

Emerging Market Debt Risk: Are We Ready for the Next Crisis?

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Flawed AME Policies Prior to the Great Financial Crisis

- Failure to recognize positive supply shocks
- Asymmetric monetary policies, cycle after cycle
- Asymmetric fiscal policies, cycle after cycle
- Inadequate structural reforms
- Excessive deregulation of the financial system

Flawed AME Policies After the Great Financial Crisis

- Initial global response appropriate
- Subsequently, too much reliance on monetary policy
- Which has been unexpectedly ineffective
- Allowing dangerous side effects to build up over a decade
- Rising debt ratios are critical but also other AME “imbalances”
- That will trigger or amplify the next global downturn

Dangerous “Spillover” Effects on EMEs

- Significant capital inflows from 2004 to 2014
- Pre-crisis driven by bank “procyclicality”
- Post-crisis largely driven by the search for yield
- Strong resistance to exchange rate appreciation
- Leading to “imbalances” in EMEs and weaker structural reforms
- EMEs are now “part of the global problem”

Special Factors Aggravating EME Vulnerability

- Major expansion in corporate bond debt
- Major expansion in bond debt of SOE's
- Risks associated with funding in dollars
- All increase vulnerability of EME sovereigns and financial institutions
- ESG goals raise the need for new finance
- Secular forces slowing EME growth

Domestic Polices Needed for Crisis Prevention

- Structural reforms in both real and financial sectors
- Better debt reporting and analysis of growing vulnerabilities
- Improve fiscal frameworks and SOE governance
- Strengthen capital flow management and macroprudential tools

International Policies Needed for Crisis Prevention

- Could the Fed take “spillovers” into account?
- Could lenders focus on EME development needs and vulnerabilities?
- Could AME regulators force them to do so?
- Could IFIs and the G20 provide better risk assessments?
- “Trust” as the basis of international cooperation and reform

Policies Needed for Crisis Management

- Will capital flight from EMEs be even more “flighty”?
- Implying EMEs have less room for fiscal and monetary expansion
- Large FX reserves could be used to offset dollar shortfalls
- Could “swap” agreements with the Fed also help?
- IMF needs bigger quotas and more access to “temporary” funding

Policies Needed for Crisis Resolution

- The **economic** case for orderly debt restructuring
- The **political** case for orderly debt restructuring
- Inadequate mechanisms for resolving **private** sector debt
- Inadequate mechanisms for resolving **public** sector debt
- And the difficulty of restructuring is getting worse

A Final Take Away for EME Policymakers

- A renewal of the GFC in the AME's cannot be ruled out.
- The EMEs are increasingly vulnerable and could even be the trigger.
- Managing and resolving the crisis will not be easy.
- Good luck to all.