INTRODUCTION

- COVID-19 presents extreme challenge to emerging markets
  - Emerging markets (EM): developing countries becoming more engaged with global markets as they grow
    - EM example: Argentina, Mexico, Brazil, Chile, India, Russia, China...
  - Limitation on policy tools
  - Benefit from international debt relief program
  - Recovery and vaccine
DEATH TOLL in EMs

- World highest COVID-19 death toll: U.S. (596k), Brazil (423k), India (253k), Mexico (219k)
- Likely many more actual death (excess/official deaths=2 in Turkey, 15 in Ecuador)

Daily new confirmed COVID-19 deaths per million people
Shown is the rolling 7-day average. Limited testing and challenges in the attribution of the cause of death means that the number of confirmed deaths may not be an accurate count of the true number of deaths from COVID-19.

Source: Johns Hopkins University CSSE COVID-19 Data
CHALLENGE for EMs

- Reduction of work activities due to lockdown/social distancing
- Lower trade/tourism from developed countries
- Lower remittance
- Larger informal sector

Data from google mobility
Emerging markets face deeper recession and slower recovery.

Source: IMF staff estimates.
Note: Per capita real GDP (2017 purchasing-power-parity dollars) is used in the calculations. AEs = advanced economies; EMs = emerging market economies; LIDCs = low-income developing countries; WEO = World Economic Outlook.
Policies in Emerging Markets

- **Monetary policy**
  - Risk of high inflation
  - Central banks gain independence after 2000, for example Brazil and Mexico

- **Fiscal policy**
  - Recurring debt crises historically
    - Latin America debt crises 1980s
  - Rising debt burden and debt service cost after pandemic
RISING SOVEREIGN SPREADS

- CDS spreads: reflect sovereign default risk; affect borrowing cost of a country

- Argentina, Ecuador, and Lebanon had defaulted in 2020

Data: daily CDS spreads in 2020
ROLE OF FINANCIAL MARKETS

- Default risk increases borrowing cost, allows for lower lockdown, generates larger death toll (0.15% of population)
- With perfect financial market, death toll reduces to 0.05%

From Arellano, Bai, and Mihalache (2021)
GREAT DEBT SPIKES

- Advanced economy (AE) and EM face debt spikes.
- AE low interest rate.
- Different debt intolerance for AE and EM.
HIGH DEBT SERVICING COST IN EMs
DOMESTIC SOVEREIGN BOND HOLDINGS

- Domestic banks absorbed the bulk of increases in domestic debt.
- Sovereign default or inflation would lower bank value and hurt domestic production through bank’s balance-sheet effect.

Unit: billions of US dollars, IMF global financial report. Based on 11 EM. Domestic debt primarily in local currency.
CHINESE BANKS: DEBT SPREAD

- China recovered rapidly
- However, domestic debt becomes risk and vulnerable

Unit: basis points, IMF global financial report
DEBT RELIEF PROGRAM

- Suppose international institution grants 10% loan/GDP with low interest.
- Debt relief reduces debt crisis by 2 years and reduce death toll by 2%.
- Country gains by 7.5% and lenders 4.7% in terms borrower’s GDP.

<table>
<thead>
<tr>
<th></th>
<th>50% Debt</th>
<th>Loan Program 60% Debt (baseline)</th>
<th>70% Debt</th>
<th>Voluntary Restructuring 60% to 51%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country welfare gains (% output)</td>
<td>5.4</td>
<td>7.5</td>
<td>7.4</td>
<td>10.6</td>
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<tr>
<td>Debt crisis: length reduction (years)</td>
<td>0.2</td>
<td>2</td>
<td>3</td>
<td>2</td>
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<tr>
<td>Debt crisis: max spread reduction (%)</td>
<td>0.4</td>
<td>4.2</td>
<td>7.5</td>
<td>4.1</td>
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<tr>
<td>Health crisis: deaths prevented (% deaths)</td>
<td>11.5</td>
<td>2.1</td>
<td>2.3</td>
<td>1.1</td>
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<tr>
<td>Lenders gains (% output)</td>
<td>0.4</td>
<td>4.7</td>
<td>6.6</td>
<td>0</td>
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VACCINE in EMs

- Vaccination campaigns against COVID-19 in many EMs have lagged behind

- WHO backed COVAX program
RECOVERY

• International aids are important
• The format is even more important: vaccine + debt relief
• Emerging market debt crisis can have major impact on developed countries