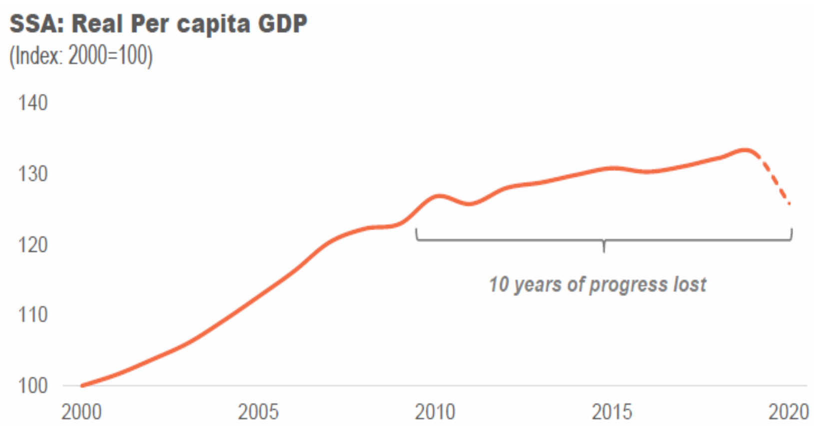
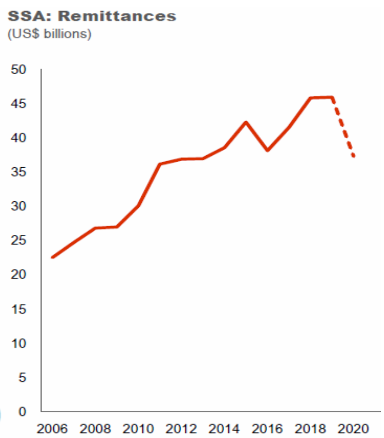
Breakout Session I:
Sustainable Finance for Africa Development

Where do we stand and what do the statistics tell us?

The COVID-19 pandemic has created severe disruptions in the global financial system, with strong impacts on all economies, advanced, emerging and developing. All growth and fiscal balance forecasts have been revised downward, creating liquidity issues for many countries. However, this challenge is particularly acute for developing countries, especially in Sub-Saharan Africa (SSA) where the World Bank and IMF estimate that 10 years of real GDP per capita gains will be lost in 2020 with a 6.7% decline. An increase in extreme poverty is also expected, as the World Bank estimates that 40 to 60 million people will fall into extreme poverty (under $1.90/day) in 2020, compared to 2019, as a result of the COVID-19 pandemic. This setback can have long-term effects in a region that was confronted even before the crisis to major financing needs to reach the Sustainable Development Goals (SDGs) in 2030.

Sub-Saharan African countries thus face two kinds of challenges exacerbated by the crisis: (i) a short-term liquidity issue to maintain functioning States while managing capital flows volatility, collapsing tax revenues (70 Bn$ lost according to the IMF), and reduction in export revenues (in particular for commodity exporters) and remittances; (ii) a medium-to long-term challenge of a permanent damage to their economies, in particular potential longer-term scarring in the private sector, including severely affected economic sectors (air transport, tourism among many), as well as limited availability of resources to foster financing for development with the view to achieve the SDGs.





Source: IMF and World Bank.

Emergency responses have focused so far on the short-term liquidity issue

To address the short-term liquidity challenge, the international community has deployed two main response mechanisms: emergency financing and debt service suspension. The IMF, World Bank and Regional Development Banks have strongly increased their available resources for emergency programs and have already approved a large number of programs. For example, 90 countries have made emergency financing requests to the IMF. As of 29 June 2020, the IMF Executive Board has already approved 72 requests for emergency financing for a total amount of SDR 18.2 billion (equivalent to $24.9 billion) out of which 31 countries and SDR 7.5 billion in SSA (equivalent to $10.2 billion). Multilateral and Bilateral Development banks have provided budgetary support and accelerated disbursements of projects, especially in the health sector.

Debt service alleviation was also used to reduce liquidity shortages in the poorest countries, most of them in Africa. G20 and Paris Club members, as well as some Gulf creditors (United Arab Emirates and Kuwait) have announced on 15 April 2020 a debt service suspension initiative (DSSI) until the end of 2020. The DSSI preserves the net present value of the debts concerned, through refinancing or rescheduling over a short time period (4 years, including a one-year grace period). The historic DSSI, in its second month of implementation, has received a total of 41 applications, 26 of which are from African countries. The initiative stands to benefit 73 eligible countries from the International Development Association's countries and the least developed countries as defined by the United Nations - including 38 in Africa. The DSSI is currently being rapidly implemented by official bilateral creditors. Private creditors have been called upon to participate in this initiative on comparable terms and on a voluntary basis. Requesting the DSSI from official bilateral creditors does not oblige beneficiary countries to make the same request to private creditors. The possibility for multilateral creditors to participate in the initiative is also under consideration. Some 27 countries also benefit from grants to cover their IMF maturity and interest payments through the Catastrophe Containment and Relief Trust.

Possible ways forward:

To address medium to long-term challenges to SSA economies, a multi-pronged approach seems necessary.

First, monitoring DSSI implementation and assessing the need for possible additional debt treatment: the immediate response provided by the DSSI should be assessed and its possible follow-up envisaged. The IMF and World Bank are expected to provide an updated analysis of the liquidity needs in the Fall. This will help inform a decision by creditors on extending the debt service suspension beyond end 2020 to further support any liquidity shortages. In addition, the DSSI will give more time to IMF and World Bank to update their debt sustainability analysis of DSSI beneficiary countries, taking into account the disclosure of all the financial commitments of their public sector. The analysis will illustrate the extent to which support beyond DSSI may be needed. Some countries may not need additional debt treatment to the DSSI, especially if it is extended. Other countries may need more extended financing support, such as a rescheduling that is NPV-neutral. However, there may be a significant number of countries where debt can only become again sustainable through a deeper stock treatment. For this third category of countries, restructuring of debt, including both official and private debt, would be necessary, and would have to be undertaken on a case-by-case basis and through a multilateral approach, including a sound medium-term macroeconomic framework and appropriate conditionality. The G20 will continue advancing DSSI and debt-related transparency initiatives, including improved public reporting, the IMF-World Bank debt reconciliation exercise, and the IMF-World Bank fiscal monitoring framework.

Second, preserving and restoring countries' market access: Another important factor for SSA countries' future prosperity will be to preserve or even restore market access for countries that have already a track record on this regard. For African countries who had access to international debt markets prior to the crisis, IFIs can help preserve or restore market access by contributing to building a solid macroeconomic framework, supported by sound economic policies. In addition, MDBs could provide temporary credit enhancement instruments, like partial sovereign guarantees, to buttress investor confidence and anchor bond rates at a sustainable level. Those instruments could be used in a limited time period, for instance until end 2021. Other instruments, such as SPVs, could play a role to restore investor confidence and reverse capital outflows. Besides, as external positions of many countries will remain durably weakened, there is a strong rationale for accelerating the development of domestic capital markets, and domestic sovereign bond markets in particular. IFIs have a role to play in helping countries implement the right set of financial sector policies, allowing for the deepening of financial market, the development of a domestic secondary market and investor base and on the longer term to foster the liquidity of foreign exchange markets.

Third, fostering development financing and private flows: against a backdrop of a post-crisis world where budgetary resources available in donor countries will remain scarce, a key objective to foster financing for development must be to develop even further than envisaged so far the private sector's contribution to the financing of African development. In a post-crisis environment, risk aversion tends to increase so that private financing can dry out. To avoid this volatility in private sector financing flows, MDBs could focus some of their interventions on de-risking private sector investments by providing co-financing and credit enhancement instruments or by playing a catalytic role for private investment. Strengthening business environments in SSA countries will also be key to attract private sector financing, especially the stability and clarity of investment and tax frameworks. Efforts of technical assistance will be useful in this regard, as well as on the development of innovative project financing and PPPs.

Fourth, supporting SMEs: Last but not least, supporting the African private sector itself, especially SMEs, will be a key element for the development and prosperity of SSA economies. After years of development, the current crisis, with lockdowns and collapsing trade flows, endanger the viability of large numbers of SMEs, almost all of whom are locally owned and operated. Just as the countries themselves, African SMEs face both a liquidity and a long-term sustainability issue. Supporting them could mean for example providing liquidity by refinancing them or by guaranteeing new loans provided by private banks or public development banks. Long-term support would rely on national stimulus plans or sectoral support that could be supported by multilateral or bilateral donors.

Breakout Session II:

Policy options to tackle the current situation and support the return of capital flows to emerging economies

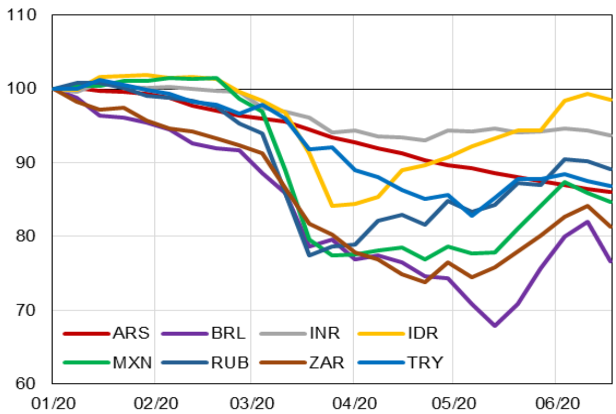
Where do we stand and what do the statistics tell us?

The global health crisis resulted in a multi-faceted shock in emerging and developing countries. As the Covid-19 epidemic evolved into a global pandemic and risk aversion escalated, emerging market and developing economies suffered a multitude of shocks. The price of oil and some other commodities collapsed, while global financial conditions tightened markedly, most notably with the access to dollar funding becoming scarcer. In this context, emerging market economies (EMEs) experienced a sudden stop and a reversal of capital flows, exchange rates of the main emerging market economies depreciated significantly, and sovereign bond spreads came under pressure.

What seems different this time around is the sheer scale and speed of the outflows. According to estimates from the Institute of International Finance (IIF), more than USD 80 bn were repatriated from emerging markets in the month of March alone, with total portfolio outflows in excess of USD 100 bn between February and early-June. The Covid-19 related capital flight from emerging market economies has therefore been more acute than during similar episodes in recent history, including the Global Financial Crisis of 2008, the Taper Tantrum of 2013 or the Chinese stock market turbulences episode of 2015-16, and its impact on EMEs has been differentiated, with oil exporters, highly indebted and frontier countries being more affected. Regarding foreign direct investment, inflows are also forecast to decline drastically, reflecting both the impact of lockdowns on the real economy as well as a fall in reinvested earnings, as earnings fall and companies put greenfield projects on hold during the crisis.

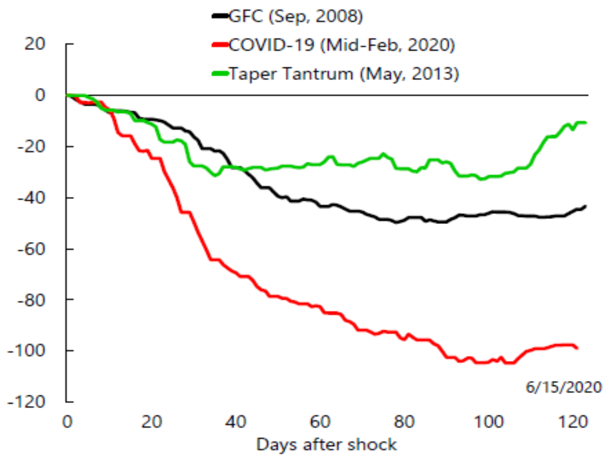
Figure 1. Covid-19 exchange rate shock and capital outflows.

A. EM exchange rates, Jan 1st = 100



Source**:** Refinitiv, Institute of International Finance, FMI.

B. Portfolio flows, USD bn

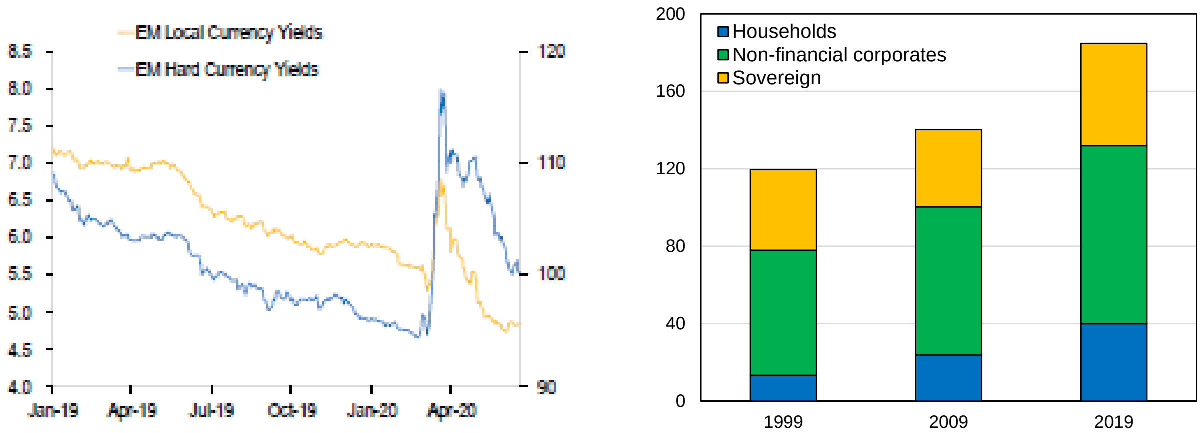


The situation is showing early signs of stabilization and overall market sentiment has improved. Since the peak of financial market turbulence in March, most emerging market currencies have started to recover from their troughs, credit spreads have narrowed, and global financing conditions have eased significantly. High-frequency data even points to a stabilization of capital outflows from emerging markets in May. Where applicable, emerging market countries have used the flexibility of their exchange rate as their first line of defense, have intervened on the FX exchange markets and have provided liquidity. However, the use of Capital Flow Measures (CFMs), especially on outflows, has been very limited so far. Market sentiment has been in particular bolstered by the unprecedented central bank measures, such as the extension of new swap lines by the US Federal Reserve, across-the-board policy rate cuts or unconventional monetary policies in emerging countries, by massive fiscal and financial packages, and by the early signs of the pandemic being brought under control in some regions. International financial institutions (IFIs) have reacted promptly to the crisis with an unprecedented package of emergency financing. The financial support presented by the World Bank Group and the other MDBs amounted to a total of more than US$ 300 billion of financing for emerging and low-income countries. This included (i) targeted investment programs in the health sector in coordination with specialized institutions such as the WHO, (ii) support to the poorest through safety nets and cash transfer programs, (iii) emergency fiscal support to affected countries, notably through general and sectorial budget supports consistent with IMF programs, (iv) support to private sector, including companies and financial institutions, notably through trade finance, liquidity and working capital programs.

Nevertheless, risks remain tilted to the downside and pre-existing vulnerabilities could be brought into materialization because of the Covid-19 pandemic. Emerging market economies now have lower fiscal, monetary and external space than before the crisis, and thus have less buffers to absorb future shocks. For example, a second epidemic wave or a longer-than-expected slump in economic activity could bring new bouts of volatility and lead to a repricing of risk on financial markets, with many adverse impacts on emerging and developing economies, including a tightening of financial conditions that could exacerbate the already unprecedented growth shock. Furthermore, the high levels of corporate and household debt – already at historical highs pre-Covid-19 – could lead to defaults and insolvencies in case of a sluggish recovery, thereby putting a strain on the overall soundness of banking systems, while further ratings downgrades could lead to an exacerbation of capital outflows.

Figure 2. Market sentiment towards emerging markets has improved, but risks remain

A. EM sovereign spreads **B. EM debt**, % of GDP



Source: Refinitiv, MSCI, Institute of International Finance, IMF GFSR update.

Possible ways forward:

The focus should gradually transition toward ensuring that the IFIs' toolkit is adapted to the new phase of the crisis and is well coordinated among themselves and with other actors.

The IMF instruments that provide rapid financing have been quickly deployed and will continue to be in the coming months. A temporary increase in access levels will be considered by the IMF Board in the coming weeks. However, in the next few months, as countries are likely to require more comprehensive, longer-term, follow-up arrangements with the IMF, the IMF should reflect on the most adequate tools, policies and levels of financing to put in place. This reflection should ensure that countries are best able to cope with the next phase of the crisis and build resilient macroeconomic frameworks. Accelerating the ongoing reflection on SDR would prove to be a useful complement to this approach.

Over the past several months, the IMF has also extended the use of its precautionary lines to new countries, notably in Latin America, and has created a new IMF short-term liquidity line to help countries with strong fundamentals deal with external shocks. The development of this type of instrument also aims to avoid stigma that could accentuate the outflows of capital from emerging and developing economies. In the coming months, it will be very useful to assess the appetite for these instruments, and whether they are well suited to every country circumstance.

These elements are part of a series of tools put in place by the international community to provide liquidity support. Also included in this toolbox is the G20 debt service suspension initiative for the most fragile countries (DSSI), as well as the other components of the global financial safety net, such as the Regional Financing Agreements and the swap and repo agreements between central banks. Ensuring adequate coordination and complementarity between the different components of the global financial safety nets, will be essential.

EMEs have some policy options to mitigate the impact of volatile capital flow movements if a second epidemic wave were to materialize. Where applicable, EMEs should rely on the flexibility of their exchange rates, with central banks standing ready to intervene on FX markets to address disorderly market conditions where reserve are adequate. Maintaining liquidity provision measures and temporarily lowering macro-prudential buffers, especially currency-based, could help limit insolvencies and FX liquidity risk that would exacerbate the economic shock. Forward guidance and unconventional monetary policy, such as asset purchase programs, could contribute to sustain market functioning in case of stress, while securing access to more layers of the global financial safety net, where applicable, could help EMEs guarantee financing from a wider array of sources. Capital flow measures could also be considered to fend-off excessive volatility and capital outflow that raise crisis risks, to the extent that they are transparent and temporary. Finally, EMEs could seek external financing, including from the IMF and multilateral development banks to engineer a more gradual adjustment to the crisis.

Facilitating flow of remittances: Contractions in major economies have substantially reduced remittance inflows to emerging markets and developing economies. These flows are a key source of foreign funding and support for household incomes in many LICs. The G20 aims to solve issues surrounding cross-border payment arrangements, taking into account the needs of both senders and recipients of remittances as well as regulatory and technological aspects.

Breakout Session III:

Building further resilience and more sustainable sources of financing for the future

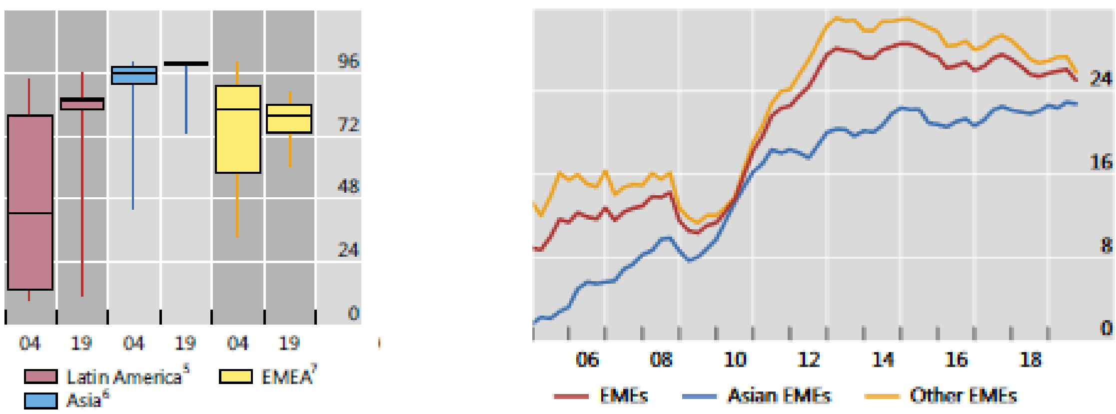
Where do we stand and what do the statistics tell us?

Emerging market economies (EMEs) have largely eliminated the currency mismatch on their sovereign debt. In the 1990s, the issuance of debt instruments in foreign currency (mostly in dollar) and the resulting currency mismatch translated into financial and debt crises in emerging market economies. Consequently, EMEs increasingly issued local currency sovereign bonds, a trend that has gained momentum in the past decade as EME assets in local currency were met with growing demand by international investors, especially as the search for yield accelerated amid accommodative monetary policies in advanced countries. Today, local currency sovereign bonds account for the majority of issuances in EMEs, and non-resident ownership of these assets account for ¼ of the total.

Figure 1. Local currency borrowing and foreign ownership of local currency sovereign bonds in emerging market economies

A. Local currency denominated debt (% of total debt)

B. Foreign ownership (% of total debt)



Note: On panel A, the box and whisker plots show the median and interquartile range in 2004 and 2019.

Source**:** Bank for International Settlements, Institute of International Finance.

Yet, the currency risk has not disappeared and emerging market economies remain exposed to a pro-cyclical feedback loop between exchange rate, bond spreads and capital outflows. First of all, a large share of EME corporate bonds is still denominated in foreign currency. On the sovereign bond market, where local currency issuance now represents the lion's share, vulnerabilities stem from the combination of the large presence of non-resident portfolio investors and the fact that these investors are largely unhedged against EME currency fluctuations. In practice, this means that exchange rate depreciations of an EME currency amplify investors' losses when evaluated in foreign currency terms, potentially leading to a repricing of risk on financial markets (*i.e.* higher bond spreads) and, ultimately, capital outflows. As these outflows tend to intensify in times of stress, they can give rise to a mutually reinforcing pattern of currency depreciation and tighter financing conditions.

Possible ways forward:

Further development of local currency bond markets, including for corporates, as well as the constitution of a larger base of local investors could help emerging market economies mitigate the volatility of capital flows. Reflecting a smaller base of local investors in emerging market economies, the development of local currency bond markets has been accompanied by a greater reliance on non-resident portfolio investors. Yet, as BIS research[3] on the COVID-19 financial shock highlighted, a higher share of foreign participation in local currency sovereign bond markets tends to be associated with stronger movements in bond spreads. Strengthening domestic revenue mobilization – through the constitution of a larger base of local institutional investor – together with attracting more stable sources of financing such as Foreign Direct Investment (FDI) can contribute to alleviate EME dependence on more volatile sources of financing like portfolio flows. This endeavor is a priority of the Saudi G20 presidency. In parallel, the development of broader capital markets, such as derivatives and repo markets, notably for FX operations and on longer maturities, could make it easier for investors to hedge for currency fluctuations and could support broader EME financial market liquidity, therefore limiting asset price volatility. Other instruments, such as sovereign GDP- or inflation-linked bonds, could be considered to shockproof EME economies against capital flow movements in crises times.

Experience shows that in order to enhance the potential for capital markets development, countries need to meet minimum preconditions that go beyond the establishment of a local institutional investor base and include, among others, sound macroeconomic environment, strong institutions and a minimal level of financial sector development. Moreover, reform implementation requires a comprehensive approach that addresses a range of inter-related areas (e.g. money markets, regulations, yield curve development, market infrastructure) while connecting advisory and downstream activities for actual mobilization of investments. Following lessons from years of country field experiences, this comprehensive approach has been adopted by the World Bank Group through its Joint

[3] BIS Bulletin No 5 « Emerging market economy exchange rates and local currency bond markets amid the Covid-19 pandemic », April 2020.

Capital Market program (J-CAP), bringing together the World Bank and IFC on the design and implementation of capital markets reforms.

Sound policy frameworks and multilateral fora also have a role to play. As past crises highlighted, FX reserves can help central banks mitigate excessive currency depreciation and prevent significant capital outflows, while well-anchored inflation expectations can help limit the pass-through of exchange rate depreciations onto inflation. A wider use of macro-prudential policy in EMEs could also contribute to enhancing the resilience of the financial system to capital flow volatility. The IMF's ongoing work on the Integrated Policy Framework, that aims at leveraging complementarities between monetary and exchange rate policies as well as macro-prudential and capital flows measures, could prove useful in guiding policy in emerging market economies. In tandem with the IMF's Institutional View on capital flows, the OECD's recently revised Capital Movements Code, as a multilateral agreement dedicated to open and orderly capital movements, serves as a platform for sharing best practices on this topic, including ways to avoid negative spillovers and unnecessary market fragmentation that could hinder the economic recovery.