September 28, 2020

IMPLEMENTATION AND EXTENSION OF THE DEBT SERVICE SUSPENSION INITIATIVE

EXECUTIVE SUMMARY

The COVID-19 pandemic is heavily impacting the world's poorest countries. Economic activity in the poorest countries is expected to drop about 2.8 percent in 2020. The pandemic spread to these countries has lagged contagion in advanced economies and emerging markets, but some countries have seen a rapid surge. Health challenges may rise and containment measures have come at an economic cost. Overall, the crisis could push 100 million people into extreme poverty and raise the global poverty rate for the first time in a generation.

The Debt Service Suspension Initiative (DSSI) has enabled a fast and coordinated release of additional resources to beneficiary countries to bolster their crisis mitigation efforts. It was endorsed by the G20 Finance Ministers in April 2020 and became effective on May 1, 2020. As of end-August, 43 countries are benefitting from an estimated US$5 billion in temporary debt service suspension from official bilateral creditors, accounting for more than 75 percent of eligible official bilateral debt service under the DSSI in 2020. The DSSI supported substantial COVID-19 related spending as participating countries faced major revenue shortfalls.

The DSSI has also allowed to make significant progress in enhancing transparency of public debt to help borrowing countries and their creditors make more informed borrowing and investment decisions. The World Bank has published detailed external public debt data by creditor group and potential debt service suspension amounts from DSSI for borrowing countries, facilitating data sharing and coordination among creditors.

An extension of up to one year of the DSSI is recommended in view of the continuing financing pressures on the beneficiary countries owing to the pandemic, with the second six months subject to confirmation in a mid-term review, in view of the need for broader participation by commercial and official bilateral creditors. More than half of all DSSI participants are assessed to be at high risk of debt distress or already in debt distress according to debt sustainability analysis as of mid-August 2020. Fiscal monitoring indicates that DSSI participating countries are undertaking substantial COVID-19 related spending even as they face major revenue shortfalls. Analysis based on WEO projections shows that liquidity support will remain essential throughout 2021. A timely decision to extend the DSSI would help countries plan and reap the full benefits of the initiative.

Some modifications of the DSSI are recommended:

- First, the DSSI should be extended by up to one year, given the depth of the crisis and elevated financing needs, subject to a midpoint review, with some possible amendments to the April term sheet as discussed below. A timely decision to extend the DSSI, which enables requests for DSSI in 2021 to come even before end 2020, together with adopting common procedures for country requests and other communications that ensure the IMF-WBG are fully informed about any delays in processing DSSI requests, would allow requesting countries to fully benefit from DSSI.

- Second, to maximize much needed support to eligible countries, all official bilateral creditor institutions, including national policy banks, should implement the DSSI in a transparent manner using a common published MOU that could clarify which claims should not be covered by the DSSI.

- Third, to maximize the ability of DSSI beneficiaries to continue providing extraordinary pandemic support to individuals and firms through health, social and economic spending, and in the spirit of fairness, G20 countries should take all possible steps to urge participation in DSSI by their private and bilateral public sector creditors, regardless of whether they are considered national policy banks or commercial entities.

- Fourth, the common MOU should provide clear debt transparency and public debt disclosure requirements which extend to the terms and conditions of public debt (including collateral as feasible) and which are based on a comprehensive statistical definition of public debt.

- Fifth, flexibility in the repayment schedule would help avoid exacerbating peaks in debt service burdens.

- Sixth, continued fiscal monitoring remains appropriate in 2021 to help ensure priority spending is protected to contain the longer-term economic and social costs from the pandemic and thereby support sustainability.

The G20 should facilitate debt resolution for countries with unsustainable debt, including for countries outside the DSSI perimeter. The public debt outlook has deteriorated sharply in DSSI-eligible countries in the first half of 2020. It is important to detect and address insolvent situations upfront. The G20 should therefore facilitate timely and comprehensive debt resolution involving the private sector to restore debt sustainability, to avoid borrowing countries with unsustainable debt burdens undergoing multiple and protracted debt reschedulings. For countries with high risk of debt distress, or that have been assessed to have unsustainable debt, the G20 could consider conditioning DSSI access in 2021 on requesting and working toward a Fund-supported reform program aimed at reducing debt vulnerabilities and addressing debt levels where needed. Building on the approach of the DSSI, it could be useful for G20 creditors to consider the adoption of a term sheet with principles to guide sovereign debt resolution during the pandemic, as timely and comprehensive resolution would benefit debtor countries and the global economy. To facilitate this process, the Development Committee should consider asking WB and IMF to develop by the end of 2020 a joint action plan for debt reduction for IDA countries in unsustainable debt situations.

Strengthening debt management and debt transparency should be top priorities. With the current uncertain outlook for global growth, debt service needs to be carefully managed even for countries where debt remains sustainable. It is important that public debt transparency be based on a comprehensive concept of public debt, and that it extends to the borrowing terms and collateral. The IMF and the World Bank will continue efforts to encourage debt and investment transparency, transparent reporting on debt stocks and flows, and full disclosure by creditors and debtors of the terms of debt restructurings and the rescheduling of any DSSI eligible debt.

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Abbreviations and Acronyms

DLP	Debt Limits Policy
DSA	Debt Sustainability Analysis
EFN	External Financing Needs
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFN	Gross Financing Needs
DLP	Debt Limits Policy
DSSI	Debt Service Suspension Initiative
IDA	International Development Association
IDS	International Debt Statistics
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
LDC	Least Developed Countries
LIC	Low-Income Country
LIC DSF	Joint Bank-Fund Debt Sustainability Framework for LICs
MDB	Multilateral Development Bank
MOU	Memorandum of Understanding
NCB	Non-concessional borrowing
NCBP	Non-concessional Borrowing Policy
NPV	Net Present Value
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
SDFP	Sustainable Development Finance Policy
UN	United Nations
WBG	World Bank Group

INTRODUCTION

1. **In April 2020, the Development Committee, the IMFC, and the G20 Finance Ministers endorsed the Debt Service Suspension Initiative (DSSI) for less developed countries.** The endorsement was a response to a call by the leaders of the World Bank and the IMF to grant debt service suspension to the poorest countries to help them manage the severe impact of the COVID-19 pandemic. All active International Development Association (IDA) and United Nations Least Developed countries (UN LDC) as of FY20 were deemed eligible to participate in the DSSI (Annex 1). The pandemic is causing severe economic stress for these countries, overwhelming weak health systems, heavily impacting their fiscal positions, and exacerbating an already challenging public debt situation, while increasing the risk of social unrest and fragility.[1] Financing from the IMF, the World Bank Group (WBG), and Multilateral Development Banks (MDBs) alone will not be sufficient to enable these countries to manage the severe health, economic, and social impacts of the pandemic. In this context, the DSSI plays an important role to help eligible countries meet their increased needs for financing to respond effectively to the COVID-19 crisis.

2. **The DSSI is being implemented as many developing countries face major adverse spillovers from the impact of the pandemic on the global economy.** The global economic impacts of the pandemic are channeled to DSSI-eligible countries via lower exports and commodity prices, especially oil prices, and through tourism (almost one-third of countries are heavily dependent on tourism, and flight arrivals have dropped by more than 75 percent). Domestic demand also suffers from a contraction in remittances, down by about 21 percent on average in 2020. Overall, the economies of DSSI-eligible countries are expected to contract by about 2.8 percent in 2020 according to the latest WEO projections, compared with average growth of 3.6 percent in the previous five years. Importantly, a permanent loss of productive capacity, or "scarring" is expected, with a drawn-out recovery rather than a rapid rebound. The world's poorest have been hit especially hard by pandemic. World Bank estimates indicate that the crisis could push 100 million people into extreme poverty, with about one-third of new poor expected in Sub-Saharan Africa.[2] As a result, 2020 will mark the first net rise in global poverty in more than 20 years, with large increases in IDA-eligible and fragile countries. Poverty outcomes could further worsen in the absence of measures to protect the poorest and most vulnerable and limit increases in inequality and from a more prolonged impact of the COVID-19 pandemic.[3] It is expected that the development challenges will deepen and become even more severe over the next year.

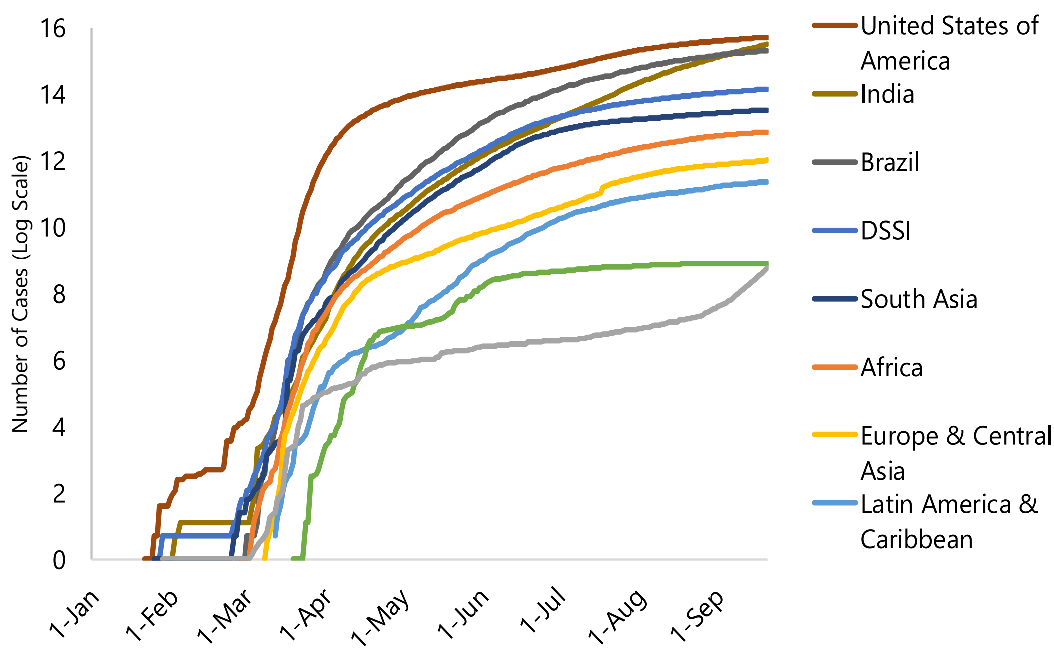
[1] Public debt vulnerabilities in lower-income countries before the onset of the pandemic were analyzed in IMF and World Bank (2020) "The Evolution of Public Debt Vulnerabilities in Lower-Income Economies".

[2] See "Profiles of the new poor due to the COVID-19 pandemic", (2020). http://pubdocs.worldbank.org/en/767501596721696943/Profiles-of-the-new-poor-due-to-the-COVID-19-pandemic.pdf

[3] See "Updated estimates of the impact of COVID-19 on global poverty", available at https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty.

3. The pandemic's spread in DSSI-eligible countries has lagged that in advanced economies and emerging markets, but some DSSI-eligible countries are now experiencing a rapid surge (Figure 1). The COVID-19 pandemic has hit DSSI-eligible countries later than AEs or EMs, and in many DSSI-eligible countries reported infection rates are still fairly low, which to some extent also reflects limited testing in DSSI-eligible countries relative to EMs and AEs. There are significant regional disparities, with the pandemic spreading (at different speeds) in South Asia, sub-Saharan Africa, Middle East and North Africa, and Latin America and the Caribbean. By contrast, the pandemic has so far been relatively contained in East Asia.[4]

Figure 1. COVID-19 Cases in DSSI Countries by Region and the United States
(as of September 20, 2020)



Source: https://covidtracker.bsg.ox.ac.uk/

4. In these unprecedented circumstances, the DSSI enabled a fast, coordinated response to enhance fiscal breathing space for the poorest countries in the world. After being endorsed in mid-April, it was implemented starting on May 1. As of end August 2020, 43 countries are benefitting from US$5 billion in debt service suspension from the initiative,[5] complementing IMF and WB financing disbursements to DSSI eligible countries in 2020 projected to be equivalent to about US$25 billion and US$12 billion, including US$4 billion in grants, respectively.[6]

[4]There is significant variation across East Asian countries with some countries facing significant pandemic spread or new surges and some countries facing a significant economic and social impact, also as a result of containment measures.

[5]This estimate is based on information provided by creditors as of end August 2020 and may not fully reflect the current list of DSSI participating countries.

[6]DSSI eligible countries hereby refers to active IDA countries as of FY20 and Angola.

5. The DSSI has also allowed significant progress in enhancing transparency of public debt. This will help borrowing countries and their creditors make more informed borrowing and investment decisions, which is critical to lay the foundations for a robust economic recovery. The IMF and the WBG are supporting the implementation of the DSSI, including through monitoring spending, enhancing public debt transparency, and ensuring prudent borrowing. The World Bank has published detailed data on external public debt and potential debt service suspension amounts from the DSSI based on the World Bank's International Debt Statistics (IDS) database. This type of debt transparency is a high priority for sustainable development and recovery from the crisis. The IMF-WBG staff have engaged with participating countries to produce an initial report on COVID-related spending using the framework for spending monitoring that was endorsed by the IFA Working Group meeting on June 23 (section on "Monitoring of Spending Under the DSSI") and provide detailed data of the debt service gains from the DSSI. The latter, is part of the commitment from beneficiaries to disclose all public sector debt (section on "Public Debt Disclosure") and to prudent non-concessional borrowing in line with ceilings established under IMF programs or the WB's non-concessional borrowing policies (section on "Non-concessional Borrowing Under DSSI").

6. However, DSSI implementation has also revealed several challenges, especially inconsistent application of terms and conditions for DSSI participation across official bilateral creditors, including national policy banks, and the absence of private sector participation (section on "DSSI Implementation Update"). G20 creditors have expressed concern that the lack of private creditor participation in the DSSI raises concerns that official debt service suspension would partially benefit private creditors. This issue is particularly important if DSSI support would defer the recognition of unsustainable debts. The G20 could consider options to mitigate such concerns in the context of the DSSI. For countries with unsustainable debt—including those outside the DSSI perimeter—enhanced coordinated among G20 creditors would improve debt resolution efficiency and support fair burden sharing between the official and private sectors.

7. In view of the evolving COVID-19 pandemic, and the severe economic and social impacts on the poorest countries that have raised their financing needs, the IMF and the WBG staff recommend extending the DSSI for up to one year. The section on "Liquidity Needs and Debt Sustainability" reports on the liquidity needs of eligible countries, including a discussion of their debt service outlook for these countries. It also provides an update on developments in debt vulnerabilities. On this basis, and taking into account the experience with implementing DSSI, the final section of the paper recommends an extension of up to one-year, with the second six months subject to a mid-term review, and suggests several modifications to ensure that it best supports the poorest countries in managing the pandemic.

DSSI IMPLEMENTATION UPDATE

8. As of September 18, 43 DSSI eligible countries had formally requested to join the initiative as confirmed by G20 creditors and information provided by beneficiary countries.[7] This brings the participation rate of the 73 countries eligible for the DSSI to around 60 percent. With the total debt service benefitting from suspension of US$5.0 billion, these 43 countries account for more than 75 percent of potentially eligible official bilateral debt service under the DSSI for the period May to December 2020 based on World Bank estimates.[8] As of September 14, 2020, the Paris Club had received 39 formal requests and had approved 31 Memoranda of Understanding.[9] In the case of non-Paris Club creditors—which approve requests independently—for 9 countries DSSI implementation was completed by all their creditors in this group as of September 8, 2020,[10] for 21 countries DSSI implementation was partially completed (by at least one of this group but not by all of their creditors) while a further 6 countries made DSSI requests without any yet implemented.

9. Participating countries are diverse, with the greatest share of applicants in Africa. Sixty-five percent of participating countries are in Africa. More than half of all participants are assessed to be at high risk of debt distress or already in debt distress according to debt sustainability analysis as of mid-August 2020. At the same time, countries with market access represent 30 percent of current DSSI participants, with 13 of the 23 countries that have issued a Eurobond participating. Nineteen participants are fragile states and 11 are small states.[11]

10. Among the 30 countries that did not join the DSSI as of September 18, 23 countries have firmly indicated that they are not interested in the initiative. Around half of the countries not interested in participating in DSSI have very low debt service to official bilateral creditors during the suspension period. Three of these countries have initiated direct dialogue with selected bilateral creditors on debt treatments outside of the DSSI process. Ten countries have expressed concerns about the potential implications from participating in the DSSI for planned non-concessional borrowing, about cross-default clauses in their other borrowing, or possible indirect impacts on their sovereign credit ratings and access to international markets. A few countries decided not to participate since they did not wish to request IMF financing.

[7] Participation of these countries in the DSSI has been confirmed both by creditors and participating countries. One country, Vanuatu, decided to withdraw from the initiative as they did not wish to request IMF financing.

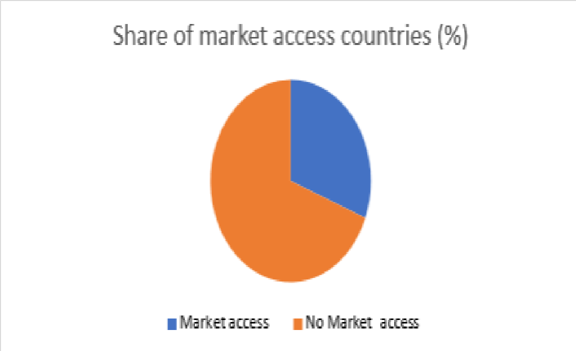
[8] This assessment is based on the list of official bilateral creditors as reported to the International Debt Statistics and excludes plurilateral (other official creditors with multi-country membership).

[9] Updates on Paris Club MOUs are provided at: http://www.clubdeparis.org/en/communications/archives

[10] One non-G20/non-Paris Club creditor (Portugal) has also joined the MOU of the Paris Club in some DSSI requests.

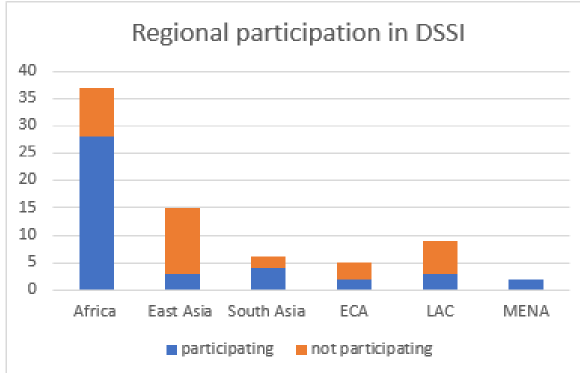
[11] This follows the definition of fragile and small states in IMF and World Bank (2020) on "The Evolution of Public Debt Vulnerabilities in Lower-Income Economies."

Figure 2. Share of Market Access Countries
(percent)



Sources: World Bank and Fund staff.

Figure 3. Regional Participation in DSSI



Sources: World Bank and Fund staff.

11. DSSI implementation so far has revealed several challenges:

I. *Lender participation and perimeter of claims covered by the DSSI*: The enhanced reporting by G20 creditors on debt service suspension by country and official lending institution helped to clarify official lender participation within the G20. This has also exposed the importance of:

- *Consistency on which creditors, lending institutions, or claims would be treated as official bilateral*. Different creditors use different definitions for which institutions qualify as official bilateral creditor, including in relation to national development banks, which creates uncertainties for beneficiary countries and could undermine comparable treatment among creditors.

- *A clear definition of the treated debt*. Under the DSSI, bilateral official creditors commit to suspend payments on all principal and interest coming due between May 1 and December 31, 2020, including all arrears from public sector borrowers. However, some creditors did not agree to rescheduling arrears. There is a need to clarify treatment of non-traditional debt instruments that may be classified and structured as deposits, long-term swap lines or equity but would classify as public debt according to international standards.[12] In addition, creditors have used different treatment of debt guaranteed by the central government and of loans involving co-financing with commercial banks.

- *Transparency and disclosure of the terms of the rescheduling of any DSSI eligible debt.* For DSSI to be fully effective, there should be a standard minimum set of debt treatment information. Lack of information disfavors other creditors and creates uncertainty for borrowing countries. Similarly, in line with a strong practice of [G20 Operational Guidelines]

[12]As defined, for example in, IMF. 2013. Public Sector Debt Statistics: Guide for Compilers and Users. 2013.

for Sustainable Financing Diagnostic Tool Paris Club Memoranda of Understanding signed by Paris Club and DSSI countries should be disclosed.

II. ***The precise terms of participation by non-Paris Club creditors***: In the early stages of DSSI implementation, participation by some non-Paris Club creditors appeared to be linked to conditions—or trigger consequences—beyond those envisaged in the G20 term sheet, such as limits on access to new financing or a requirement to clear arrears before participating in the DSSI. More recently, there have been some signs of progress toward clarifying these terms by non-Paris Club creditors, with some having discussed using or adapting the MOU of the Paris Club, while China has circulated the Paris Club MOU to relevant agencies and financial institutions for their reference in implementing the DSSI. Nonetheless, some creditors have recently suggested that additional fees may apply to the debt service suspension. Indeed, a few countries have withdrawn their DSSI request to selected official bilateral creditors after these creditors imposed additional conditions. A common MOU for a DSSI extension, which ruled out such conditions, would reduce uncertainties for debtors, especially if the MOU is published.

III. ***Efficient implementation of DSSI***: A number of countries report a lack of responses by some creditors, or relatively lengthy discussions, including in relation to the terms above. Some have continued to pay debt service in the interim, much reducing the benefits of the suspension. It would be important to standardize procedures for making and processing requests to ensure IMF-WBG staff are aware of new requests and the progress being made toward approval.[13] A timely decision by the G20 to extend the DSSI, together with enabling countries to initiate requests for debt service suspension ahead of end 2020, would support budgeting and planning by country authorities, along with G20 assurances that the suspension will be effective from January 1, 2021 even if a DSSI request is approved later in the year.

IV. ***IMF financing requirements***: According to the term sheet endorsed by the G20, access to the initiative requires countries to be benefiting from, or to have made a written request to IMF Management for IMF financing, including emergency facilities (RFI/RCF). The IMF prepared guidance to Fund staff around requests for Fund financing from DSSI eligible countries, noting that approval of the request is not required for DSSI participation. Nonetheless, one country (Vanuatu) rescinded its DSSI participation as this required it to request IMF financing.

V. ***MDB options***: The G20 asked multilateral development banks (MDBs) to further explore options for the suspension of debt service payments over suspension period, while maintaining their current rating and low cost of funding. MDBs, working with the IMF, provided a joint response to the G20.[14] The participation of MDBs in the DSSI would likely reduce net funding to

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[13]While IMF and World Bank can support the implementation of the initiative by furnishing templates and information provided by the G20 to borrowing countries and supporting other implementation arrangements, such as fiscal monitoring, debt transparency commitments and the implementation of debt ceilings, borrowing countries would need to contact creditors.

[14]See "Protecting the Poorest Countries: Role of the Multilateral Development Banks in Times of Crisis - Explanatory Note", July 7, 2020.

IDA countries by undermining the attractiveness of MDB debt, including IDA debt, and increasing IDA and IBRD's funding costs significantly. Because of its terms - low interest rates, long grace periods, and in many cases outright grants - the World Bank's transfers to client countries entail significant concessionality and present value reduction. More than half (39 of 70) of IDA19 active countries already receive all, or half, of their IDA resources on grant terms, which carry no payments at all. The attractiveness of IDA and IBRD terms relies in part on the ability to access capital markets to secure the additional financing that will be needed for the scaled-up crisis response. Two out of the three major rating agencies have emphasized that participation in debt service suspension could exert downward rating pressure. Without their very strong triple-A ratings, MDBs such as IBRD and IDA could not sustain their business model of borrowing cheaply and lending to clients that would represent much higher risk to other, non-preferred creditors. For the period April-December 2020, debt service from IDA19 eligible countries (plus Angola) to MDBs amount to approximately US$7 billion. While this is a large number, it is far less than new commitments and disbursements from these institutions. For instance, projected disbursements from the MDBs to IDA19-eligible countries (plus Angola) during the same period amount to US$45 billion, which is more than six times the total debt service, and 129 percent higher than the three-quarter average for years 2017–19.

12. These implementation challenges should be addressed to ensure participating countries gain the full intended benefits of the DSSI. Lack of full creditor participation, delayed implementation, and requests from some creditors to impose additional conditions, reduce the benefits for participating countries and increase uncertainty. Participating countries would therefore greatly benefit if all official bilateral creditors were to implement the DSSI consistently, as agreed in the context of a common MOU. In particular, G20 governments should consider steps to ensure participation by all private sector creditors and all bilateral public sector creditors, regardless of whether they are considered official bilateral creditors, commercial or policy banks, while, in parallel, beneficiary countries could be expected to make requests to all their official creditors, and official creditors should process these requests in a timely and transparent manner.

13. The G20 called on private creditors to participate in the initiative on comparable terms, which is most relevant for about one-quarter of DSSI participants with sizable commercial debt service (Box 1). More than half of countries that participate in the DSSI have debt service coming due to commercial creditors (both loans and international bonds) during the May-December 2020 period.[15] While debt service to private creditors is small in many of these countries, it exceeds debt service to official bilateral creditors in ten countries according to IDS data. Five of the latter countries receive IDA grants.

[15]Private creditors here are defined in line with the following IDS guideline: https://databank.worldbank.org/data/download/site-content/ids2020-backmatter.pdf

Box 1. Commercial Debt Service and DSSI

According to DRS data, DSSI participants' total external PPG debt service to private creditors is estimated at USD6.8 billion over May-Dec 2020 (31 percent of total debt service on external PPG debt) and US$ 10.1 billion for 2021 (33 percent of total debt service on external PPG debt). Around one-third of total debt service to private creditors during this period is for international bonds. There are significant differences among countries:

- Around 14 countries have no debt service to private creditors, while three countries (Angola, Pakistan, and Ethiopia) account for 75 percent of debt service to non-official creditors. Four DSSI countries Angola, Cote d'Ivoire, Pakistan and Senegal account for about 79 percent of international bond debt service.
- Congo Rep., Ethiopia, Senegal, and Zambia owe more than 50 percent of their debt service to commercial creditors during the period May 2020 to December 2021.

Non DSSI participants' total external PPG debt service to private creditors is estimated at US$3.4 billion over May-Dec 2020 (35 percent of total debt service on external PPG debt) and US$4.1 billion throughout 2021 (29 percent of total debt service on external PPG debt). Bondholders account for two-thirds of debt service to private creditors:

- Ghana and Kenya account for 73 percent of non-official debt service, while Kenya and Nigeria for the 53 percent of international bond debt service. Fiji, Nigeria, Ghana, and Mongolia owe more than 50 percent of their debt service to private creditors between May and December 2020. None of them benefit from IDA grants.
- None of the non-participating countries has an investment grade credit rating, but 15 countries have tapped international markets in the period 2010-2020 ahead of the COVID-19 crisis and a few plan to issue bonds going forward.

14. To date, private creditors have not participated in the DSSI. At least three DSSI participating countries are so far known to have asked private creditors to participate in the DSSI. In addition, five countries are reported to have made requests to a national policy bank which is participating as a commercial creditor, of which two requests have been processed according to the creditor. The IIF released a terms of reference for private participation in DSSI on a voluntary basis, on terms to be agreed by the creditor and the debtor, but these do not appear to have been used.[16] Private creditors were reluctant to reschedule debt service on comparable terms (NPV neutrality, using the prevailing contractual interest rate as the discount rate) as this would often imply a loss relative to market interest rates. Similarly, despite economic fundamentals deteriorating, most DSSI eligible countries so far assessed that the costs of requesting a debt service rescheduling from their private creditors outweigh the short-term benefits.

15. Key concerns that deter debtor countries from requesting private creditors to participate include:

[16] https://www.iif.com/Press/View/ID/3918/IIF-Releases-New-Framework-to-Facilitate-Voluntary-Private-Sector-Involvement-inthe-G20Paris-Club-Debt-Service-Suspension-Initiative.

- **Reputational concerns**. Some debtor governments may have feared that a request for such participation would be penalized by the debt markets. There is currently limited evidence that DSSI participation negatively affects borrowing spreads in participating countries.

- **Ratings downgrades**.[17] While no credit rating agency has downgraded any country merely for requesting DSSI participation, Moody's placed several participating countries temporarily on a negative watch, citing the G20's call for private sector creditors to participate in the DSSI on comparable terms. More recently, Moody's has reviewed these countries, with no downgrades. Some remain on negative watch (Annex III). Furthermore, all three major credit agencies have made it clear that requesting private sector participation on comparable terms could lead to a downgrade (although this might be temporary).

- **Legal risks.** Depending on terms of private debt agreements, requesting debt service suspension from private creditors could potentially trigger default or cross-default clauses in private debt contracts, as well as litigation.[18]

16. Greater private creditor participation would enhance DSSI benefits for participating countries; a general requirement for comparable treatment of private creditors could, however, significantly lower DSSI participation. Private sector participation in the DSSI could yield significant debt service savings in 2021 for some countries currently participating. This would appear to be most attractive for countries with significant debt to the private sector that have lost market access. Yet, in practice mandating that countries participating in DSSI must request comparable treatment from private creditors could deter DSSI participation by the significant numbers of countries seeking to protect or (re)gain market access, which they have worked hard to achieve, even if they stand to gain resources to address the crisis in the near term.

17. To enhance the benefits of DSSI for beneficiary countries, it will be important that the extension of the DSSI encourages full participation by private and bilateral public creditors. To maximize the ability of DSSI beneficiaries to continue providing extraordinary pandemic support to individuals and firms through health, social and economic spending, and in the spirit of fairness, G20 countries should take all possible steps to urge participation in DSSI by private sector creditors under their jurisdiction, and by bilateral public sector creditors regardless of whether they are considered official bilateral, commercial or policy banks.

18. Relatedly, with DSSI-eligible countries showing rising risk of debt distress, there are also concerns that DSSI could, in some cases, defer the recognition of unsustainable debt burdens. As discussed in the section on "Liquidity Needs and Debt Sustainability", many DSSI-eligible countries entered the COVID-19 crisis with high debt vulnerabilities and the public debt outlook has deteriorated sharply in these countries. Since the onset of COVID-19, the LIC-DSF risk of debt distress ratings of four countries were downgraded, and further downgrades are likely

[17] Most DSSI-eligible countries do not have a sovereign credit rating and none has an investment grade rating.

[18] Bond contracts and loan agreements typically contain cross-default clauses. Although the precise drafting of cross-default clauses varies, even a voluntary rescheduling of other external debt may give rise to an event of default.

forthcoming. An unconditional extension of the DSSI to countries that have unsustainable debts, or which are at high risk of becoming unsustainable could be counterproductive, by making the debt crisis deeper and harder to resolve. Furthermore, G20 creditors have expressed concerns that repayment of private creditors assisted by DSSI would shift the burden of debt restructuring from the private sector to the official sector.

19. The G20 could therefore give consideration to the feasibility of targeted modifications of the DSSI to mitigate these risks while protecting DSSI participation. Countries evaluated by IMF-WBG staff to have a high risk of debt distress, or which are in debt distress, have the highest likelihood of debt becoming unsustainable and of requiring a debt restructuring if other policy measures cannot restore sustainability. If these countries also have significant debt service to the private sector, or other non-participating creditors, the debt payment moratoria risks potentially delaying the resolution of unsustainable debt. To prevent this from happening, for countries that have high risk of debt distress, or that have been assessed to have unsustainable debt, the G20 could consider conditioning DSSI access in 2021 on requesting and working toward a Fund supported reform program aimed at reducing debt vulnerabilities and addressing debt levels where needed. To facilitate this process, the Development Committee should consider asking WB and IMF to develop by the end of 2020 a joint action plan for debt reduction for IDA countries with unsustainable debt. All other currently DSSI eligible countries would remain eligible in 2021 without further requirements. Broader issues would also need to be assessed in considering such an approach, including potential market implications for other DSSI-eligible countries.

20. Moreover, the midpoint review would assess progress in DSSI implementation, such as details on the debt service relief approved by participating institutions including those participating as commercial creditors, developments in private creditor participation, and the monitoring of fiscal policy responses to the pandemic including priority spending. It could also consider updated assessments of the debt vulnerabilities of DSSI beneficiaries, developments in the international framework for case-by-case sovereign debt resolution, together with any further steps appropriate to promote a timely transition to deeper debt treatments by DSSI beneficiaries where needed.

21. Looking further ahead, a contingency clause in bonds and loans to promote participation by the private sector in temporary debt service suspension could be considered, including for potential inclusion in restructured debt. Such a clause could be modeled after natural disaster clauses in bond contracts, which automatically suspend debt service payments in the year of a disaster. A comparable contractual provision would trigger a debt service suspension on contractually defined terms upon suspension of debt service by G20 official bilateral creditor (either on its own, or possibly in combination with a natural disaster or major external shock). Unlike private sector participation in the DSSI, such a clause would lead to private sector participation in an official debt service suspension without requiring action by the debtor country and likely without triggering rating downgrades, as the private sector debt service suspension would be governed by the debt contract. The implications for borrowing costs would need further analysis. Private investors are less inclined to invest in instruments whose repayment is conditional to possible reprofiling of another class of debt on which they have no control and would price this new risk. If any such clause was adopted through new issuance, it would take time for such provisions to be reflected in the stock of debt. One way to accelerate the adoption of such clauses would be to include them in bond exchanges and loan refinancing for countries resolving debt to restore debt sustainability.

MONITORING OF SPENDING UNDER THE DSSI

22. The G20 endorsed the proposed IMF-WB framework for monitoring DSSI beneficiaries' fiscal efforts in response to the crisis on June 23, 2020. The monitoring system reports fiscal policy responses to the COVID-19 pandemic in the context of overall fiscal and economic activity developments.[19] It consists of a fiscal data table and a brief text commentary to complement and explain the tabular information for each participating country, covering the authorities' plans reflected in supplementary/revised 2020 budgets or other budget (re-)allocation decisions, or the latest fiscal projections if necessary. Information to be reported by the system includes: (i) aggregate fiscal developments; (ii) the evolution of priority sector, social expenditure as well as recurrent and development expenditure; (iii) COVID-19 related spending in response to the crisis; and (iv) debt service suspension.[20] When interpreting the results, it is important to keep in mind that COVID-19 related spending and priority spending in most cases overlap.

23. This section discusses early trends of fiscal efforts of 41 beneficiaries of the DSSI based on the information provided by the endorsed monitoring system.[21] The data for the system (the table and text commentary) were jointly requested by the IMF country mission chief and WB country director. The fiscal data reported are the change from the original 2020 budget (or the 2019 outcome) to the revised 2020 budget (or the latest staff projection for 2020 in case the revised budget is not available), in local-currency-denominated inflation-adjusted terms, unless stated otherwise. To facilitate aggregation of the data (either simple average or median), the change and COVID-19 related spending are normalized by the 2020 GDP projection that was used for the original budget. The numbers in Table 1 as well as a text chart should be interpreted as illustrative,

[19]Its details are presented in Section III in Annex II "Monitoring System of Fiscal Impact and Responses to the Crisis" of the Third Update of the Debt Service Suspension Initiative prepared by the staff of the IMF and the World Bank.

[20]Clearly separating COVID-19 related spending and priority spending would be operationally difficult. Priority spending may include some (but typically not all) COVID-related expenditure. Its definition varies country by country, making comparisons difficult. Generally, it includes spending on education, health, and social protection/social assistance. COVID-related spending would likely include spending on the prevention, containment, and management of COVID-19 (including medical equipment as well as the direct fiscal cost of organizing and enforcing social distancing) and COVID-19 related support to households, businesses, SOEs, and government entities (the coverage depends on country-specific impacts and policy responses). Thus, not all COVID-19 related spending is included in priority spending, while some COVID-19 spending—for instance, implemented through existing social protection/assistance and health systems—may be included in priority spending.

[21]For the fiscal monitoring, information was requested for the 41 countries that were confirmed as formerly requesting the debt suspension to the Paris Club or G20 as of July 31. The 100 percent submission rate validates the effectiveness of the design of the DSSI fiscal monitoring system: drawing to the greatest extent possible on existing reporting and public financial management mechanism, counting limited capacity in several low-income country administrations. World Bank and IMF staff will continue to work with the authorities to further improve the effectiveness of the fiscal monitoring system.

because priority spending and COVID-19 related spending do not have the same coverage across countries and countries follow different conventions for their fiscal years.

Table 1. Summary of Fiscal Policy Responses[1]

	Change from Original Budget to Revised Budget (In percentage points of GDP used for the original 2020 budget)		Share of Countries with Lower Revenue (Higher Spending) in the Revised Budget than the Original
	Average	**Median**	**(Percent)**
Overall revenue	-3.7	-1.8	90
Domestic revenue	-3.9	-2.3	98
Grants	0.2	0.3	32
Overall spending	-1.5	0.6	56
Recurrent spending	0.2	0.7	63
Development spending	-1.6	-0.9	37
Priority/social sector spending[2]	0.9	0.6	85
of which,			
Health	0.6	0.3	87
Education	-0.1	0.0	41
Social protection	0.4	0.1	63
COVID-19 related spending	2.1	1.9	n.a.
of which,			
Prevention, containment and management	0.6	0.6	n.a.
Households	0.7	0.5	n.a.
Businesses, SOEs and government entities	0.8	0.6	n.a.

[1]Change in absolute values from the original 2020 budget to the revised 2020 budget, with inflation adjusted and normalized by GDP used for the original budget. Note that definition of priority spending and COVID-19 related spending varies by country, the values presented in the table are interpreted only as illustrative.
[2]Countries were requested to report priority sector spending based on local definitions that pre-date the COVID-19 pandemic.

24. The COVID-19 pandemic and deep economic recession have put severe pressures on the fiscal accounts of the DSSI beneficiaries. Such pressures occur on two fronts: first, increased spending needs to mitigate the health, social, and economic impacts of COVID-19; second, government revenue losses stemming from a sharp decline in economic activity and, for many commodity exporters, a concurrent drop in commodity prices.

- ***The beneficiaries have devoted substantial resources to tackle the COVID-19 crisis***. On average, the beneficiaries are projected to spend 2.1 percent of GDP on COVID-19 related items in 2020 (calendar or fiscal year). While there are major differences across beneficiaries, on average, COVID-19 related spending has been broadly evenly allocated across three areas: prevention, containment and management (share: 29 percent); support to households (34 percent); and support to businesses, SOEs and government entities (36 percent). In the process of tackling the pandemic, countries have also boosted priority spending indicators relative to the original budget by an average of 0.9 percentage points of (pre-COVID-19 budget/projected) 2020 GDP, mostly on health and social protection.[22, 23]

- ***Revenues were hit hard in a large majority of beneficiary countries with only partial cushioning from increased grants***. On average, overall revenue has declined by 3.7 percentage points of (pre-COVID-19 budget/projected) 2020 GDP. This is driven by the sharp decline in domestic (non-grant) revenue (3.9 percentage points), with almost all of beneficiaries having lower domestic revenue, reflecting adverse effects of economic spillovers including the decline in trade, commodity prices, tourism, and remittances as well as containment measures (e.g., lockdown). Increased grants (budgetary as well as in-kind grants, like medical equipment) from the global community (0.2 percentage points) have only partly offset the decline in domestic revenue.

25. In response to these pressures, the beneficiaries have made difficult choices to reprioritize spending while allowing higher overall fiscal deficits.

- ***Substantial offsetting measures limit the average increase in overall spending, and many countries are expected to reduce overall spending relative to the original budget***. On average, overall spending (including interest payments) is projected to decline. The overall increase in recurrent spending averaging 0.2 percentage points of GDP is significantly below COVID-19 related spending estimated at 2.1 percent of GDP, indicating that the beneficiaries have substantially reprioritized recurrent spending.[24] Development spending has also been cut (on average, by 1.6 percentage points, with more than a half of the beneficiaries cutting it), with potentially adverse long-term impacts on development.

- ***The overall fiscal deficit is expected to widen, on average, by 2.2 percentage points of GDP.*** Although fiscal deficits have risen, it is notable that the increase is expected to be much smaller than in advanced economies or emerging market economies with access to market financing.[25] As illustrated in Figure 4, for DSSI recipient countries, an increase in COVID-19 related spending (green bar), was made possible despite the fall in revenues (blue bar), by more

[22]Larger increase in COVID-19 related spending than priority spending partly reflects the different coverage of priority spending and COVID-19 related spending (e.g., the latter includes spending on support for businesses, SOEs, and government entities, and measures to promote and enforce lock-downs and social distancing which typically would not be counted as health spending).

[23]Most countries benefitting from the DSSI have made commitments, in the context of their letters of intent for IMF emergency financing (RFI/RCF), aimed at enhancing transparency in procurement and ex-post audits of COVID-19-related emergency spending. For details, see *Progress In Implementing The Framework For Enhanced Fund Engagement On Governance*, International Monetary Fund, July 2020.

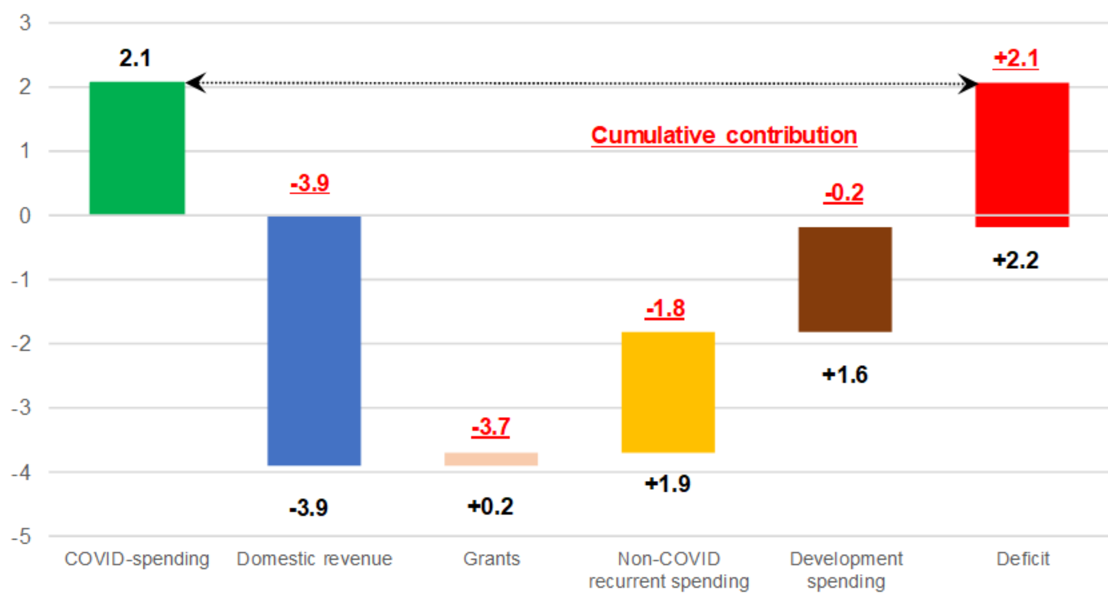
[24]Also, lower net interest payments somewhat help reprioritize non-COVID-19 related recurrent spending. Net interest payments, measured as the difference between the primary and overall balances, show on average a decline of 0.4 percentage points of GDP (and its median is slightly lower than zero (-0.05 percentage points of GDP)).

[25]About 80 percent of the beneficiaries have larger overall deficits. Those beneficiaries with shrinking overall deficits have cut spending, especially development spending.

grants from donors (pink bar), together with lowering expenditure by reprioritization (orange and brown bars), and by higher deficits (red bar).

Figure 4. Revenues, Expenditures (including COVID-related), and Fiscal Deficits 1/

(Contribution to support the priority spending, in percentage points of GDP in the original budget, simple average)



1/ Since the chart shows how COVID-related spending is financed, positive sign of grants indicate more receipt of grants, positive sign of non-COVID recurrent spending and development spending numbers indicates lower spending, and positive sign of deficit number indicates and an increase in the deficit.

26. The DSSI, together with other exceptional financing, is helping countries to respond to the COVID-19 pandemic, and it would continue to do so if extended. Beneficiary countries have increased COVID-19 related spending by an estimated 2.1 percent of 2020 (pre-COVID-19 budget/projected) GDP. Indicators of priority spending have increased by 0.9 percentage point on average. Both these amounts exceed the liqudity support from DSSI in 2020 of US$5.0 billion (0.4 percent of GDP).[26] Other financing from the IMF, WB, and other MDBs, from bilateral donors and other sources of new net borrowing has enabled countries to run larger deficits than envisaged before the pandemic. Continuing elevated financing needs in 2021 (Section VI) would also benefit from DSSI to help the poorest countries to safeguard COVID-19 related and priority spending.

[26] Based on creditor information.

PUBLIC DEBT TRANSPARENCY

27. Enhanced transparency of public debt is a central part of the DSSI's objectives to help borrowing countries and their creditors make more informed borrowing and investment decisions, which is critical in the current crisis context. In this light, DSSI beneficiaries have made a commitment to disclose all public sector debt to IMF and WBG staff. This involves full disclosure of external public and publicly guaranteed debt stocks by creditor and lending institution. The World Bank and the IMF have therefore requested detailed loan by loan information on government debt portfolios from debtor countries participating in the DSSI as well as information on debt service suspended under the DSSI. To further enable stakeholders to track progress in the implementation of DSSI and improve debt transparency, the World Bank also launched a DSSI website,[27] which has been frequently updated, and publishes information about participation status, debt sustainability ratings, and potential debt service suspension amounts.[28]

28. Most beneficiary countries have provided information on debt service suspended and more detailed information is expected to be received in the coming weeks. As of September 21, thirty two countries have provided detailed bilateral debt service payments falling due between May 1 to December 31, 2020, including Afghanistan, Angola, Burkina Faso, Central African Republic, Cabo Verde, Cameron, Chad, Comoros, Congo Rep, Congo Dem Rep., Côte d'Ivoire, Djibouti, Dominica, Ethiopia, Gambia, Grenada, Kyrgyz Republic, Madagascar, Mali, Maldives, Mauritania, Mozambique, Myanmar, Nepal, Niger, Pakistan, St. Lucia, Senegal, Sierra Leone, Togo, and Zambia. For these countries, the total debt service under the DSSI is estimated at US$4.8 billion.[29] Angola and Pakistan account for more than 56 percent of this amount. The remaining amount of debt service under the DSSI for the eleven countries, according to creditors' data, is estimated at US$854 million, with the Yemen, Rep. accounting for 42 percent of this amount. More detailed information about the PPG external debt on a loan-by-loan basis is expected to be received from each beneficiary country, which requested more time to provide comprehensive and accurate data of their debt portfolios. Estimates of debt service savings provided by creditors and borrowing countries differ significantly in a few countries. Possible explanations for the differences in the estimates of debt service deferred include: (i) different effectiveness dates for DSSI payment deferrals by some countries which joined the initiative at a later stage and the treatment of bilateral lending

[27] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative?cid=EXT_WBEmailShare_EXT

[28] Potential debt service suspension amounts are estimated as debt service on debt outstanding and disbursed as of end 2018 on public and publicly guaranteed debt by official bilateral creditors as compiled in the IDS.

[29] This compares to US$8.8 billion of potential debt service savings as estimated by the World Bank's International Debt Statistics (IDS). Key differences arise from: (i) lender participation covered under the DSSI, especially with respect to the treatment of national policy banks in countries not included in the Paris Club group of creditors; (ii) perimeter of claims, since the DSSI also includes debt service on non-guaranteed debt; (iii) vintage of data in IDS, as the potential debt service is projected based on the disbursed and outstanding long-term external debt at end 2018 net of principal and arrears; and (iv) differences in exchange rate and interest rate assumptions. The debt service provided by PNG do not have enough detail to be included in the total.

instruments reflecting ongoing discussions among governments and creditors; and (ii) exchange rate assumptions; and (iii) discrepancies in debt data and reporting.[30]

29. **The IMF and the World Bank staff are working with DSSI eligible countries to enhance debt recording and reporting throughout FY21**. In the context of the IMF-World Bank multipronged approach to address debt vulnerabilities in low-income and emerging market economies, technical assistance and operational engagements to enhance public debt recording and reporting in borrowing countries have been scaled up. An upcoming IMF COVID-19 Special Series note will provide specific methodological guidance on recording DSSI-related operations in both external sector and government finance statistics. Enhanced public debt reporting will also be supported in FY21 through the implementation of the World Bank's Sustainable Development Finance Policy (SDFP).

30. **Creditors can also play an important role in supporting debt disclosure.** The Diagnostic Tool on the Implementation of the G-20's *Operational Guidelines for Sustainable Financing*, developed by Bank and Fund, identifies publishing loan-by-loan information, including terms, on a single website and regular updates on new lending as a strong practice with respect to debt reporting in support of information sharing and transparency (guideline 2). The Institute of International Finance (IIF) *Voluntary Principles for Debt Transparency* set out a framework for private lenders to disclose information about their lending to sovereigns. Still, disclosure of amounts and terms of public debt data by most creditors is limited. Creditors can further support debt transparency by refraining from excessively using confidentiality clauses as well as other legal provisions in loan contracts that undermine transparency, such as the use of undisclosed or hidden escrow arrangements and the use of procurement arrangements that avoid, or are not consistent with, the procurement rules of borrowing countries and which are not properly disclosed. Also, it is important that public debt transparency is based on a comprehensive concept of public debt, including information on swap lines, and that it extends to borrowing terms, including information related to collateral.

NON-CONCESSIONAL BORROWING UNDER DSSI

31. **Each DSSI beneficiary country has committed to contract new non-concessional debt during the suspension period only if such lending is in compliance with limits agreed under the IMF Debt Limit Policy (DLP) or WBG policies on non-concessional borrowing.** IMF and WBG staff clarified in the second DSSI update report (see summary in Annex II) that the DSSI does not impose any debt ceiling other than those required under the IMF DLP or the World Bank's Sustainable Development Finance Policy (SDFP) which entered into effect on July 1, 2020.[31] These debt ceilings are aligned with the debt risks facing a country, thereby serving to help contain debt vulnerabilities, consistent with DSSI goals.

[30]See G20 note on Public Sector Debt Definitions and Reporting in Low Income Developing Countries.

[31]It may be useful to clarify this language should the G20 term sheet be amended.

32. The IMF and World Bank limits that are applicable to DSSI participating countries during the debt service suspension period from May 1, 2020 to December 31, 2020 are summarized in the Debt Limits Conditionality table.[32] For countries that use the LIC DSF, with the exceptions of Mauritania and Cameroon which have exemptions for specific projects (in line with the DLP), all countries assessed at high risk of debt distress have a zero non-concessional borrowing limit under the Fund-supported program. The World Bank's SDFP normally sets a zero non-concessional borrowing ceiling for countries within this high-risk group unless the country has a debt ceiling under an IMF program or if the country has access to borrowing on market terms. For market-access countries, ceilings would take debt management objectives into account and would be calibrated to support a reduction in debt vulnerabilities.

33. DSSI beneficiaries have observed IMF borrowing limits. Compliance with IMF borrowing limits can typically only be verified with a delay, for instance in the context of a program review. Due to the considerable uncertainty regarding the duration and the scale of the pandemic and the practical constraints on conducting comprehensive discussions with the authorities among the pandemic, timely augmentation of access under existing ECF arrangements was not feasible in many countries cases and countries financing needs in light of the global health crisis were largely met through RCF/RFI, which have no ex post conditionality including debt limits. Having said that, since March 13, 2020, there have been no non-observance of non-concessional borrowing limits in program review reports of DSSI beneficiaries that have been considered by the IMF Executive Board.[33] In two cases the debt limits have been revised: (i) Cabo Verde's concessional borrowing limit was modified in line with the revisions to the macroeconomic framework, but this occurred before COVID-19; and (ii) Senegal's nominal public debt limit under the PCI was revised upward in response to COVID-19.

34. Reviews of seven country cases by the World Bank's Non-Concessional Borrowing Policy (NCBP) Committee showed that all but one country complied with the relevant limit on non-concessional borrowing (NCB). Comoros, Ethiopia, Mozambique, and Tajikistan complied with the zero NCB in FY20. Uganda, a country at low risk of debt distress at the time, requested and was granted a non-zero NCB. Tanzania also considered to be at low risk of debt distress contracted NCB. On the other hand, the Maldives, despite having a zero NCB ceiling, borrowed in non-concessional terms to address COVID-19 emergency response. The Maldives, however, are implementing the Committee's recommendations. With the replacement of the NCBP by the SDFP

[32]The Debt Limits Conditionality table is available through this link.

[33]A total of seven Upper Credit Tranche and Policy Coordination Instrument reports have been considered for DSSI-participants. Sierra Leone's breach of a concessional borrowing limit related to borrowing conducted in August 2019 for which a waiver was granted by the IMF Executive Board in April 2020 and the authorities refrained from external borrowing subsequently in 2019.

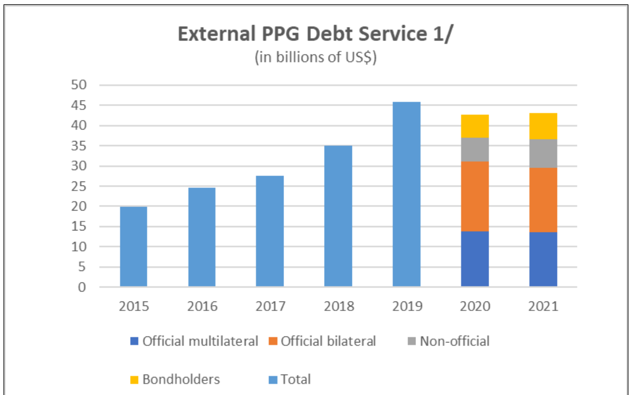
at end June 2020, the remaining cases transited to the SDFP and will inform the SDFP's Committee recommendations for FY21.[34]

LIQUIDITY NEEDS AND DEBT SUSTAINABILITY

35. This section presents an analysis of the liquidity needs of DSSI countries and developments regarding debt sustainability.[35] The liquidity analysis considers both external financing needs and their fiscal financing needs, drawing primarily on data and projections from the most recent vintage of the October *World Economic Outlook (WEO)*.[36] It provides an update on market financing for these countries and makes an overall assessment of their need for liquidity support. It also gives an update on debt and debt service indicators and on developments in debt sustainability assessments after about six months of the COVID-19 pandemic, which show a marked deterioration.

Financing Needs

36. Key drivers of external financing needs are expected to remain high in 2020–21. Current account balances are projected to deteriorate sharply in most DSSI countries in 2020, falling by an average of 3.5 percent of GDP, as exports and remittances fall more sharply than imports. External imbalances partially unwind in 2021, by some 1.5 percent of GDP, as a projected partial recovery in external demand is coupled with subdued domestic demand growth, in part reflecting some assumed fiscal consolidation. DSSI countries have estimated public and publicly-guaranteed (PPG) external debt service due in 2021 of US$43 billion (about 2½ percent of GDP for an average DSSI country), similar to 2020.[37] This includes $15.9 billion due to official bilateral creditors, $13.5 billion to multilateral creditors, and $13.6 billion to private creditors.



Source: WB DRS.
1/ Debt service for 2019 to 2021 is based on debt contracted through end-2018.

[34]The SDFP was approved by the World Bank Board on June 9, and the policy became effective on July 1st, 2020. Out of the current 74 IDA-eligible countries, 56 are required to prepare Performance and Policy Actions (PPAs) for the fiscal year (FY) 21, 39 of which are FCS or Small States. All PPAs agreed in the context of the SDFP are expected to be finalized by October 31, 2020.

[35]DSSI countries in this section refers throughout to DSSI eligible countries.

[36]Findings are broadly consistent with the World Bank's Macro-Poverty Outlooks. https://www.worldbank.org/en/publication/macro-poverty-outlook.

[37]Debt service data from the World Bank's IDS. Debt service due could be somewhat higher due to net borrowing in 2019-20 which is not captured by the IDS series used for this analysis. Sixty-eight of the 73 DSSI-eligible countries have DRS data on debt service. Kiribati, Marshall Islands, Micronesia, South Sudan, and Tuvalu do not have data.

37. External financing pressures are projected to remain elevated in 2021, with reserve cover deteriorating notably. External financing needs (EFNs) are projected to expand to an average of 9.2 percent of GDP (equivalent to a total of US$179 billion) among DSSI countries this year, well above their average of 4.3 percent of GDP (a total of around US$90 billion per annum) in 2015–19.[38] The expected partial unwinding of the current account deterioration, along with a projected recovery in FDI, would help reduce EFNs in 2021 to an average of 7 percent of GDP (equivalent to a total of US$144 billion) among DSSI countries. Nonetheless, this external financing need remains elevated by historical standards, at some US$54 billion above the average in 2015–19. At the same time, DSSI countries' FX reserves are projected to fall by around $22½ billion collectively in 2020, leaving half of them with less than 2-years EFNs coverage (and a handful of them with less than full-year EFNs coverage). In comparison, the share of DSSI-eligible countries with FX reserves less than 2-years EFNs coverage was 30 percent in 2018.

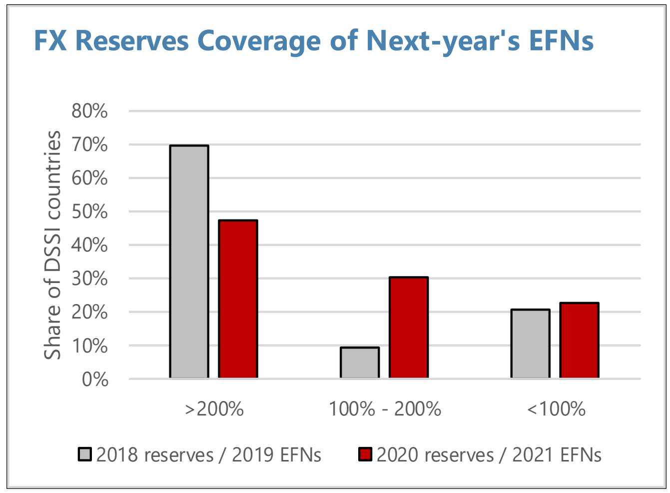
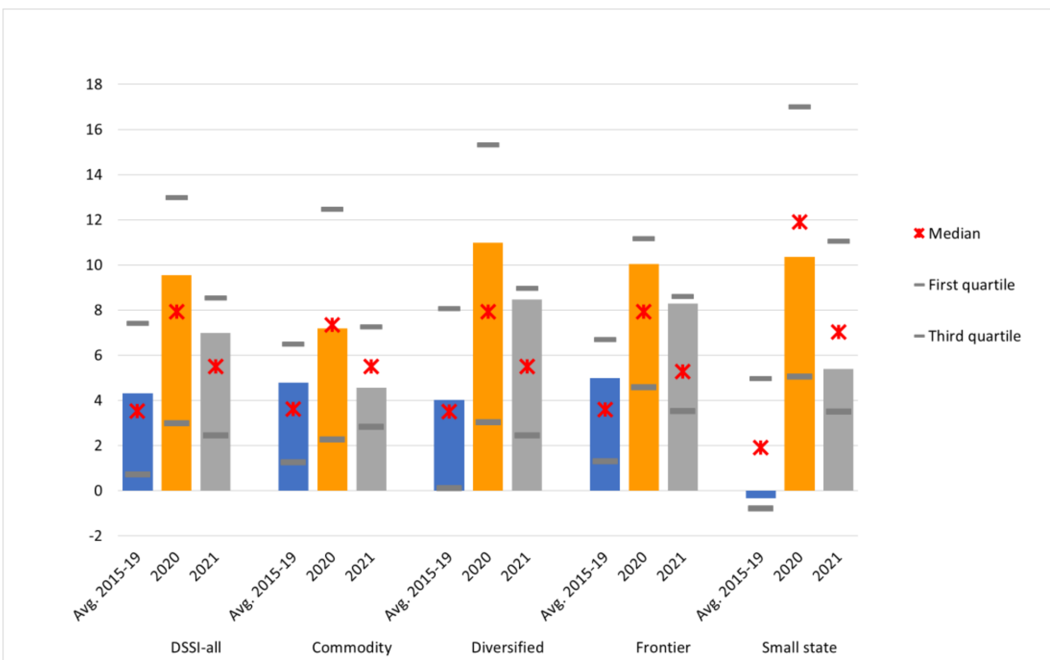


Figure 5. External Financing Needs
(In percent of GDP)



[38]External financing needs are calculated as current account balance + capital account balance + external debt amortization – net FDI inflows. These are calculated for 53 out of 73 countries for which data is available from the WEO. The overall EFN estimate is derived by extrapolating to cover the countries for which data is not available.

38. DSSI countries' fiscal gross financing needs (GFN) are also projected to remain high in 2021 despite some easing in fiscal deficits.[39] Their fiscal deficits are projected to widen to an average of 6½ percent of GDP in 2020 (cf. 2⅔ percent of GDP in 2015-19) as revenues fall and spending needs rise. Taking into consideration the debt amortization due, the average fiscal GFN in 2020 is projected at 11.5 percent of GDP. For 2021, IMF staff projects deficits to narrow by an average of 2 percentage points as revenues benefit from the projected growth recovery and emergency spending needs ease somewhat. Even so, fiscal GFNs are projected to remain high at an average 10 percent of GDP in 2021, compared with about 7.4 percent in 2015-19, an excess equivalent to US$58 billion.

39. Countries with pre-existing vulnerabilities face additional challenges. DSSI-eligible countries currently assessed to be at high risk or in debt distress, have on average GFN-to-GDP and EFN-to GDP ratios higher than the other debt risk groups (Figures 6.a and 6.b).

Figure 6. Estimated Fiscal and External Gross Financing Needs

(Average by debt risk group; in percent of GDP)

Figure 6.a GFN/GDP

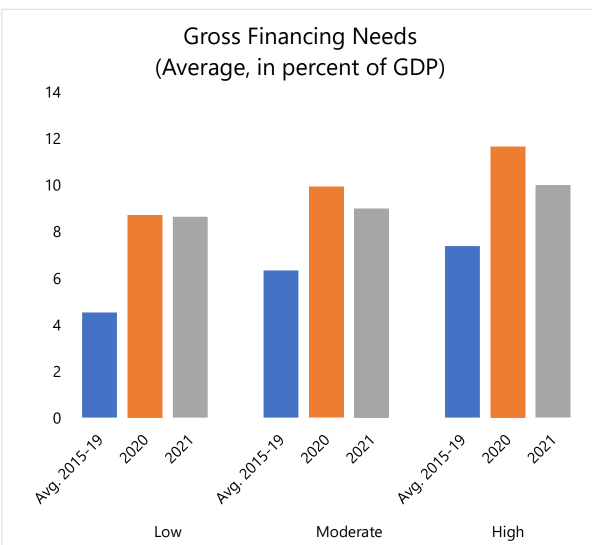
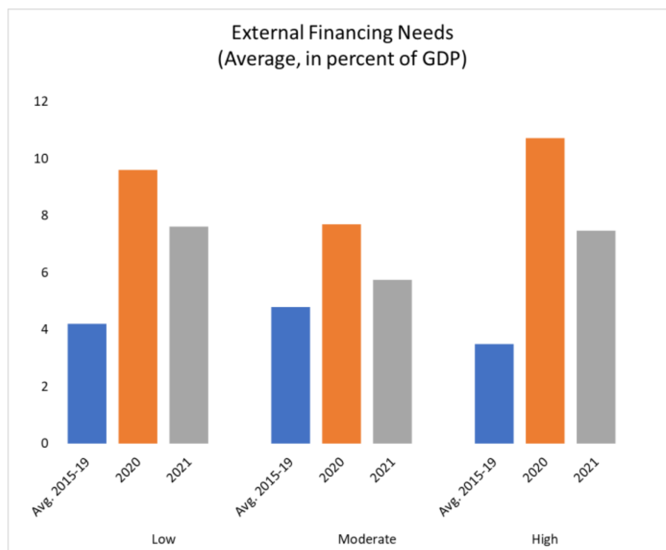


Figure 6.b EFN/GDP



Source: WEO October 2020 and LIC DSA Database as of End-July, 2020.

Financing Conditions and Liquidity Support Needs

40. Meanwhile, financing conditions—both international and domestic—may well remain tight for most DSSI countries (Annex III). Very few DSSI countries have been able to tap international capital markets (through Eurobonds or syndicated loans) since the pandemic started, as sovereign spreads of most frontier markets remain wide despite having declined partially from

[39]Fiscal gross financing needs are calculated as overall fiscal deficit + government debt amortization. These are calculated for 68 out of 73 countries for which data are available from the WEO and LIC DSA databases. The overall estimate for the GFN is derived by extrapolating to cover the countries for which data are not available.

their peak.[40] Presently, only 4 DSSI countries are rated B or higher while trading at spreads below 600 basis points.[41] Domestically, reflecting the relatively low level of financial development, the capacity of local banks to absorb higher government borrowing is generally modest in DSSI countries. Further, the scope to mobilize additional revenues is limited under still weak economic conditions.

41. **Overall, needs for liquidity support needs are expected to remain elevated in 2021**. External and fiscal financing needs are estimated at about 7 percent and 10 percent of GDP, respectively, staying well above recent historical norms by about US$54-58 billion. After receiving emergency financing in the first half of 2020 from the IMF and increased lending by MDBs, many DSSI countries are expected to continue seeking additional financing in 2021 from the IMF under longer-term programs, coupled with support from the WBG and other MDBs.

42. **The extension of the DSSI by up to one year would make a substantial complementary contribution to meeting these liquidity needs given the limited availability of new financing**. According to the World Bank's International Debt Statistics (IDS) debt service on official bilateral loans would be in the order of up to US$15.9 billion in aggregate for all DSSI-eligible countries in 2021, roughly 30 percent of their overall financing needs. By releasing resources equivalent to up to about 0.9 percent of GDP on average for these countries, DSSI extension helps deter potential cuts in priority spending that could impair economic recovery in the short-term and undermine long-term developmental goals. A full-year extension would provide not only additional debt service savings, but also facilitate budget planning during this time of heightened uncertainty and allow time for reform programs aimed at reducing debt vulnerabilities and addressing debt levels where needed, to be developed and implemented with the Bank and Fund in the cases where this is necessary.

Debt Developments and Debt Sustainability

43. **The public debt outlook has deteriorated sharply across the globe owing to the pandemic, including in DSSI-eligible countries**. The latest WEO projects the average debt-to-GDP ratio in DSSI-eligible countries at 57 percent of GDP in 2020 up by 7 percentage points from 2019.[42] This is similar to the increase in EMs of 9 percentage points, but well below the 15 percentage-point increase in AEs (Figure 7). The average debt level in DSSI countries is projected to remain around this higher level over the next five years. A large portion of the deterioration in debt ratios reflects the sharp falls in GDP, the effect of which is amplified as fiscal revenue declines widen fiscal deficits. The somewhat smaller debt ratio increase in DSSI-eligible countries, at least in comparison with AEs, mostly reflects the smaller fiscal space for budgetary measures to cushion the crisis, even with the support provided by emergency financial assistance and debt initiatives under the DSSI and CCRT, in

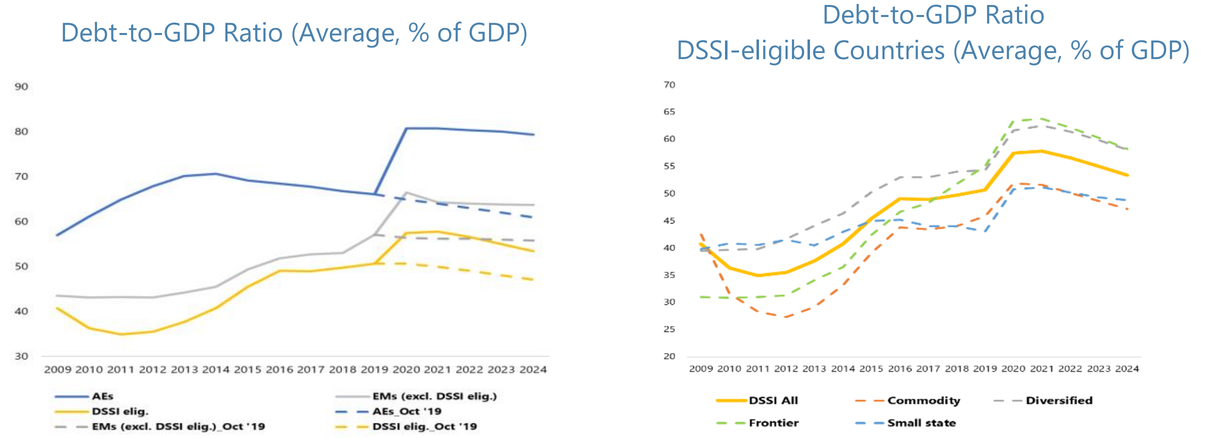
[40]Honduras (B1/BB-/) was the only DSSI country that has returned to the Eurobond market ($600 million, 5.625%) since the pandemic, while few other countries received syndicated loans of smaller amounts.

[41]There has been no issuance by a CCC+ or lower rated countries and very limited issuance at spread above 600 bps during the past 20 years.

[42]This is similar to the World Bank's MPO data.

part reflecting the limited market access of those countries since the pandemic started. All country groups among DSSI-eligible countries show similar debt trajectories with the debt-to-GDP ratio peaking in 2020 and 2021 before declining in the medium term.

Figure 7. Development of Public Debt (2009–24)



Source. WEO

44. Many DSSI-eligible countries entered the COVID-19 crisis with high debt vulnerabilities, which increased in the first half of 2020.

- Thirty-four out of the 66 DSSI-eligible countries (52 percent) that use the LIC DSF are now assessed at a high risk of debt distress or in debt distress, up from 48 percent as of end-2019 (Figure 8).[43] Since the onset of COVID-19, debt distress ratings were downgraded for five countries for which Bank-Fund staff use the LIC-DSF (Kenya, Rwanda, Papua New Guinea, Madagascar, and Zambia) and one was upgraded (Gambia) (Table 2).[44] The downgrades largely related to the worsened macroeconomic outlook amid the pandemic. Zambia has been hit hard, exacerbating an already difficult economic situation. As a result, the authorities announced their intention to restructure their debt in May triggering a downgrade to "in debt distress".

- Most of the updated LIC DSAs were prepared in the context of the provision of emergency financing in the early stages of the pandemic during April-June 2020, when the effects of the pandemic on the economy and public finances were likely not yet fully reflected because of the highly uncertain outlook.

- Based on the IMF's debt sustainability analysis for market access countries (MAC DSA), four of seven DSSI-eligible countries with access to international capital markets were facing high debt

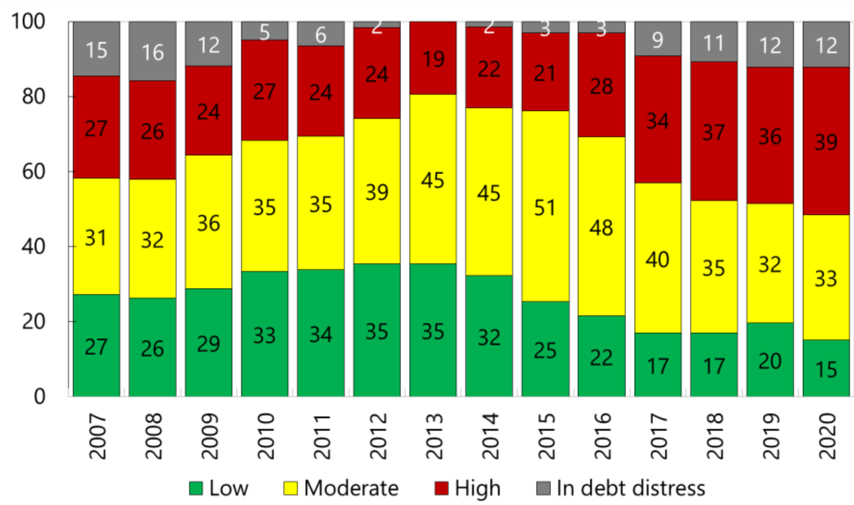
[43]Looking at the broader sample of LICs that use the LIC DSF, 38 out of 70 low-income countries (54 percent) are now assessed at a high risk of debt distress or in debt distress up from 51 percent as of end-2019. For the LIDC group (which excludes the high-income disaster-vulnerable small states and some recent PRGT graduates), 47 percent of countries are at high risk or in debt distress up from 44 percent at end-2019.

[44]The Gambia's upgrade from an "in debt distress" rating to a high risk of debt distress is related to the finalization of a restructuring agreement. Also, the downgrade of Senegal's risk rating preceded the onset of COVID-19.

vulnerabilities even before the crisis (Angola, Pakistan, Mongolia, and St. Lucia). The MAC DSA heat maps used for these countries indicated high risks for both solvency (debt-to-GDP ratio) and liquidity (public gross financing needs) indicators. The pandemic and resultant larger financing needs are further exacerbating the difficult macroeconomic and debt outlook. For instance, Angola has initiated debt reprofiling discussions with some of its creditors. Other DSSI-eligible countries with market access (Fiji, and Nigeria) are also projected to experience a worsening debt path due to the pandemic.

Figure 8. Evolution of Risk of External Debt Distress

(in percent of DSSI-eligible countries with LIC DSAs)



Note: 66 out of 73 DSSI-eligible countries apply the LIC DSA. Countries for which a new DSA has not been prepared retain the same risk rating until a new DSA is prepared. The ratings for Burundi (2015) and Guinea-Bissau (2018) are based on dated DSAs. Yemen and Zambia are in debt distress based on announcements of accumulation of arrears and restructuring, respectively.

Table 2. Recent Changes in the Risk Rating Under the LIC DSF (since end-2019)

	2018	2019	2020*		Main reasons for a change in risk of debt distress
Downgrades					
Senegal	L	L	M	January	Substantial non-concessional borrowing accumulated before the pandemic
Kenya	M		H	May	A worsening in economic outlook due to the pandemic.
Zambia		H	D	May	Entered into restructuring negotiations.
Rwanda	L	L	M	June	A worsening in economic outlook due to the pandemic and updates on investment program.
Papua New Guinea	M		H	June	A worsening in economic outlook due to the pandemic.
Madagascar	M	L	M	July	A worsening in economic outlook due to the pandemic.
Upgrades					
Gambia, The	D	D	H	March	Reflect debt restructuring agreed before the pandemic

Source. LIC DSAs.

Note: D: in debt distress (orange), H: high (red), M: moderate (yellow), L: low (green). Blank years reflect the rating assigned in the latest DSA available at that time. * As of September 21, 2020.

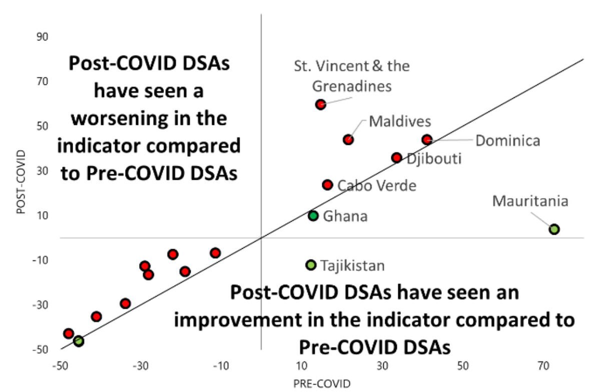
45. Some countries' growing solvency concerns are compounded by liquidity pressures:

- Reflecting the deteriorating macroeconomic outlook, solvency and liquidity indicators have worsened in DSSI-eligible countries that use the LIC-DSF compared with indicators from before the COVID-19 pandemic. It is notable that the magnitude of the threshold breaches has increased for some countries and for others the space to the threshold has narrowed for high-risk and in-debt-distress countries since the pandemic, while the distance to the threshold has declined for many low- and moderate-risk countries (Figure 9).

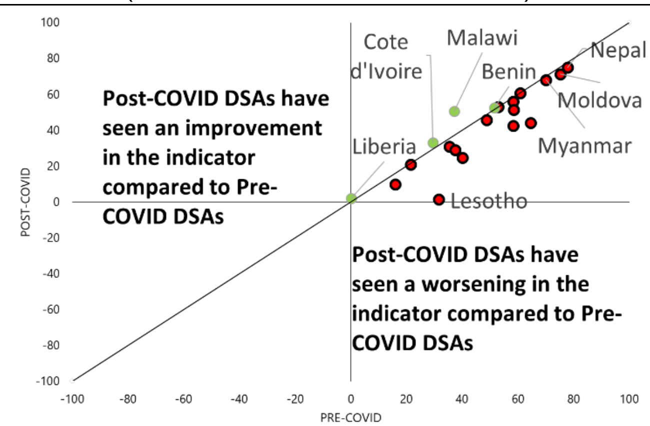
Figure 9. Key Debt Ratios Relative to Thresholds for Pre and Post COVID Periods 1/

External PPG Debt-to-GDP

Magnitude of breaches of the thresholds
(high-risk / in debt distress countries)

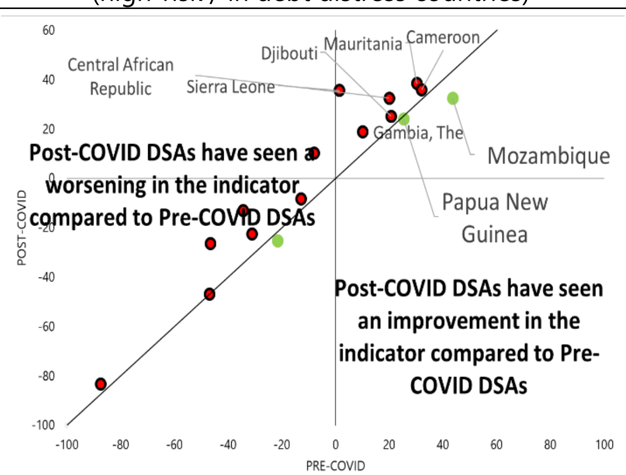


Space to the thresholds
(low- and moderate-risk countries)

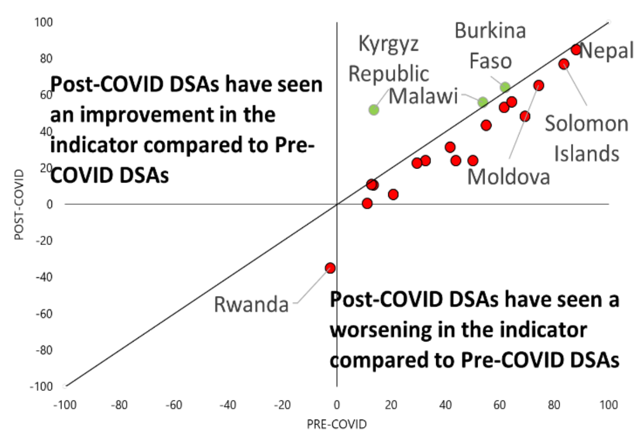


External PPG Debt Service-to-revenue

Magnitude of breaches of the thresholds
(high-risk / in debt distress countries)



Space to the thresholds
(low- and moderate-risk countries)



1/ For countries in debt distress and high risk, the data points reflect the magnitude of breaches. For moderate and low risk countries, the data points reflect the distance to the threshold. Green and red dots represent improvements and deteriorations, respectively.

- Of 14 countries with protracted breaches of solvency indicators under the baseline (defined as breaches of solvency indicators over 5 years and more), 12 are accompanied by protracted breaches of liquidity indicators.[45] Similarly, as highlighted in the most recent IMF staff reports on these countries, two eligible market access countries (Pakistan and St. Lucia) are projected to breach the benchmarks for both debt-to-GDP and gross financing needs for almost the entire projection period (5 years).

- For the countries with deteriorating solvency indicators coupled with immediate liquidity pressures, a more extended suspension of debt service would be helpful to contain distress that could impair their capacity to address the pandemic (Box 2). Fundamental measures to strengthen debt sustainability would also be required including fiscal consolidation and reforms.

- External debt service-to-revenue ratios and external debt service-to-export ratios for countries with protracted breaches of both solvency and liquidity indicators are on average larger in the medium term than for countries that do not have protracted breaches. This highlights that while an extension of the DSSI could provide useful breathing space for the latter group of countries, countries in the former group would probably need a more comprehensive solution taking advantage of the time provided by a DSSI extension.

Addressing Unsustainable Debt

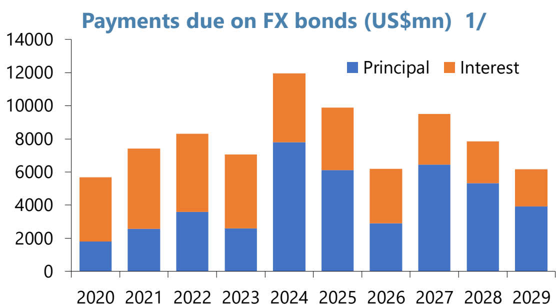
46. Amid worsening solvency concerns, more countries may face unsustainable debt burdens. In several countries, debt sustainability is contingent on the authorities' commitment to steep and prolonged fiscal adjustment and investment reprioritization, which will be difficult to achieve in the current crisis context. While some COVID-19 measures are intended to be unwound over the course of 2021, there is nevertheless a risk of countries tipping into unsustainable debt situations, especially if the COVID-19 shock is more protracted and deeper than envisaged in macroeconomic frameworks underlying the DSAs. Some countries could require a strong and comprehensive debt treatment that provides, together with sound policies, a return to a path of sustained inclusive growth.

47. Given the exceptional circumstances, creditors should pursue a case-by-case approach to ensure debt burdens remain sustainable and achieve debt stock reduction where it is needed during the extension of the DSSI. The case-by-case approach, informed by IMF-World Bank DSAs, would focus restructuring efforts on countries with unsustainable debt. Official creditors can incentivize the debtor to seek and obtain comparable treatment from their private creditors. In the current low growth environment, a permanent reduction in nominal debt stock may be needed to achieve a sustainable debt burden in low income countries hit the hardest.

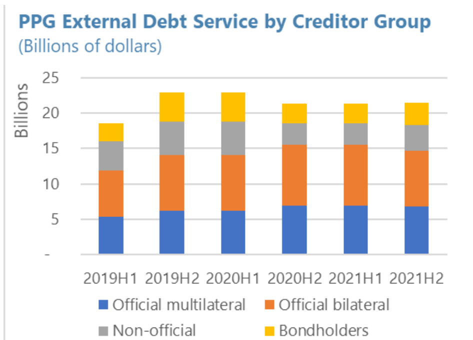
[45] The LIC DSF assesses the risk of debt distress based on two solvency indicators (present value of PPG external debt-to-GDP ratio and PV of PPG external debt-to-exports ratio) and two liquidity indicators (debt service-to-exports ratio and the debt-service-to-revenue ratio).

Box 2. Debt Service Profile and the Terms of Suspension

Some countries have large debt service in the medium term beyond 2021, potentially reducing the efficacy of a rescheduling under the DSSI. Based on end-2018 data from the World Bank's IDS database, debt service on existing debt of DSSI countries are projected to peak in 2021 (spread broadly evenly between the first and second half of the year), but would go up again in 2024, *inter alia*, for frontier economies largely due to bond redemptions. Several of these countries have been downgraded recently and Senegal and Ethiopia have been put on negative outlook by major rating agencies, signaling increasing rollover risks and negative implications for borrowing costs. Payments due on outstanding Eurobonds of the frontier DSSI countries will increase to $7.4 billion in 2021 and $8.3 billion in 2022 (vs. $5.7 billion in 2020), and further to $12 billion in 2024. Such bunching of maturities in some countries in the medium term might diminish the efficacy of the DSSI, if provided with the same rescheduling terms,[46] and deter some countries from applying



1/ Captures the 23 DSSI eligible countries that have issued under foreign laws.



for the DSSI in light of debt management considerations.

Providing more options for DSSI rescheduling terms could be considered to avoid exacerbating debt service burdens in the coming years. Given its NPV-neutrality, it would be useful for G20 creditors to consider providing options to eligible countries so that principal repayments under the DSSI do not overlap with large debt service. For instance, the risk of breaches of DSA thresholds could be reduced through a flexible grace period (e.g. up to four years) with the same repayment period of three years. A rescheduling will be NPV-neutral with a longer grace period as long as the original interest rate in the underlying loan is used for the rescheduling interest rate. Alternatively, the grace period can be maintained, and the repayment period extended (e.g., up to six years). Countries with large bond redemptions should be engaged in proactive debt management once they re-establish global market access, for example, through pre-emptive debt exchanges or debt buy-back to smooth out future humps in debt services.

48. Speedy and efficient debt resolution depends on timely recognition of sustainability problems. A country facing solvency problems should seek comprehensive debt restructuring as soon as feasible to avoid a repetition of "too-little-too-late" debt restructurings seen in recent years which ultimately prolonged and deepened the economic cost of the needed restructuring. But the Paris Club countries with well-established procedures for debt restructuring now account for a small portion of the debt of countries assessed to be in debt distress or at high risk of debt distress in 2018 (Table 3) owing to the rise in commercial debt and non-Paris Club bilateral debt.

49. Enhanced creditor coordination, led by the G20 which includes Paris Club and non-Paris Club creditors, would limit the risk of delays. The DSSI implementation clearly indicates that

[46] The 2020 DSSI provides an NPV-neutral debt rescheduling with a one-year grace period and four-year maturity, using the interest rate set in the original loan contract.

comprehensive debt reconciliation and information sharing among creditors, as well as clarity around participating creditor institutions and treated debt, are critical. Debt restructuring would also need to involve commercial creditors by requiring comparable treatment.

Table 3. Public Debt Composition for Countries Assessed to be in Debt Distress or at High-risk of Debt Distress (Average share in percent, 2018)

	Multilateral	Paris Club	Non-Paris Club	Commercial
In debt distress	35	14	33	18
High risk of debt distress	48	4	32	16

Source. World Bank International Debt Statistics

RECOMMENDATIONS

50. As the pandemic continues to spread and its consequences for the global economy remain uncertain, an extension of the DSSI of up to one year, with the second six months subject to confirmation in a mid-term review, would support the poorest countries in implementing appropriate policies. Projections for external and fiscal financing requirements remain high in these countries in 2021. At the same time, their financial buffers are deteriorating and they have not enjoyed the same recovery in financial market conditions that has benefitted many emerging market countries, in part reflecting concerns about rising debt vulnerabilities. Hence, it is critical to extend the DSSI, which, by deferring official debt service of up to about US$16 billion in aggregate for all DSSI-eligible countries (or about US$12 billion for current DSSI participants), releases financing to support these countries in mitigating the severe adverse health, social, and economic impacts of the pandemic. A full year extension would provide more certainty to DSSI countries formulating their 2021 budgets helping them take appropriate measures in the face of a more uncertain macroeconomic outlook. The second six months would be subject to confirmation in a mid-term review.

51. In addition to extending the DSSI until end-December 2021, the G20 should take steps to improve its efficiency in supporting the efforts of beneficiary countries in mitigating the impact of the COVID-19 pandemic:

- First, to maximize much needed support to eligible countries, all official bilateral creditor institutions should be encouraged to implement the DSSI in a transparent manner. The implementation of DSSI can be made more efficient by (i) clarifying the participation of lending institutions such as by publishing an agreed list; (ii) utilizing a common MOU to guide the implementation of DSSI, and publishing the MOU to ensure a common understanding between debtors and creditors;

- Second, the common MOU should provide clear debt transparency and public debt disclosure requirements which extend to the terms and conditions of public debt (including collateral as feasible) and which are based on a comprehensive statistical definition of public debt.

- Third, making a timely decision to extend the DSSI, which enables requests for DSSI in 2021 to come even before end 2020; and

- Fourth, adopting common procedures for country requests and other communications that ensure the IMF-WBG are fully informed about any delays in processing DSSI requests.

- Fifth, to maximize the ability of DSSI beneficiaries to continue providing extraordinary pandemic support to individuals and firms through health, social and economic spending, and in the spirit of fairness, G20 countries should take all possible steps to urge participation in DSSI by all private sector creditors under their jurisdiction, as well as by all bilateral public sector creditors, regardless of whether they are considered official bilateral, commercial or policy banks.

- Sixth, considering the existing DSSI repayments due in 2022-24, and the peaks in debt service schedules of the eligible countries, the G20 should also consider providing options for rescheduling terms while maintaining NPV neutrality, such as a longer grace period (up to four years) or a longer repayment period (up to six years), so that DSSI repayments do not exacerbate the peaks in debt service burdens and add to the challenges these countries face in managing their debt and debt service.

- Seventh, continued fiscal monitoring remains appropriate in 2021 to help ensure priority spending is protected to contain the longer-term economic and social costs from the pandemic and thereby support sustainability.

52. The G20 could also give consideration to the feasibility of modifying the design of DSSI in a targeted manner to ensure the DSSI addresses financing needs and supports an expeditious resolution of debt sustainability challenges. With debt vulnerabilities increasing, there are likely to be increased cases where debt becomes unsustainable. Allowing delays in the recognition of unsustainable debt would only deepen the difficulties that countries may face in the future. This suggests a need to bring in some safeguards to address debt sustainability risks. Most current DSSI participants would remain eligible in 2021 without further requirements. However, for the subset of countries with high debt vulnerabilities, the G20 could consider conditioning DSSI access in 2021 for countries at high risk of debt distress, or countries that have been assessed to be in an unsustainable debt situation, on requesting and working toward an IMF financing program aimed at reducing debt vulnerabilities and addressing debt levels where needed, which could provide such safeguards in a manner that protects participation in DSSI given the still-high financing needs of eligible countries. Broader issues would also need to be assessed in considering such an approach, including potential market implications for other DSSI-eligible countries. In addition, DSSI extension would be subject to a midterm review, which would assess progress in DSSI implementation together with any further steps appropriate to promote a timely transition to deeper debt treatments by DSSI beneficiaries where needed. To facilitate the efficient implementation of sovereign debt resolution, the Development Committee should consider asking the IMF and WB to develop by the end of 2020 a joint action plan for case-by-case debt restructuring in countries with unsustainable debt. It is important that public debt transparency is based on a comprehensive concept of public debt, including information on swap lines, and that it extends to borrowing terms, including information related to collateral.

53. Building on the DSSI, the G20 could facilitate more timely, efficient, and comprehensive sovereign debt resolutions, including for countries outside the DSSI perimeter to the benefit of debtor countries and the global economy. Some countries could require a strong and comprehensive debt treatment that provides, together with sound policies, a return to a path of sustained inclusive growth; indeed, a deep reduction in nominal debt stock may be needed to achieve a sustainable debt burden in low income countries hit the hardest.

54. Improvements in coordination among the major official creditors and clear expectations for involving the private sector could yield major economic and social benefits by reducing the duration of the restructuring process and ensuring that restructuring is broader and more durable. Accordingly, it is important that G20 creditors agree to coordinate in an efficient manner by determining principles that will guide their approach in specific country cases, such as in relation to the treatment of other creditors including commercial creditors, and on equitable burden sharing among G20 creditors. Drawing on the example of the DSSI, it could be useful for the G20 creditors to consider the adoption of a term sheet for sovereign debt resolution during the pandemic.

55. Strengthening debt management and debt transparency should be top priorities. With the current uncertain outlook for global growth, debt service needs to be carefully managed even for countries where debt remains sustainable. The World Bank–IMF multi-pronged approach provides a critical and comprehensive framework to help countries address debt vulnerabilities. In this regard, a forthcoming Board paper will lay out a holistic framework to strengthen debt management and help reduce vulnerabilities, including through capacity development to enhance recording and reporting. The World Bank will continue efforts to promote debt transparency, including increasing the level of detail included in the International Debt Statistics and encouraging Bank borrowing countries to transparently report on debt stocks and flows. The IMF and the World Bank will continue to encourage both creditors and debtors to provide full disclosure of the terms of debt restructuring, including of the rescheduling of any DSSI eligible debt.

Annex I. DSSI Eligibility and Participation

All DSSI eligible countries are listed. The 43 countries that have requested to participate as of September 18, 2020 are denoted by an asterisk (*).

AFRICA

Angola*	Benin	Burkina Faso*
Burundi*	Cameroon*	Cabo Verde*
C.A.R.*	Chad*	Comoros*
Congo, Democratic Rep. of*	Congo, Republic of*	Cote d'Ivoire*
Ethiopia*	Gambia, The*	Ghana
Guinea*	Guinea-Bissau	Kenya
Lesotho*	Liberia	Madagascar*
Malawi*	Mali*	Mauritania*
Mozambique*	Niger*	Nigeria
Rwanda	Sao Tome and Principe*	Senegal*
Sierra Leone*	Somalia	South Sudan
Tanzania*	Togo*	Uganda*
Zambia*		

EAST ASIA

Cambodia	Fiji	Kiribati
Lao, PDR	Marshall Islands	Micronesia
Mongolia	Myanmar*	Papua New Guinea*
Independent State of Samoa*	Solomon Islands	Timor-Leste
Tonga*	Tuvalu	Vanuatu

SOUTH ASIA

Afghanistan*	Bangladesh	Bhutan
Maldives*	Nepal*	Pakistan*

EUROPE AND CENTRAL ASIA

Kosovo	Kyrgyz Republic*	Moldova
Tajikistan*	Uzbekistan	

LATIN AMERICA AND CARIBBEAN

Dominica*	St. Vincent	Grenada*
Guyana	Haiti	Honduras
Nicaragua	St. Lucia*	

MIDDLE EAST AND NORTH AFRICA

Djibouti*	Yemen, Republic of*	

Annex II. Non-concessional Borrowing in the Context of the DSSI

A request for DSSI does not impose any new or additional limits on non-concessional borrowing to those that are already applicable under existing IMF arrangements or under applicable World Bank/IDA debt limit policies:

- When a country has an IMF-supported adjustment program, the debt limits prevailing under the program are the debt limits consistent with the DSSI. The absence of a debt limit in an IMF supported arrangement implies that no limit is required by the DSSI.

- From July 1, 2020 onward, all IDA countries will be subject to the Sustainable Development Finance Policy (SDFP). The SDFP is intended to incentivize IDA-eligible countries to move toward transparent and sustainable financing. In particular, countries will implement concrete Performance and Policy Actions (PPAs) to (i) strengthen debt transparency; (ii) enhance fiscal sustainability; and (iii) strengthen debt management. Examples of PPAs to foster debt transparency include disclosure of loan contract terms and payment schedules. Enhancing debt transparency will be critical to make sure additional fiscal space has significant development impacts.

Countries that are not required to have non-concessional borrowing ceilings under an IMF program or the SDFP will not need to implement ceilings under the DSSI.

Annex III. Debt Service Suspension Initiative—Term Sheet

Scope of Beneficiary Countries

All IDA-countries and all least developed countries as defined by the United Nations, that are current on any debt service to the IMF and the World Bank.

Setting the Right Incentives

Access to the initiative will be limited to countries which:
(i) have made a formal request for debt service suspension from creditors, and;
(ii) are benefiting from, or have made a request to IMF Management for, IMF financing including emergency facilities (RFI/RCF).
Each beneficiary country will be required to commit:

- to use the created fiscal space to increase social, health or economic spending in response to the crisis. A monitoring system is expected to be put in place by the IFIs;
- to disclose all public sector financial commitments (debt),[1] respecting commercially sensitive information. Technical Assistance is expected to be provided by the IFIs as appropriate to achieve this;
- to contract no new non-concessional debt during the suspension period, other than agreements under this initiative or in compliance with limits agreed under the IMF Debt Limit Policy (DLP) or WBG policy on non-concessional borrowing.

Scope of Creditors

All official bilateral creditors will participate in the initiative.
Private creditors will be called upon publicly to participate in the initiative on comparable terms.
Multilateral development banks will be asked to further explore options for the suspension of debt service payment over the suspension period, while maintaining their current rating and low cost of funding.

Duration of the Suspension of Payment

The suspension will last until end-2020.
Creditors will consider a possible extension during 2020, taking into account a report on the liquidity needs of eligible countries by the World Bank and IMF.

Perimeter of Maturities and Cut-off Date

The suspension period will start on May 1st, 2020.

[1]According to *Government Finance Statistics Manual 2014* (GFSM2014) definitions.

Both principal repayments and interest payments will be suspended.
A cut-off date protecting new financing in case of possible future restructuring will be set on March 24th, 2020.

Modalities for the Debt Service Suspension

The suspension of payments will be NPV-neutral.
The repayment period will be 3 years, with a one-year grace period (4 years total).
Treatment will be achieved either through rescheduling or refinancing.

Implementation Process

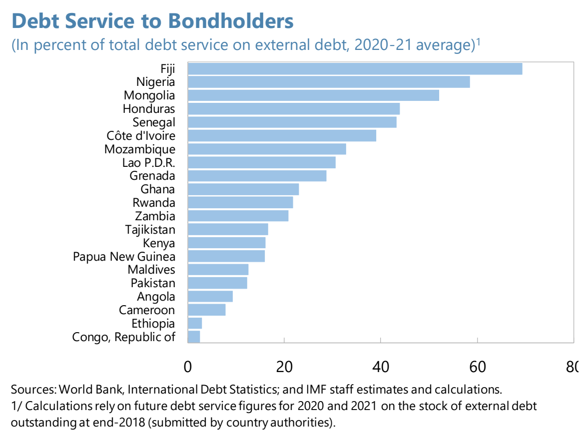
Creditors will implement, consistent with their national laws and internal procedures, the debt service suspension initiative as agreed in this term sheet to all eligible countries that make a request.
Creditors will continue to closely coordinate in the implementation phase of this initiative. If needed, creditors will complement the elements in this term sheet as appropriate.

Annex IV. Private Financing of DSSI-Eligible Countries[1]

Of the 73 DSSI-eligible countries, 23 economies have outstanding Eurobonds, totaling nearly US$71 billion at end-July 2020.[2] For these countries, bondholders constitute a large share of the external creditor base (Figure 1, left figure). The stock of Eurobonds is concentrated in a few economies with Nigeria, Ghana, Angola, Côte d'Ivoire, Kenya and Pakistan accounting for over 70 percent of the total amount. As a percentage of GDP, borrowing in the international bond market has been the highest for Mongolia (27 percent of 2019 GDP), Senegal (18 percent of GDP), and Ghana (15 percent of GDP) (Figure 1, right figure).

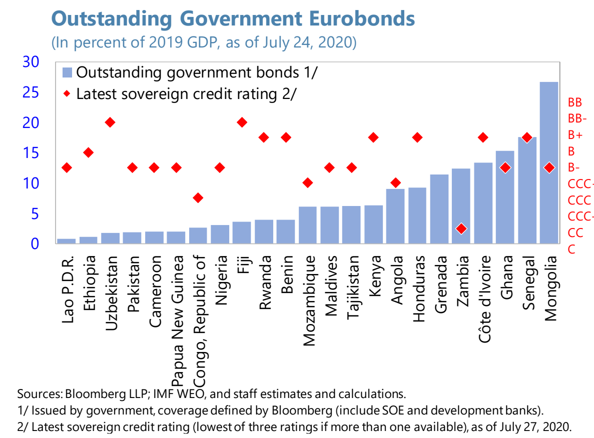
Figure AIV.1. DSSI-Eligible Countries: Contribution of Private Sector Financing

Significant portion of some DSSI-eligible countries' debt service is owed to private bondholders.



Source: World Bank, International Debt Statistics; and Fund staff estimates and calculations.
1/ Calculations rely on future debt service figures for 2020 and 2021 on the stock of external debt outstanding at end-2018 (submitted by country authorities).

DSSI-eligible countries' Eurobonds amount to about US$71 billion.



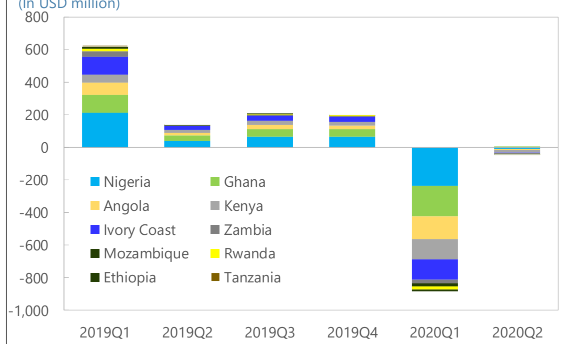
Source: Bloomberg LLP; IMF WEO, and Fund staff estimates and calculations.
1/ Issued by government, coverage defined by Bloomberg (include SOE and development banks).
2/ Latest sovereign credit rating (lowest of three ratings if more than one available), as of July 27, 2020.

The COVID-19 shock initially triggered massive capital outflows from emerging markets and low-income countries, before stabilizing. After a precipitous outflow in bond funds from some DSSI-eligible countries in 2020Q1, signs of stabilization appear to have emerged in Q2 (text chart).

[1] Private financing covers Eurobond issuance and syndicated loans in this annex.

[2] Includes Eurobonds issued by the government, as defined by Bloomberg. May include SOEs and development banks, among others.

Selected DSSI-Eligible Countries: Cross- Border Bond Flows
(In USD million)



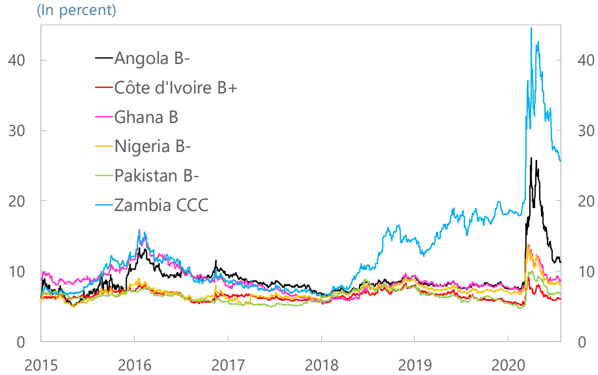
Sources: EPFR; and IMF staff estimates and calculations.

As market conditions began to stabilize in April, bond yields began to decline, but remain elevated for several DSSI-eligible economies. Greater risk aversion by international investors, coupled with debt vulnerabilities and a worsening economic environment due to the COVID-19 shock, pushed up the yields for non-investment grade issuers early in the crisis, thereby keeping many of them out of the market (Figure 2). Yield spreads on DSSI-eligible economies' 10-year bonds between B- and BBB- sovereigns rose from an average 3.3 percent at end-2019 to 9.3 percent by May 2020. Resumption of the search for yield, following the initiation of asset purchase programs of advanced economies' central banks, has helped lower interest rates, including for some non-investment grade DSSI-eligible issuers.

Figure AIV.2. DSSI-Eligible Countries: Yields and Spreads

The COVID-19 pandemic led to a considerable spike in sovereign yields on DSSI-eligible bonds, …

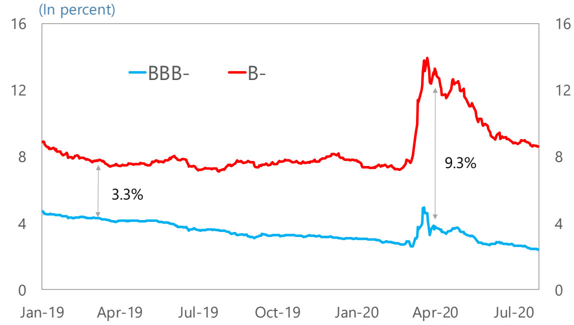
DSSI-Eligible Countries: EMBIG Sovereign Yields
(In percent)



Sources: Bloomberg LLP; and Fund staff estimates and calculations.

… with yield spreads on 10-year bonds between B- and BBB- rated sovereigns rising from an average of 3.3 percent at end-2019 to 9.3 percent by May 2020.

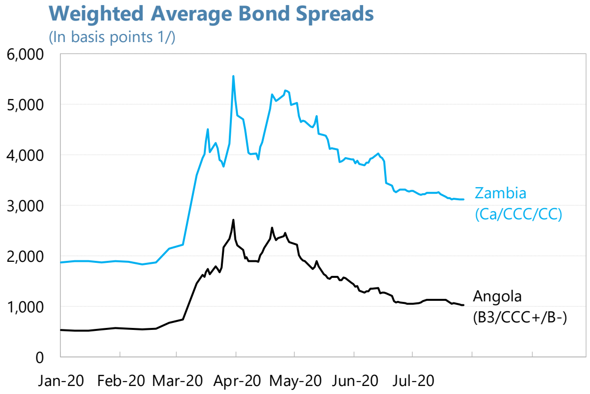
DSSI-Eligible Countries:
USD 10-Year Sovereign Bond Yields: BBB- vs. B-
(In percent)



Sources: Bloomberg LLP, and Fund staff estimates and calculations.

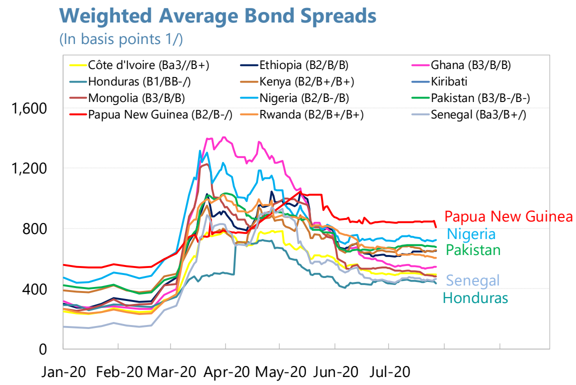
Figure AIV.2. DSSI-Eligible Countries: Yields and Spreads (concluded)

Zambia and Angola continue to show signs of debt distress, as average weighted bond spreads remain above 1,000 bps.



Source: Bloomberg LLP; and Fund staff estimates and calculations.
1/ (Moody's/S&P/Fitch) sovereign credit rating as of July 30, 2020.

While bond spreads for many other DSSI-eligible countries have declined, several countries' bond spreads remain above the pre-crisis level.



Source: Bloomberg LLP; and Fund staff estimates and calculations.
1/ (Moody's/S&P/Fitch) sovereign credit rating as of July 30, 2020.

Elevated bond yields and spreads continue to make access to international capital markets prohibitively expensive for lower-rated non-investment grade issuers. Secondary market sovereign bond yields vary significantly by country, partly reflecting each country's economic, debt and financial situation. For countries experiencing bouts of distress, such as Zambia and Angola, bond spreads remain prohibitively high – above 1,000 bps. For several other countries, bond spreads have declined markedly from the peak levels, but remain above the pre-crisis level, particularly for the lower-rated economies (Figure 2). This makes it difficult to raise funds in the international capital markets, limiting the sovereign's borrowing from private investors.

Since the onset of COVID-19, many DSSI-eligible countries have seen several sovereign credit rating and outlook downgrades (text table). Most DSSI-eligible countries do not have a sovereign credit rating. Others—mostly those who have previously accessed the international capital markets—carry non-investment grade ratings, ranging from BB- (Fiji, Bangladesh, Uzbekistan) to CC (Zambia). Several rating and outlook downgrades have taken place this year, largely reflecting growing financing needs and deteriorating fiscal position stemming from the COVID-19 pandemic (Table 1). Five countries—Ethiopia, Pakistan, Cameroon, Senegal and Côte d'Ivoire—were placed by the Moody's credit rating agency under review for downgrade in May and June after they requested bilateral debt service suspension from G20 creditors. The decision reflected fears that DSSI participation raises the risk of losses for private investors, since the G20 has called on private-sector creditors to offer comparable terms, which subsequently could lead to losses to private creditors in the short and medium run.[3] Upon completing the review on 7 August 2020, neither country received

[3]See Hogson, C., 20 July 2020, "Moody's Clashes with UN under G20 Debt Relief Efforts". Available at: https://www.ft.com/content/7d51d373-c12e-4440-a408-e61a939e3a3c

a rating downgrade, but Senegal and Ethiopia were placed on negative outlook. While Moody's continues to believe that the ongoing implementation of DSSI poses risks to private creditors, it concluded that the previous ratings already reflected the risks adequately.

Table AIV.1. DSSI-Eligible Countries: Sovereign Credit Rating Changes in 2020

Country	Moody's						S&P					Fitch				
	Credit Rating						Credit Rating					Credit Rating				
	Previous			New			Previous		New			Previous		New		
	Rating	Outlook	Date	Rating	Outlook	Date	Rating	Outlook	Rating	Outlook	Date	Rating	Outlook	Rating	Outlook	Date
Angola	B3	Stable	4/27/2018	B3	Under review	3/31/2020	B-	Negative	CCC+	Stable	3/26/2020	B	Negative	B-	Stable	3/6/2020
Cape Verde												B	Positive	B-	Stable	4/17/2020
Cameroon	B2	Under review	5/27/2020	B2	Stable	8/7/2020	B	Negative	B-	Stable	4/10/2020					
Ivory Coast	Ba3	Under review	6/12/2020	Ba3	Stable	8/7/2020										
Ethiopia	B2	Under review	5/7/2020	B2	Negative	8/7/2020										
Lao P.D.R.	B3	Under review	6/19/2020	Caa2	Negative	8/14/2020						B-	Stable	B-	Negative	5/15/2020
Maldives	B2	Negative		B3	Negative	5/21/2020										
Nicaragua	B2	Negative		B3	Stable	2/14/2020										
Nigeria							B	Negative	B-	Stable	3/26/2020	B+	Negative	B	Negative	4/6/2020
Pakistan	B3	Under review	5/14/2020	B3	Stable	8/7/2020										
Papua New Guinea							B	Stable	B-	Stable	4/28/2020					
Senegal	Ba3	Under review	6/12/2020	Ba3	Negative	8/7/2020										
Republic of Zambia	Caa2	Negative		Ca	Stable	4/3/2020	CCC+	Stable	CCC	Negative	2/21/2020	CCC	Negative	CC	n/a	4/16/2020

Source: Bloomberg LLP; and Fund staff estimates and calculations.
Note: Changes highlighted in blue. Data as of August 20, 2020.

In the first half of 2020, private financing of DSSI-eligible countries amounted to about $6.5 billion, well below the 2016-19 average ($10.7 billion, over the same period). Only one DSSI-eligible country has issued a Eurobond post-COVID-19 (Honduras), and several economies received syndicated loans, albeit of smaller amounts. This contrasts with some non-DSSI lower-rated issuers, which continued to tap the international capital markets in 2020 (Albania B+, Belarus B, Jordan B+, El Salvador B-, Ukraine B, etc).

Compared to the previous four years, DSSI- eligible countries have raised less private financing in 2020 (Figure 3). Only two countries have issued Eurobonds in 2020: Ghana (pre-COVID), and Honduras.

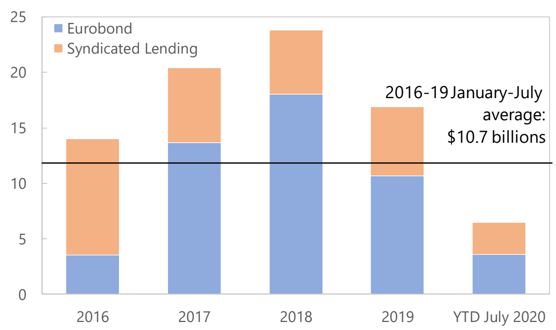
- Taking advantage of the near-perfect issuing conditions in early 2020 (pre-COVID), *Ghana* (B3/B/B) returned to the international bond market after less than a year's absence with a US$3 billion amortizing triple-tranche issue on 4 February 2020. The issue was oversubscribed about 4.7 times.

- Following the completion of the IMF's Second Review Under SBA and SCF Arrangement and the approval of the augmentation of access to support Honduras' COVID-19 measures, *Honduras* (B1/BB-/) returned to the international markets after a 3-year absence to issue a US$600m 10-year deal at 5.625 percent coupon. The country received a positive response from investors with high-yield appetites, with books seven times oversubscribed. Honduras has an upcoming US$500 million issue maturing later this year on 16 December 2020.

Figure AIV.3. DSSI-Eligible Countries: Sovereign Eurobond and Syndicated Loan Issuance

2020 to date, Eurobond and syndicated loan issuance by DSSI-eligible countries has fallen short of the 2016–19 January-July average.

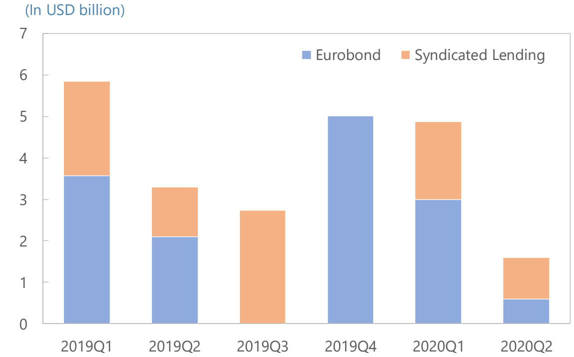
DSSI-Eligible Countries: Government Private Financing
(In USD billion)



Source: Dealogic; BondRadar; Bloomberg LLP; and Fund staff estimates and calculations.

With a large portion of this year's issuance taking place pre-COVID-19 (January and February).

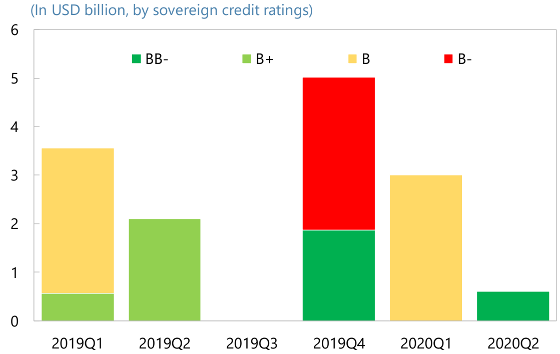
DSSI-Eligible Countries: Government Private Financing
(In USD billion)



Source: Dealogic; BondRadar; Bloomberg LLP; and Fund staff estimates and calculations.

Only one DSSI-eligible country has issued Eurobonds since the start of the pandemic: Honduras ("BB-" rated) in June.

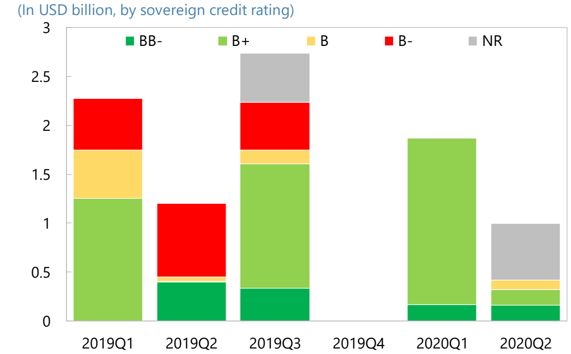
DSSI-Eligible Countries: Government Bond Issuance
(In USD billion, by sovereign credit ratings)



Source: Dealogic; BondRadar; Bloomberg LLP; and Fund staff estimates and calculations.

More countries were able to access syndicated loans in 2020Q2: Côte d'Ivoire, Senegal, Ghana, Lao PDR, and Malawi.

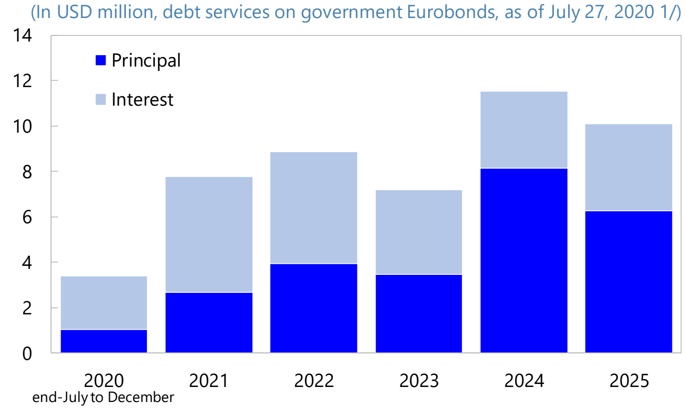
DSSI-Eligible Countries: Syndicated Loan Issuance
(In USD billion, by sovereign credit rating)



Source: Dealogic; BondRadar; Bloomberg LLP; and Fund staff estimates and calculations.

The 23 DSSI-eligible countries with outstanding Eurobonds have about US$3.4 billion in bond debt service payments coming up between end-July and December of 2020. This includes about US$1 billion in principal and US$2.4 billion in interest payments (text chart).

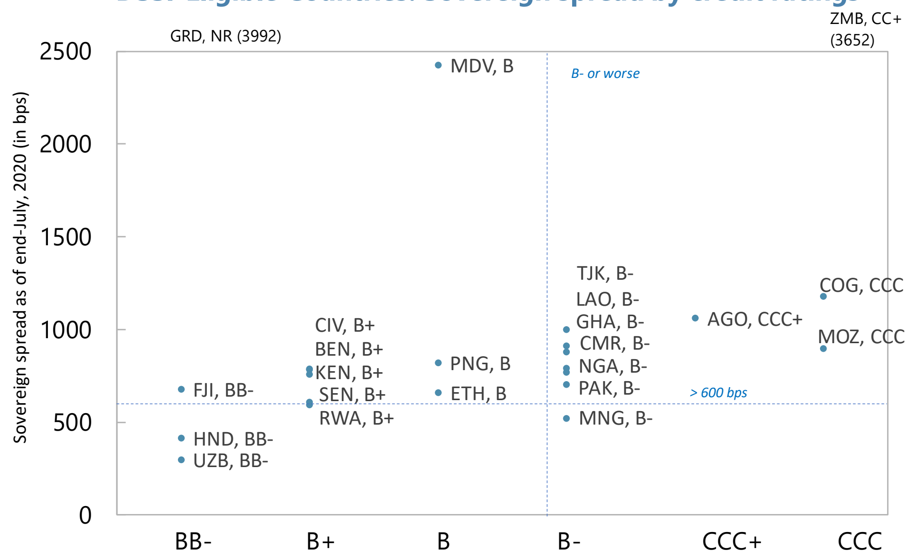
Projected Debt Service on Eurobonds
(In USD million, debt services on government Eurobonds, as of July 27, 2020 1/)



Sources: Bloomberg LLP; and IMF staff estimates and calculations.
1/ Includes 23 DSSI-eligible countries. Eurobonds issued by government, coverage defined by Bloomberg (include SOE and development banks).

Given current ratings and spreads, market access for most DSSI-eligible countries' market access currently appears limited. Historically, there has been no issuance by a CCC+ or lower rated countries and very limited issuance at spread above 600 bps during the past 20 years. While 11 countries of 23 DSSI-eligible countries with credit ratings are rated B or higher, only 4 countries are trading at spreads below 600 basis points. Under current condition, new bond issuance and access to syndicated loans is likely to be very limited.

DSSI-Eligible Countries: Sovereign spread by credit ratings



Source: Bloomberg.

Future market conditions will largely determine the prospect of how fast non-investment grade sovereigns can recover their market access to deal with redemptions falling due in 2021. Elevated bond yields have made access to international capital markets prohibitively expensive for some lower-rated non-investment grade issuers. However, continued easing of market conditions amid global resumption of the search for yield, fueled by advanced economies' large asset purchase programs, could help open up issuance prospects for non-investment grade issuers.