# IMF chief warns of debt crisis for developing countries

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The International Monetary Fund has warned that lower-income countries face a debt sustainability crisis as interest rates on bonds start to rise.

IMF chief Kristalina Georgieva delivered a speech this week at a virtual meeting, ahead of the spring meetings of the IMF and the World Bank. She said tightening financial conditions resulting from stronger economic growth in the US “could cause a rapid rise in interest rates… and significant capital outflow from emerging and developing economies.”

Such a development “would pose major challenges especially to middle-income countries with large external financing needs and elevated debt levels.”

The IMF warning follows similar statements from the UN secretary-general António Guterres. In an interview with the *Financial Times* this week, he said the world faced severe problems of debt sustainability in the wake of the coronavirus crisis that had not been properly understood or addressed.

He said the response to COVID-19 and to the financial aspects of the crisis “has been fragmented and geopolitical divides are not helping. It has been too limited in scope and too late.”

Guterres said the fact that only six countries—Argentina, Belize, Ecuador, Lebanon, Suriname and Zambia—had so far defaulted on their debts created the “illusion” of stability and a “misperception of the seriousness of the situation.”

In failing to address debt sustainability, “the risk is that we compromise the recovery of the economies of the developing world with catastrophic consequences for people’s lives, with an increase in hunger and poverty and dramatic problems with health and education systems, in many cases leading to instability, social unrest and, at the limit, conflict. Everything is now interlinked.”

In her remarks, Georgieva said the IMF would upgrade its forecast for global growth from the level of 5.5 percent it had predicted in January as a result of the stimulus measures in the US and fiscal action by other governments. But she said while the overall outlook had improved “prospects are diverging dangerously not only within nations but also across countries and regions.”

Compared to pre-COVID projections the cumulative loss in per capita income for advanced economies will be 11 percent by next year. But for emerging and developing economies, excluding China, the loss will be much worse, coming in at 20 percent.

“This loss of income means millions of people will face destitution, homelessness, and hunger,” she said.

“There could also be much more pressure coming to vulnerable emerging market, low-income and fragile states. They already have much more limited fiscal power to fight the crisis. And many are highly exposed to hard-hit sectors, such as tourism.”

The IMF chief also warned of impact of the rolling back of government support measures on small and medium-sized enterprises (SMEs).

SMEs are the world’s biggest employer, she said, and “our research shows that the share of insolvent SMEs could rise sharply this year as support is scaled back—threatening one in ten jobs in this vital sector.”

The warnings over the debt sustainability for lower-income countries come as the yield on US Treasury bonds has risen sharply in the first three months of this year. Earlier this week the yield on US 10-year Treasury bonds, the benchmark for global interest rates, rose to 1.77 percent—the highest point since January 2020 before the pandemic struck.

A continued rise will mean that capital will be sucked out of developing economies.

The fall in US bond prices and the consequent rise in yields, interest rates, is being fuelled by two interconnected processes—the fear that inflation will start to rise and the increased supply of bonds to finance US government debt will lead to further falls in their price.

As one financial analyst told the *Financial Times*, the "massive" scale of the stimulus in the US and globally—estimated by the IMF to be around $16 trillion—had caused "considerable nervousness over inflation and has been behind the recent sell-off in government bonds."

The potential for rapid shifts in the Treasury bond market was seen in what had been as described as a "disastrous" auction of new seven-year bonds on February 25. Some 40 percent of the $68 billion issue had to be bought by the underwriters because there were no buyers. Some stability has returned in the past month but the threat of another freeze is ever-present.

Fed chair Jerome Powell has insisted the central bank does not fear a rise in long-term inflation and that any price hikes over the next year will not be structural.

But there is concern in financial markets that inflation could take off and the extent of the US stimulus measures will bring a rise in interest rates, notwithstanding the Fed's commitment to keep its base rate near zero at least until 2024.

In a recent comment entitled "The return of the inflation spectre," *Financial Times* columnist Martin Wolf warned that an inflation overshoot could trigger a deflationary response from central banks, leading to much higher rates. And its effects would go far beyond lower-income countries.

"That could lead to waves of defaults far more pervasive than in the early 1980s, when the big story was the debt crisis in developing countries. This time, the debt crisis could be almost everywhere, because there is so much more debt."

It is a measure of the profound crisis within the capitalist system that the prospect of higher growth in the US—normally regarded as a positive for the world economy—has sparked fears it will lead to rising interest rates, resulting in economic devastation for lower-income countries. And not only there but it could hit the advanced countries as well because the profit-making machine centred in Wall Street and other major financial markets has become so addicted to the endless supply of cheap money.