Macroeconomic impact series

Access to finance, post-Brexit

The IMF should improve access to liquidity

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Key messages

- Although financial stress remains contained, several developing country external debt-to-reserve ratios are rising, which could make access to finance prohibitively expensive.
- Divergent borrowing costs are notable. Although developed country bond yields are low, or, increasingly, negative, developing economies have seen rate rises.
- The G20 should ensure improved access to finance for developing countries, including to IMF facilities, given the multiple economic shocks they face.

Liquidity as an emergent risk

Sterling's 10% trade-weighted drop is likely to cost developing countries around $3.8 billion in reduced trade, aid and remittances.[1] Further depreciation is expected, which will increase this cost. Three weeks on from the UK's decision to leave the EU, there has been some stabilisation in financial markets. However, continued economic uncertainty is likely to keep risk aversion elevated, threatening financial and economic stability in countries that have stronger UK trade links, are resource exporters, or have persistent current account deficits.

Access to finance may prove problematic for economies that investors and credit rating agencies deem risky. The Bank of England has pledged £250 billion of support for the UK economy. Liquidity is high for developed economies, given global central banks' easy monetary policy and the likelihood of more stimulus. By contrast, many developing economies, largely resource exporters, have seen a rising debt-to-reserve ratio. As a result of this, they have shrinking resources to counter the 'Brexit' shock as well as lower oil and commodity prices and China's slowing economy.

Economies with large external financing needs could see greater risks to growth, particularly if they can no longer access global markets owing to higher bond yields, or if there is a lack of appetite for purchasing their debt. Resource exporters, such as Nigeria and Angola, contending with lower oil revenues, look vulnerable. So do economies with persistently large current account deficits, such as South Africa and Ghana. Difficulties in raising finance through bond issuance could make it hard to fund domestic budgets and investment.

Borrowing cost divergence

What is problematic is that some interest rates for resource exporters and deficit economies have increased following the UK's vote, making borrowing costly, and at times, prohibitively expensive. By contrast, interest rates for developed countries are at historic lows. In fact, the share of outstanding government bonds with negative rates has reached a record.[2] Globally, low yields indicate weak expected investment returns. Investors have sought higher returns in riskier markets, such as in developing countries. But the perceived risk in these markets has now increased because of unease about the global growth outlook. This has resulted in demand for developed country bonds as a safe haven asset.

Both resource exporters and current account deficit economies have seen rate rises in the immediate wake of the UK's vote. Bond yields, interbank rates and key policy rates have been raised, or have risen in the market. For example, Mexico, an oil exporter and a current account deficit economy, saw its central bank raise its policy rate from 3.75% to 4.25% on 30 June. Following the vote, the yield on Zambia's 2024 debt rose 33 basis points to 11.69% and Nigeria's yield for its 2023 dollar bond rose 24 basis points, the most since 8 February. Kenya, which has both a current account deficit and recent bank failures, saw its interbank rate, at which banks lend to each other, rise from 5.6% on 22 June to 7.9% on 24 June, its highest since November 2015 (10.5%), according to the Central Bank of Kenya.

July's G20 focus: improve access to IMF facilities

Stabilisation in financial markets could see borrowing costs fall through lower bond yields. However, with risk aversion high, this will be limited. And, even if there is some stabilisation, indebted economies are vulnerable to a sudden stop in capital inflows. Such a retraction would threaten both growth and investment.

At a domestic level, we have highlighted the temporary usage of a dual currency in a *previous issue*. This could help exporters. Additionally, oil- and commodity-importing economies should use the windfall gains from lower prices. Gold exporters could do the same with the rise in gold prices, given safe-haven-demand.

At a global level, the G20[3] April statement[4] reaffirmed the increase in International Monetary Fund (IMF) BRICS[5] quota shares. At their meeting on 23-24 July, the G20 and the IMF should increase access to finance for the poorest non-G20 economies. Ultimately it should raise, rather than preserve, their IMF quota shares.[6]

The $1.1 billion IMF Poverty Reduction and Growth Trust, effectively a zero-rate lending facility for low-income economies,[7] is inadequate against sub-Saharan Africa's oil-related revenue loss (potentially $63 billion)[8] or the $3.8 billion initial Brexit cost. Larger quota shares, greater automatic financing and higher lending limits are needed.

Endnotes

1. https://www.odi.org/publications/10480-brexit-and-development-how-will-developing-countries-be-affected
2. https://www.bis.org/publ/arpdf/ar2016e2.htm
3. The G20 is a forum for international cooperation and comprises the European Union and the following 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Korea, Turkey, the United kingdom and the United States.
4. http://www.g20.utoronto.ca/2016/160415-finance.html
5. BRICS denotes Brazil, Russia, India, China and South Africa.
6. http://www.imf.org/external/np/exr/facts/quotas.htm
7. https://www.imf.org/external/np/fin/prgt/
8. https://www.odi.org/comment/9458-low-oil-prices-africas-winners-losers

Erratum: This briefing was amended on Friday, 15 July 2016 to reflect that the initial likely cost of Brexit to devevloping countries was $3.8 billion and not $5 billion as previously stated.

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