	Malawi	Niger	
Guinea	Mali	Papua New Guinea	
Guinea-Bissau	Marshall Islands	Sao Tome	
Haiti	Mauritania	Solomon Islands	
Honduras	Papua New Guinea	Somalia	
Kenya	Sierra Leone	South Sudan	
Kiribati	Solomon Islands	Sudan	
Kyrgyz Republic	Somalia	Syria	
Lao P.D.R.	Sudan	Timor-Leste, Dem. Rep. of	
Lesotho	Tajikistan	Tuvalu	
Liberia	Tuvalu	Yemen	
Madagascar	Zambia	Zimbabwe	
Malawi	Zimbabwe		
Maldives		**Frontier (17)**	
Mali	**Diversified & Manufacturing (23)**	Benin	
Marshall Islands*	Bangladesh	Cameroon	
Mauritania	Bhutan	Congo, Republic of	
Micronesia, Fed. States of*	Cambodia	Côte d'Ivoire	
Moldova	Cameroon	Ethiopia	
Mozambique	Cote d'Ivoire	Ghana	
Myanmar	Ethiopia	Honduras	
Nepal	Haiti	Kenya	
Nicaragua	Honduras	Mozambique	
Niger	Kenya	Papua New Guinea	
Papua New Guinea	Lao P.D.R.	Rwanda	
Rwanda	Lesotho	Senegal	
Samoa	Madagascar	Tajikistan	
Sao Tome	Micronesia, Fed. States of	Tanzania	
Senegal	Myanmar	Togo	
Sierra Leone	Nicaragua	Uzbekistan	
Solomon Islands	Niger	Zambia	
Somalia	Rwanda		
South Sudan*	Senegal	**SDS (19)**	
St. Lucia	Syria	Bhutan	
St. Vincent and the Grenadines	Tanzania	Cabo Verde	

Annex I. Table 2. Complete Classification Lists (concluded)

Sudan
Syria*
Tajikistan
Tanzania
Timor-Leste, Dem. Rep. of
Togo
Tonga
Tuvalu*
Uganda
Uzbekistan
Vanuatu
Yemen
Zambia
Zimbabwe*

Togo
Uganda
Uzbekistan

Tourism (9)
Cabo Verde
Dominica
Grenada
Maldives
Samoa
Sao Tome
St. Lucia
St. Vincent and the Grenadines
Vanuatu

Other Services (8)
Comoros
Djibouti
Gambia, The
Kyrgyz Republic
Moldova
Mozambique
Nepal
Tonga

Comoros
Djibouti
Dominica
Grenada
Kiribati
Maldives
Marshall Islands
Micronesia, Fed. States of
Samoa
Sao Tome
Solomon Islands
St. Lucia
St. Vincent and the Grenadines
Timor-Leste, Dem. Rep. of
Tonga
Tuvalu
Vanuatu

Note: 5 countries with * were not eligible for financing under the PRGT since its start in 2008. The remaining 65 countries have been PRGT-eligible members since 2008. *Countries in italics blue are currently under a Fund-supported program.*

Annex I. Table 3. Classification by Income

By Income

Poorest LICs (GNI per capita at or below IDA cutoff of US$ 1,335. US$1,335=100 percent)	**More advanced LICs (GNI per capita above IDA cutoff of US$ 1,335. US$1,335=100 percent)**		
<=100 (29)	**>100=<150 (11)**	**>150<=300 (18)**	**>300 (12)**
Afghanistan	Benin	Bangladesh	Cabo Verde
Burkina Faso	Cambodia	Bhutan	Dominica
Burundi	Cameroon	Congo, Republic of	Grenada
Central African Republic	Comoros	Cote d'Ivoire	Maldives
Chad	Guinea[1]	Djibouti	Marshall Islands
Democratic Republic of Congo	Haiti[1]	Ghana	Micronesia
Eritrea	Kyrgyz Republic	Honduras	Moldova
Ethiopia	Nepal[1]	Kenya	Samoa
Gambia, The	Senegal	Kiribati	St. Lucia
Guinea-Bissau	Tajikistan	Lao P.D.R.	St. Vincent and the
Lesotho	Zimbabwe	Mauritania	Grenadines
Liberia		Nicaragua	Tonga
Madagascar		Papua New Guinea	Tuvalu
Malawi		Sao Tome	
Mali		Solomon Islands	
Mozambique		Timor-Leste, Dem. Rep. of	
Myanmar		Uzbekistan	
Niger		Vanuatu	
Rwanda			
Sierra Leone			
Somalia			
South Sudan			
Sudan			
Syria			

Annex I. Table 3. Classification by Income (concluded)

Tanzania
Togo
Uganda
Yemen
Zambia

[1] Haiti, Nepal, and Guinea are classified as poorest LICs, even though their GNI per capita is above the IDA cutoff, for consistency with 2024 Review of PRGT Finances and Facilities approved by the Board in October 2024.

Annex I. Table 4. Evolution of PRGT List

	Entrants				Graduates					
2010					Albania	Angola	Azerbaijan	India	Pakistan	Sri Lanka
2013	Marshall Islands	Micronesia	South Sudan	Tuvalu	Armenia	Georgia				
2015					Bolivia	Mongolia	Nigeria	Vietnam		
2017	Zimbabwe[1]									
2020					Guyana					
2024	Syria									

[1] Zimbabwe was not included in the PRGT-eligible list of countries until 2017 due to its overdue financial obligations (arrears) to the Fund, which prevented an assessment against the PRGT eligibility criteria, as the country was not eligible to any form of financing until full clearance of the arrears.

4. This report's LIC universe compared with IDA eligibility: 69 out of the 70 PRGT-eligible IMF members are also eligible for IDA-financing. The remaining nine countries eligible for IDA financing but excluded from PRGT eligibility (and hence this sample) are Belize, Eswatini, Fiji, Guyana, Kosovo, Nigeria, Pakistan, Sri Lanka, and Suriname. Moldova is PRGT-eligible but graduated from IDA eligibility in 2020.

5. This report's LIC universe compared with the WB's coverage in the Global Economic Prospects (GEP) report: Of the 70 PRGT countries, 25 overlap with the World Bank's list of 26 Low-Income Countries (LICs) from the January 2025 Global Economic Prospects Report. All other LICs covered in this report are included in the general sample of the GEP, which however also includes higher income developing countries.

Methodological Note: Aggregation Methodologies used in this report

This report uses several approaches to summarize and present data, aimed at ensuring that the analysis reflects both typical trends and the relative importance of different countries. The methods include medians, averages, and weighted averages. Below is a summary of how these methodologies are applied:

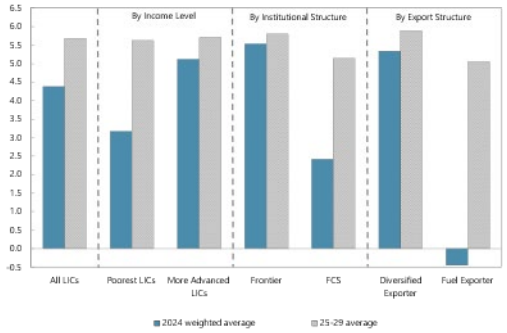
- **Medians:** The median is the middle value in a dataset when all values are arranged in order. It is particularly useful when the data include extreme values or outliers that could distort the overall picture. This gives a better sense of the "typical" experience within the group, rather than being skewed by a few countries with unusually high or low data outturns relative to the mean. In addition, medians do not assign different weight to countries based on their economic size proxied by their respective GDP.

- **Simple Arithmetic Average:** This is the most common type of average, calculated by adding all the values of observation and dividing this sum by the number of countries in the sample. It is used for data where each country's data point is given equal importance.

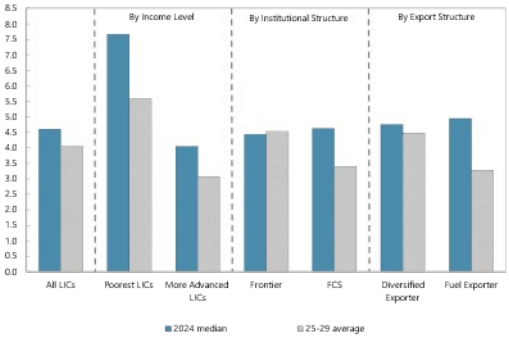
- **Weighted averages** are used to reflect the relative economic size or systemic importance of countries when calculating group totals or averages. For data related to aggregate real GDP growth rates, this report uses weights based on GDP measured at purchasing power parity. This method adjusts for differences in price levels between countries, making it more suitable for comparing living standards or economic output across countries.

Annex II. Macroeconomic Divergence across LICs: Outcomes and Projections

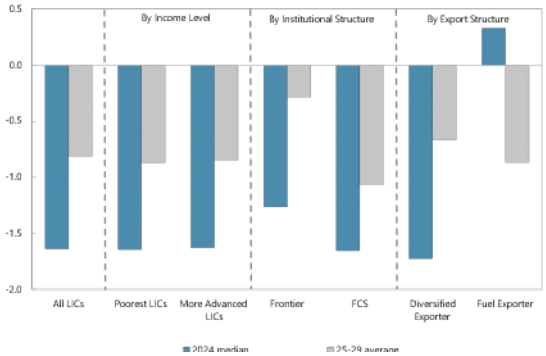
Real GDP Growth
(In percent)



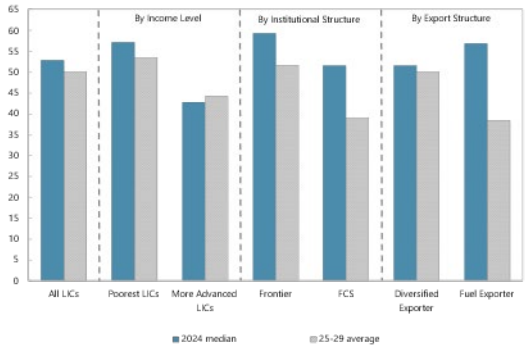
Annual CPI Inflation (period average)
(In percent)



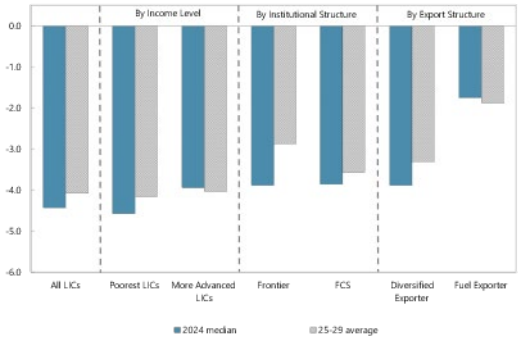
Primary Balance
(In percent of GDP)



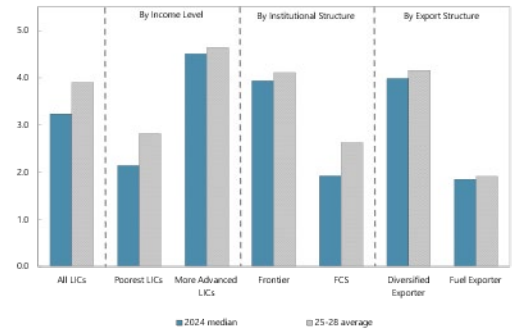
Public Debt
(In percent of GDP)



Current Account
(In percent of GDP)



FX Reserves
(Months of imports)



Sources: January 2025 WEO and IMF staff calculations.

Annex III. Estimating Fiscal Multipliers in LICs

Methodology

1. A fiscal multiplier quantifies the response of output to an exogenous marginal change in a fiscal variable. Despite this simple definition, there is no standardized empirical framework to estimate fiscal multipliers (Batini et al. 2014). This complexity arises from factors such as two-way causality between fiscal variables and output (endogeneity), the dependence of the multiplier on macroeconomic conditions (including the business cycle, trade openness, and the level of uncertainty), and noise from fiscal policies and automatic stabilizers (for a detailed discussion, see Geli and Moura 2023). For LICs, these challenges are further compounded by often poor data quality and availability.

2. This analysis uses an autoregressive distributed lag (ADL) specification to estimate public spending multipliers at different horizons. To address the pitfalls above, the analysis follows IMF (2017, Chapter 2; 2020c, Chapter 2), Gbohoui (2021), Arizala et al. (2021), and Honda et al. (2020):

$$y_{i,t} = \alpha_i + \beta_t + \sum_{h=0}^{3} \boldsymbol{\mu_h^C S_{i,t-h}^C} + \sum_{h=1}^{3} \boldsymbol{\mu_h^K S_{i,t-h}^K} + x_{i,t}\delta + \varepsilon_{i,t}, \quad (1)$$

for $i = 1, \ldots, N$ and $t = 1, \ldots, T$, where $\boldsymbol{y_{i,t}} = \ln(Y_{i,t}/Y_{i,t-1})$ is the real GDP growth rate; α_i and β_t are respectively country-specific and time-specific fixed-effects; $\boldsymbol{S_{i,t}^C} = \left(G_{i,t,t}^C - G_{i,t,t-1}^C\right)/Y_{i,t-1,t-1}^n$ and $\boldsymbol{S_{i,t}^K} = \left(G_{i,t,t}^K - G_{i,t,t-1}^K\right)/Y_{i,t-1,t-1}^n$ are fiscal expenditure shocks in percentage of previous year's GDP with $G_{i,t}^C$ and $G_{i,t}^K$ denoting nominal public consumption expenditure and public investment variables; $\boldsymbol{\mu_h^C}$ and $\boldsymbol{\mu_h^K}$ (*h=0,1,2,3*) are the fiscal spending multipliers at different lags, representing the percent increase in output in response to unit increase in the normalized fiscal variables, ceteris paribus; $x_{i,t}$ is a vector of relevant control variables which includes $g_{i,t-1}^C, g_{i,t-1}^K, g_{i,t-1}^T, y_{i,t-1}, \pi_{i,t-1}, R_{i,t}$ and $R_{i,t-1}$, where $g_{i,t}^T$ is tax revenue in percentage of GDP, $\pi_{i,t}$ is inflation, and $R_{i,t}$ is a dummy variable that equals 1 during negative output gas episodes and 0 otherwise; and $\varepsilon_{i,t}$ is an idiosyncratic error term. After estimating Equation (1), the cumulative multipliers are inferred as follows: μ_0^C and μ_0^K are the current expenditure and capital expenditure multipliers in the year of the shock; $\mu_0^C + \mu_1^C$ and $\mu_0^K + \mu_1^K$ are the cumulative multipliers one year after the shock; $\sum_{h=0}^{2} \mu_h^C$ and $\sum_{h=0}^{2} \mu_h^K$ are the cumulative multipliers two years after the shock; and $\sum_{h=0}^{3} \mu_h^C$ and $\sum_{h=0}^{3} \mu_h^K$ are the cumulative multipliers three years after the shock.

3. A separate model is specified and estimated for the tax revenue multiplier. The model uses the same set of control variables:

$$y_{i,t} = \alpha_i + \beta_t + \sum_{h=0}^{3} \boldsymbol{\mu_h^T S_{i,t-h}^C} + x_{i,t}\delta + \varepsilon_{i,t}, \quad (2)$$

where $S_{i,t}^T = \left(G_{i,t,t}^T - G_{i,t,t-1}^T\right)/Y_{i,t-1,t-1}^n$ is the tax revenue shock obtained similarly as above. Here, the tax revenue multipliers are inferred from the coefficients of the lagged shocks to avoid capturing a revenue mobilization capacity effect that tends to be positively related to contemporaneous GDP

growth. The tax revenue multiplier one year after the shock is therefore given by μ_1^T; the cumulative multiplier two years after the shock is $\mu_1^T + \mu_2^T$; and the cumulative multiplier three years after the shock is $\sum_{h=1}^{3} \mu_h^T$.

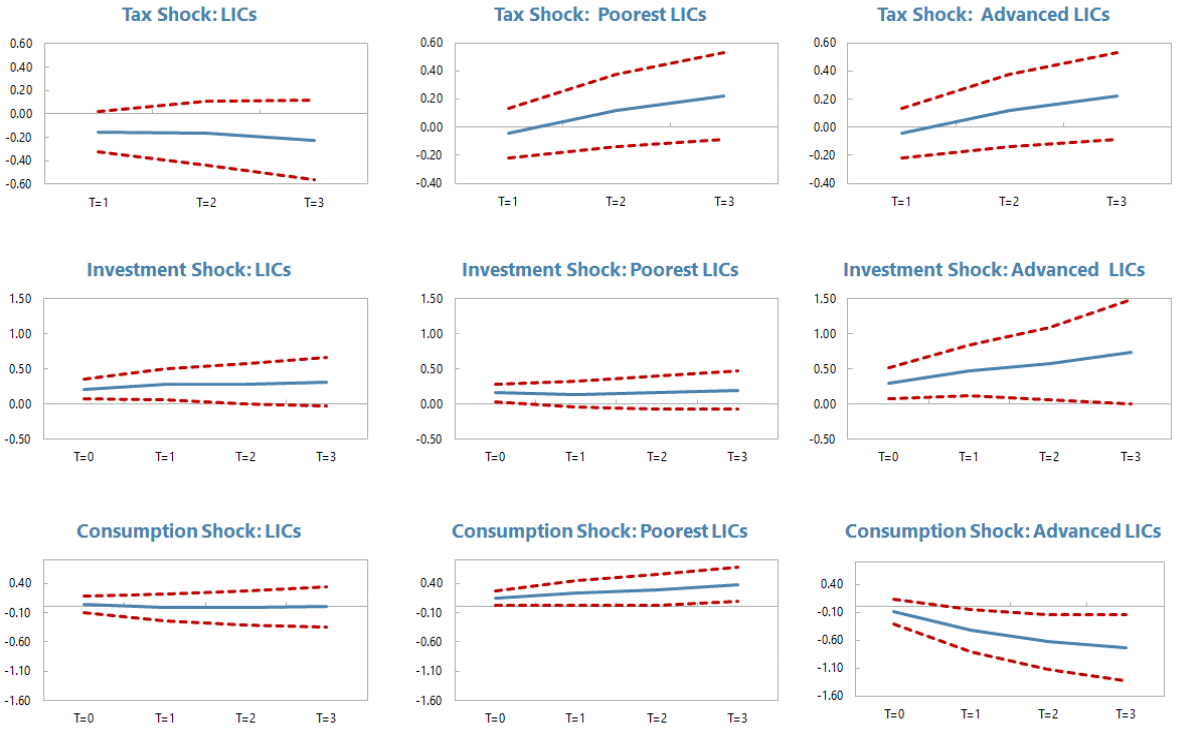
Data

4. The models are estimated using the January 2025 WEO database for most indicators. The shocks are calculated using the October vintages of the 2014-2024 WEO databases. In practice, the fiscal shocks are obtained as the difference between the Year *t* October WEO release of $G_{i,t}^c$ and $G_{i,t}^K$ and their forecasts in the October WEO from one year earlier, divided by the year t-1 October WEO release of $Y_{i,t-1}^n$. The fiscal variables are expressed in percent of GDP. The sample covers 38 AEs, 84 EMs, and 68 LICs with available data during 2015 and 2024. The LIC group is composed of 32 countries included in the poorest LICs and 26 more advanced LICs. It comprises 29 FCS, 17 FMs, and 19 SDS (see Annex I for definitions).

Empirical Findings

5. Most of the coefficients show the expected signs and magnitudes. The coefficient on tax revenue is negative in most cases, but its statistical significance falls below 90 percent for the full sample of LICs. On the expenditure side, an increase in public consumption expenditure has no visible growth impact on average for LICs, while an increase in public investment has positive and significant impact in the year of the shock and the year after. The average impacts hide a significant amount of heterogeneity across LICs, with consumption expenditure having positive impact in the poorest LICs while investment entails larger coefficients for the more advanced LICs.

Annex III. Figure 1. Effects of Fiscal Policy Shocks on Output: Types of LICs



Note: T=0 is the year of the shock. Solid lines present the responses (in percent) to an unanticipated shock to government spending of 1 percentage point of GDP. Dashed lines denote 90 percent confidence bands. Estimates are based on a sample of countries that experienced fiscal policy shocks during the 2015-2024 window
Source: IMF Staff calculations.

Annex IV. Empirical Analysis of Financial Inflows

1. Determinants of FDI and Other investment Inflows to LICs

Methodology. Following the standard pull-push factor model in the empirical literature (Forbes and Warnock, 2012; Giordani et al. 2017), the following panel regression specification has been estimated for a sample of over 60 LIC countries covering period 2000-23:

$$Kflow_{i,t} = \boldsymbol{\beta_1} \times \boldsymbol{PUSH_t} + \boldsymbol{\beta_2} \times \boldsymbol{PULL_{i,t-1}} + \gamma_i + \varepsilon_{i,t}, \quad (1)$$

where $Kflow_{i,t}$ is gross FDI or other investment inflows to country i at year t.[1] $\boldsymbol{PUSH_t}$ is a vector of two global "push" factors: the VIX index, a measure of US stock market volatility and a proxy for global uncertainty and market sentiment; and the real US interest rate, a proxy for global financial conditions. $\boldsymbol{PULL_{i,t-1}}$ is a vector of country-specific pull factors that capture domestic conditions conducive to attract inflows, including lagged real GDP growth rate, capital account openness, perception of good governance, and fiscal balance that captures policy prudence (Table 1). All domestic pull factors are lagged by one year to alleviate potential endogeneity. γ_i stands for the country fixed effects, and $\varepsilon_{i,t}$ is the error term. Note that all push variables are global and hence they vary across time but not across countries.

Data. Following the standard empirical literature (Koepke and Paetzold, 2024), gross FDI/other investment inflows are defined as net incurrence of liabilities (financial claims on residents by non-residents) in the FDI/other investment categories of the BPM6 classification.[2] Gross FDI/other investment inflow data for 70 LIC countries over the sample period of 2000-2023 and by type, i.e. FDI, other investment (which can be further broken down into government, banks, and non-banks) are available from the IMF BOP database monitored by STA or from country desk submissions to WEO.[3] Table 1 lists the data sources of the push and pull factors mentioned above. All data are at annual frequency.

[1] Portfolio inflows are not analyzed due to their low relevance for LICs.

[2] As opposed to "net inflows" that subtracts net acquisition of financial assets (financial claims on non-residents by residents).

[3] Gross inflow data from STA BOP database and WEO database are broadly consistent. Some minor data discrepancies exist due to: a) sources: STA BOP are data reported by country authority while WEO data is collected by the IMF country desk; b) definition: the accounting conventions for particular variables may vary; c) adjustments may be applied in the data collection process for WEO data, while STA BOP data may involve backward adjustments. In the regression exercises, we use only STA BOP data to ensure consistency over the sample period.

Annex IV. Table 1. Push and Pull Factors: Data Sources

Factor	Variable	Source
"Push"	VIX index	Chicago Board Options Exchange (CBOE)
	Real US interest rate	Federal Reserve Economic Data (FRED)
"Pull"	Real GDP growth	World Economic Outlook (WEO)
	Capital inflow restrictiveness	Baba et al. (forthcoming IMF)
	Control of corruption	Worldwide Governance Indicators (WGI)
	Fiscal balance	World Economic Outlook (WEO)

Empirical Findings. Four variations of (1) are analyzed, with the first two columns of Table 2 presenting the regression results with FDI inflows serving as dependent variable. The primary distinction between the two columns is that the regression reported in the first column does not include country fixed effect, which allows more estimation of sticky institutional variables such as the perception of good control of corruption. Similarly, columns 3 and 4 display regression results where Other Investment inflows serve as dependent variable, with one column excluding and the other including country fixed effects.

Most of the coefficients show the expected signs. Specifically, the perception of good governance yields positive coefficients across all regressions; however, its statistical significance falls below 90 percent when country fixed effects are incorporated.[4] The coefficients on the fiscal deficit are negative in the first two columns, indicating that less prudent macroeconomic policies can deter investors. Notably, the sign of the coefficients reverse while remaining statistically significant in columns 3 and 4 when Other Investment inflows are used as dependent variable. This change likely reflects the countercyclical nature of IFI and donor financing in the case of LICs, where financing, including concessional loans, tends to increase during economic downturns and is captured in other investment flows.

[4] One exception is VIX, which is typically found to have a negative impact on capital inflows to EMs, reflecting the risk-on/risk-off sentiment that usually leads to surge/retrenchment in inflows to EMs (Forbes and Warnock, 2012). However, the coefficient on VIX is statistically insignificant for both FDI and other investment inflows to LICs. This opposite and insignificant coefficient on VIX likely reflects the weaker integration of LICs' financial markets compared to the case of EMs.

Annex IV. Table 2. Determinants of FDI and Other Investment Inflows to LICs

	FDI inflows	FDI inflows	Other investment inflows	Other investment inflows
Global push factors				
Logged VIX index	0.41	0.42	0.51	0.41
	(0.31)	(0.32)	(0.81)	(0.81)
Real US interest rate	-0.39	-0.40*	-0.89***	-0.91***
	(0.24)	(0.31)	(0.22)	(0.22)
Domestic pull factors (lagged)				
Real growth rate	0.07	0.07	0.01	-0.02
	(0.05)	(0.05)	(0.05)	(0.04)
Capital inflow restrictiveness	-0.02	-0.00	0.02	0.01
	(0.01)	(0.02)	(0.01)	(0.03)
Control of corruption	1.43*	1.29	1.05*	-2.04
	(0.87)	(1.35)	(0.57)	(1.24)
Fiscal deficit/GDP	-0.12*	-0.12*	0.18***	0.14***
	(0.06)	(0.06)	(0.04)	(0.05)
Country FE	No	YES	NO	YES
Sample period	2000-23	2000-23	2000-23	2000-23
Number of LICs	56	56	56	56

Note: Robust standard errors in parentheses. Due to data limitations, the regression sample includes 56 out of 70 LICs.

2. Determinants of Portfolio Inflows to LICs

Nearly 80 percent of the observations on portfolio inflows to LICs are recorded as zero.[5] This phenomenon highlights the lack of developed domestic financial markets where non-residents can engage in trading financial assets with residents. The limited positive inflows primarily reflect sporadic issuance of sovereign bonds, while the negative inflows are indicative of repayments associated with those bonds.

Methodology and Data. With portfolio inflow data heavily skewed at zero, a logit model on portfolio inflows is employed instead of the typical pull and push factor model. Determinants include global financial conditions and domestic financial development:

$$\Pr(y_{i,t} \neq 0 | X_{it}) = P(\boldsymbol{X_{it}\beta} + \boldsymbol{v_i}), \quad (2)$$

where $y_{i,t}$ are portfolio inflows, and X_{it} is a vector of determinants including logged VIX index, real US interest rate, and a lagged domestic financial development index (from IMF Financial Development Index).

[5] By comparison, less than 10 percent of the observations of FDI inflows are zero.

Empirical Findings. Table 3 presents the results of running regression specification (2) on a sample of 54 LICs for the period from 2000 to 2022.[6] All coefficients in the regression show the expected signs, indicating consistency with theoretical predictions. Among the statistically significant findings, a lower real US interest rate is associated with an increased probability of positive portfolio inflows to LICs. This effect is primarily driven by the encouragement of sovereign bond issuances. Additionally, higher levels of financial development contribute to enhancing the likelihood of positive portfolio inflows.

Annex IV. Table 3. Determinants of Portfolio Inflows: Logit Model Estimation Results

VARIABLES	Portfolio Inflows
Logged VIX index	-0.391
	(0.326)
Real US interest rate	-0.224**
	(0.0872)
Lagged Financial Development Index	33.70***
	(5.223)
Country FE	No
Number of Countries	54

Note: *** p<0.01, ** p<0.05, * p<0.1. Due to data limitations, the regression sample includes 54 out of 70 LICs.

3. Relationship between Financial Inflows and Consumption and Investment

Methodology and Data. To examine the relationship between various types of financial inflows—including remittance, FDI, portfolio, and other investment inflows—a panel regression analysis is conducted on a sample of 44 LICs covering the period from 2000 to 2023:

$$y_{i,t} = \boldsymbol{\beta} \times \boldsymbol{x_{i,t}} + \boldsymbol{\alpha_t} + \gamma_i + \varepsilon_{i,t}, \quad (3)$$

where $y_{i,t}$ is the consumption or investment-to-GDP ratio in country i at year t. $\boldsymbol{x_{i,t}}$ is one of the financial inflows, which is lagged to alleviate potential endogeneity. α_t is the year fixed effect, capturing omitted time-variant global variables, while γ_i stand for the country fixed effects that capture omitted time-invariant country-specific variables. $\varepsilon_{i,t}$ is the error term.

[6] The sample period ends in 2022 because the financial development index is only available up to 2021. Lagging it allows for one additional year of observation for the regression.

Consumption and investment data are from the WEO database, and remittance data are from the Migration Data portal.[7] Other inflow data are from the WEO database and are defined the same way as explained in the previous section.

Empirical Findings. A total of 8 regressions are estimated where specification (3) varies based on the selection of either consumption or investment for $y_{i,t}$ and remittance, FDI, portfolio, or other inflows for $x_{i,t}$. The coefficient $\boldsymbol{\beta}$ obtained from each regression result is reported in Table 4.

Annex IV. Table 4. Financial Inflows and Consumption and Investment: Coefficient of β

	Consumption	Investment
Remittance inflows	0.36**	0.24*
	(0.14)	(0.12)
FDI inflows	0.14	0.52***
	(0.13)	(0.08)
Portfolio inflows	0.01	0.37
	(0.24)	(0.26)
Other inflows	0.10***	0.07***
	(0.03)	(0.02)

Note: Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Financial flows are positively correlated with consumption and investment. Remittance inflows play a crucial role in alleviating financial constraints faced by recipient households, leading to increases in both consumption and investment. Analysis indicates that a one dollar increase in remittances is associated with a 36-cent average increase in consumption and a 24-cent average increase in investment in LICs. FDI inflows help boost investment as the investment is typically geared toward capital accumulation. However, its impact on consumption is statistically insignificant. Given its countercyclical nature (see the previous section), other investment inflows exhibit only a small positive impact on consumption and investment as the financing is likely used more for demand stabilization than stimulation. Given its limited role in most LICs, portfolio inflows are found to have a positive but statistically insignificant impact on both investment and consumption.

[7] https://www.migrationdataportal.org

Annex V. Improving Labor and Capital Productivity

1. Labor and capital, alongside total factor productivity (TFP), are key factors of the growth function, but their contributions in LICS have been lower than could be expected. A considerable labor productivity gap exists between LICs and AEs (Dieppe 2021). At current productivity growth rates, it would take over a century to halve this gap. The contribution of capital to growth has remained broadly unchanged in LICs over the last two decades, indicating limited support for economic expansion.

2. Human capital investment, particularly in education and health, plays a vital role in enhancing labor productivity. Studies indicate that additional schooling can increase global income by 9.7 percent, with even greater impacts in LICs. Leveraging AI is also crucial for increasing labor productivity and reducing the technology gap (see Figures below). Despite some progress in SDGs related to health, such as infant mortality, the impact of the pandemic and other crises continued to take a toll on public health in LICs. This is concerning as healthy workers are more efficient and engaged in improving their skills.[1]

3. Increasing female labor participation is also crucial for enhancing productivity in LICs. Many LICs experience loss in economic potential due to a "misallocation of talents": by forcing women to concentrate in only a few economic activities, they limit women's ability to exploit their comparative advantage in other occupations. This holds back aggregate productivity. A study by staff shows that many LICs would reap sizeable long-term income gains if female occupational barriers were to fall to 2015 U.S. levels (Li et al, forthcoming). For example, Cote d'Ivoire and Mali stand to experience increases in their income per capita by 8 percent and 20 percent, respectively. About three quarters of these gains reflect an improved allocation of female talent across occupations, which also incentivizes complementary investments in women's human capital.

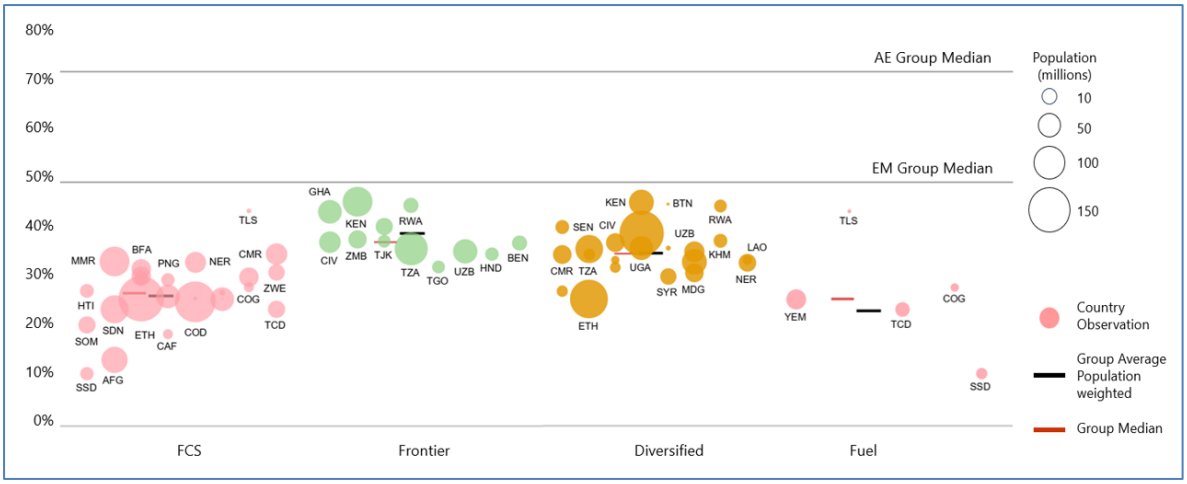
4. Accumulating capital in LICs is difficult. This can be attributed to several factors including limited access to finance. Public investment projects are frequently viewed as a residual category, receiving funding only during favorable economic conditions, which negatively affects planning predictability and implementation. High transaction costs, often resulting from inefficiencies and issues related to transparency and governance, further elevate the barriers to investment. The vulnerabilities faced by LICs, including increased frequency and intensity of shocks such as natural disasters, also deter capital accumulation and often result in physical destruction of existing infrastructures.

5. Improving labor and capital productivity requires a comprehensive mix of policies aimed at creating a favorable environment for all workers and businesses. To enhance human capital, LIC governments must implement significant structural reforms to expand and upgrade the digital infrastructure and healthcare and change the composition of fiscal spending to better support these areas. To improve the business environment, critical reforms should focus on the

[1] However, global health progress has decelerated alarmingly during the last decade, and the COVID-19 pandemic has reversed nearly a decade of gains in life expectancy. See World Bank, 2018, and Sachs, Lafortune and Fuller, 2024.

development and expansion of productive enterprises through tax incentives and domestic financial reforms. Strengthening banking supervision and reducing credit controls are essential steps, and minimizing red-tape and addressing corruption will help eliminate obstacles to private sector investments. Externally, governments should actively work to attract productive and sustainable FDI by ensuring a stable and predictable policy environment, along with effective regulatory frameworks that discipline external financial flows (An, 2023). Trade policies that promote openness and integration into the global economy can further enhance the flow of foreign capital.

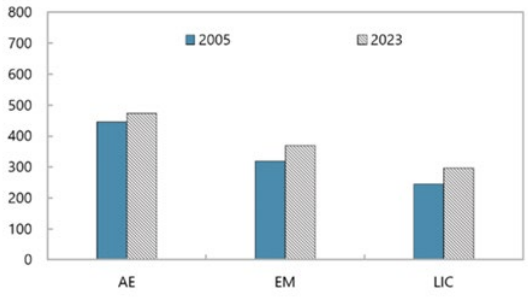
Annex V. Figure 1. AI Preparedness Index by LIC Subgroups



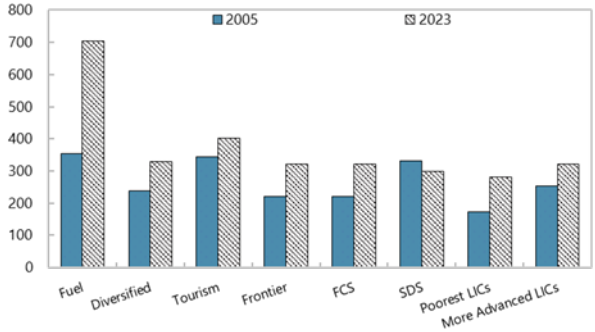
Sources: WEO and IMF staff calculations.

Annex V. Figure 2. Capital Stock Over Time

Evolution of Capital Stock by Income Level
(Percent of GDP)



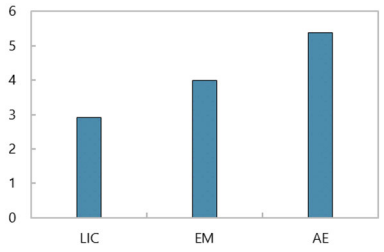
Heterogenous Evolution of Capital Stock Across LICs Over Time
(Percent of GDP)



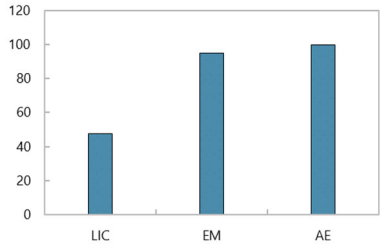
Sources: WEO, IMF staff calculations.

Annex V. Figure 3. Selected Infrastructure Indicators

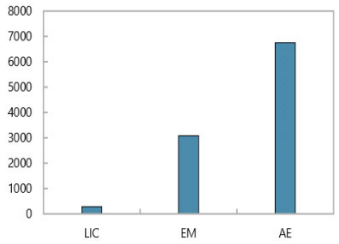
Infrastructure Quality (Index: 1-7) (Median, 2017)



Access to Improved Sanitation % of total population (Median, 2022)



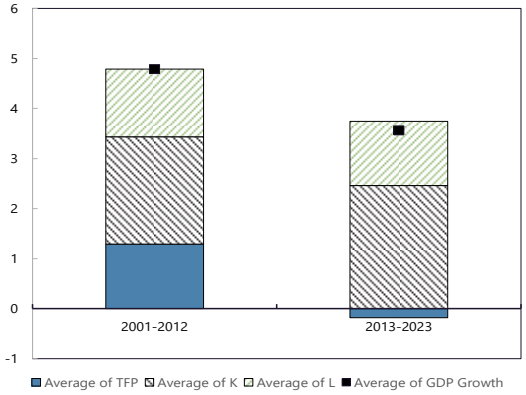
Electricity Production (kWh per capita, median, 2022)



Sources: World Bank, IMF staff calculations.

Annex V. Figure 4. Components Contributions to GDP Growth for LICs (2001–23)

Overall



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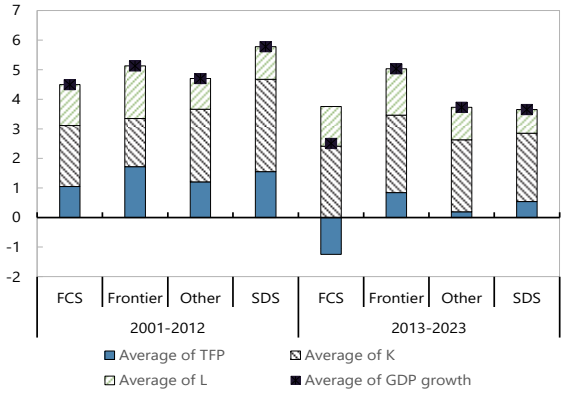

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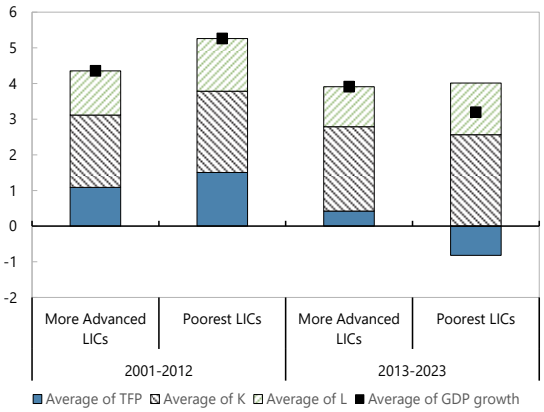

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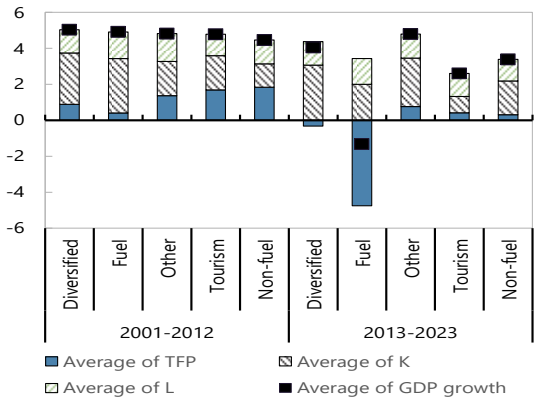

Sources: WEO, Penn World Table, IMF Staff Calculations
Note: The period 2013-2023 excludes year 2020, which was an outlier due to the Covid pandemic.

INTERNATIONAL MONETARY FUND

April 11, 2025

MACROECONOMIC DEVELOPMENTS AND PROSPECTS IN LOW-INCOME COUNTRIES—2025—SUPPLEMENTARY INFORMATION

Prepared By

Prepared by Strategy, Policy, and Review Department

This supplement reports on recent developments and information that became available since the 2025 Macroeconomic Developments and Prospects in Low-Income Countries report was issued to the Board on March 20, 2025.

1. The outlook for the global economy has worsened since the publication of the report, amid a further increase in uncertainty. Recent announcements on trade policy are affecting international trade flows and have caused a risk-off phase and volatility in financial markets. Moreover, trade policy uncertainty remains elevated, as the modalities of imposing additional tariffs (e.g., with regard to their size, timing, and coverage of product groups) as well as the incidence and scope of potential retaliatory actions is unclear. As highlighted in the forthcoming April 2025 World Economic Outlook, global growth would weaken in 2025 and 2026 compared with projections in the January WEO update as a result of elevated uncertainty, new tariffs, and tighter global financial conditions.

2. It is too early to draw definitive conclusions, but the impact of the worsened global outlook will likely be negative for most LICs. Lower growth in key export markets together with higher tariffs imply lower demand for LICs' exports of goods. Meanwhile, tighter global financial conditions, unfavorable exchange rate movements, and a potential flight to safety among investors would add to the pressure from already announced reductions in official development assistance. As a result, some LICs could face additional constraints in servicing debt and further delays in advancing their development path. The net impact of these anticipated pressures will depend on country-specific conditions, including the magnitude of tariff increases imposed by partner countries, the structure of their economies, and fluctuations in international commodity prices.

3. The policy agenda laid out in the report remains pertinent and, if anything, becomes even more urgent in the new global context. A continued focus on strong domestic policy and structural reform efforts remains critical to maintain

macroeconomic stability, rebuild policy buffers, and promote strong and inclusive growth. This agenda calls for prioritizing spending efficiency and revenue mobilization during the often-necessary fiscal adjustments, while safeguarding social spending and growth-enhancing public investment. Moreover, efforts to mobilize capital inflows and further develop domestic financial markets will be critical to support macroeconomic demand and thus growth, together with other measures to improve Total Factor Productivity, capital formation and human capital accumulation, and labor force participation. Beyond these domestic efforts, LICs will continue to depend on strong support from the international community to cover their large and—through the recent changes in the global outlook—increasing financing needs and make meaningful progress on the standards of living for their often-fast-growing populations.