3 The impact of the COVID-19 crisis on emerging market borrowing

In the global fight against the COVID-19 pandemic and its detrimental social and economic impact, governments have launched various measures since March 2020. This, combined with reduced tax revenues, has resulted in an upsurge in sovereign borrowing needs globally. While most advanced economies have been experiencing ultra-low interest rates and strong demand for public debt, a number of underlying vulnerabilities have made borrowing conditions more difficult for many developing and emerging market economies.

The pandemic greatly complicated the ability of developing and emerging market sovereign issuers' to access to the markets in 2020, in particular at the initial stages of the crisis. The global risk-off environment resulted in sharp reversal of capital flows, which had a particularly profound impact on market access of non-investment grade issuers. This chapter presents an overview of debt issuance trends in developing and emerging market economies, and assesses the impact of the COVID-19 crisis on issuance conditions.

3.1. Introduction

In 2020, this publication explored sovereign debt issuance developments in developing and emerging markets and developing economies (hereafter 'EMEs') for the first time. Chapter 2 of the 2020 OECD Sovereign Borrowing Outlook presented an overview of issuance trends in emerging-market government securities from 2000 to 2019, and touched upon the initial impact of the COVID-19 crisis. The main objective of this second chapter on EMEs is to provide an update on the impact of the COVID-19 crisis on sovereign debt issuance by different income levels and geographic regions, with a particular focus on maturity and currency structure.

The key source of information is a unique n exclusive dataset comprising 10 621 sovereign government securities issued by 88 EME sovereign issuers in 2020 (see Annex for details of the methodology used).

Key findings

- The COVID-19 shock initially caused sharp fluctuations in capital flows to EMEs, leading to deterioration in sovereign funding conditions, particularly for CCC and lower graded sovereign issuers. Following rapid responses by central banks, funding conditions eased relatively rapidly in the second half of the year, but remained fragile.
- A number of EME sovereign issuers were downgraded in the wake of the pandemic as a result of strained budget conditions and weak economic outlook. Thirty countries, the majority of which were associated with the non-investment grade, experienced 68 downgrades in 2020.
- In total, EME sovereigns issued about USD 3.4 trillion of debt in financial markets in 2020. Compared to the average of the previous five years, the amount issued was 35% higher, but was driven by fewer issuers in 2020. Overall sovereign funding costs, which had surged dramatically during the initial phase of the Covid-19 pandemic, fell down close to pre-pandemic levels towards the end of the review period amid an environment of ample global liquidity.
- While emerging Asia, led by People's Republic of China (China), continued to be the largest emerging regional issuer in 2020, issuance by other regions including MENA and Sub-Saharan Africa were below the historical averages.
- The impact of global risk aversion was much more pronounced on market access of low- and lower middle-income countries compared to other EMEs during 2020. The result was a sharp decline in net debt issuance relative to previous 5-year averages.
- Another important impact of the lower appetite for EMEs sovereign debt throughout 2020 was the decline in the share of foreign currency-denominated debt issuance in total debt issuance, with the exception of euro. The decline was particularly marked in the MENA and Sub-Saharan African regions, where foreign currency borrowing was most costly.
- Maturity of borrowings shortened dramatically at the initial stages of the crisis across EMEs. As market conditions improved, investment-grade issuers were able to increase the share of long-term securities. Again, the impact was larger for non-investment grade issuers, where T-Bills accounted for 45% of total borrowing in 2020.
- In view of global risk factors that could put strong downward pressure on EME sovereign borrowing conditions, greater attention to refinancing risk of EME sovereign debt is warranted. Countries that have access to market funding may benefit from lengthening debt maturities and build-up contingency buffers through pre-financing programmes. Countries with limited or no market access will continue to require official sector grants and loans to ease their financing constraints, and in some cases, debt relief.

3.2. The pandemic has weighed greatly on emerging market sovereign issuers

In the wake of the COVID-19 crisis, governments of many EMEs have faced two sources of intense funding pressures: financing needs arising from the COVID-19-related measures, and refinancing of the outstanding debt at unreasonable interest costs. The impact of the crisis on EME sovereign funding varied widely in terms of the social and economic consequences of the epidemic, the country's capacity to use fiscal policy to mitigate these consequences, including their stage of development and efficiency of local currency bond markets.

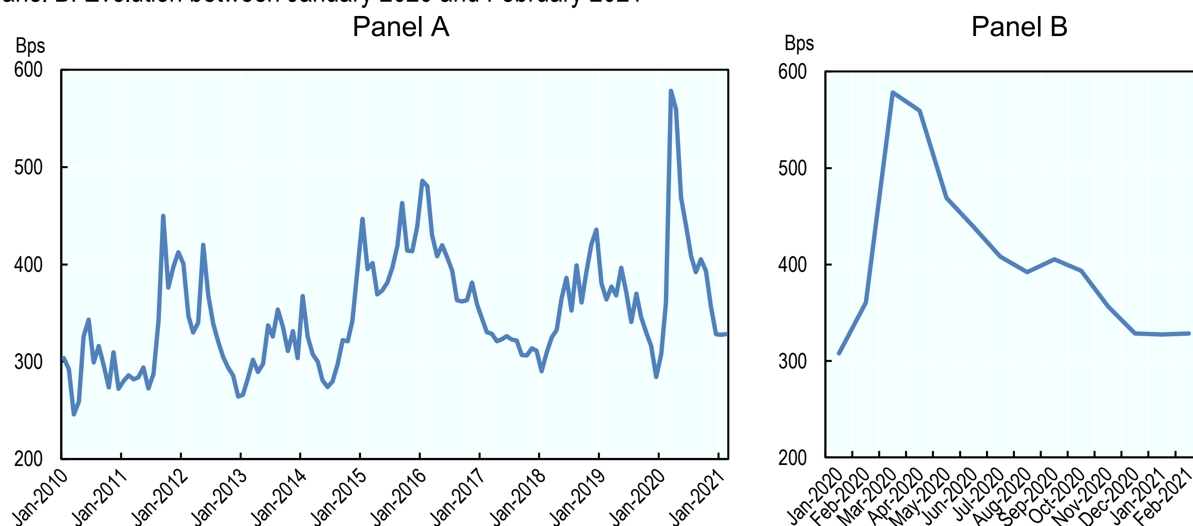
While many EMEs entered the COVID-19 crisis with public debt already at elevated levels, the pandemic weighed considerably on investor risk appetite, and exposed pre-existing vulnerabilities in these economies (OECD, 2020[1]). The circumstances were particularly challenging for countries with less fiscal leeway, limited policy buffers and constrained market access. Despite the challenging market conditions with episodes of high volatility, EMEs survived 2020 without experiencing a materialisation of the systemic debt crisis, largely due to the global monetary and fiscal policy response to the crisis, as well as rapidly arriving good news on vaccination development and debt relief by the international community.

3.2.1. Funding conditions have improved, but vulnerability to global risk sentiment remains high

In EMEs, funding conditions are vulnerable to global risk sentiment and therefore historically more volatile than in advanced economies (e.g. fears of contagion of the European sovereign debt crisis to EMEs in 2011, the 'taper tantrum' in 2013, political tensions between the United States and China as well as monetary policy tightening in the United States in 2018). At the onset of the COVID-19 crisis, a sharp deterioration in investor sentiment and risk appetite translated into a sudden reversal of capital flows. The cost of EM sovereign borrowing surged dramatically in March and April 2020, due to sharp increases in EM risk premiums (Figure 3.1). This, in turn, particularly affected the financing ability of countries that lack deep and liquid local currency bond markets.[1]

Figure 3.1. Spreads on EM sovereign debt

Panel A: Evolution between January 2010 and February 2021
Panel B: Evolution between January 2020 and February 2021



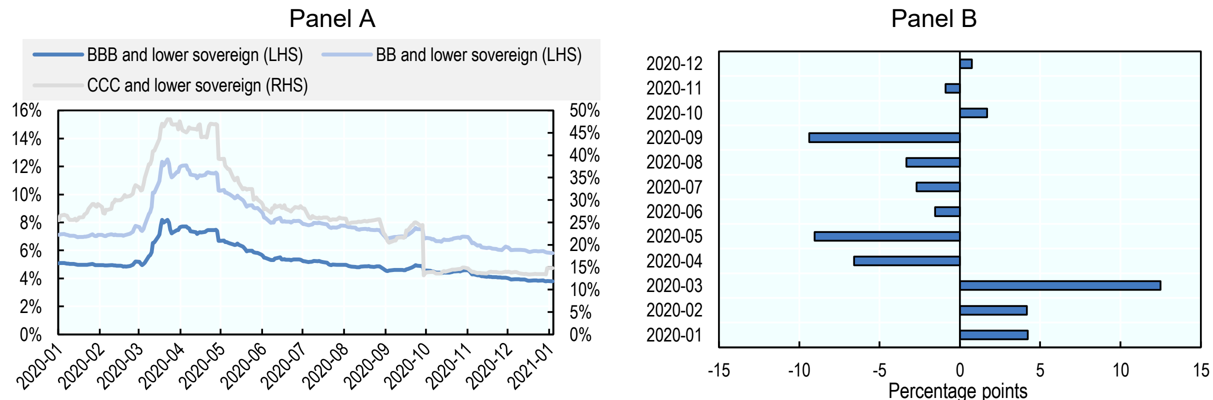
Notes: JP Morgan Emerging Markets Bond Indices. Y axes are cropped to help show changes between dates.
Source: Factset.

While yields across all the EM sovereign bond categories have deteriorated, “CCC and lower rated sovereign bonds in particular were affected more strongly (Figure 3.2). This resulted in a wide differential between high-yield and investment-grade bonds, which in turn impaired some countries’ access to international capital markets when it was needed the most.

Figure 3.2. Yields on external EM government securities

Panel A: Yield group evolution between January 2020 and January 2021

Panel B: Changes in yield for CCC and lower rated securities on a month on month basis (2020)



Source: Bank of America ICE EM Indices, Refinitiv and OECD calculations.

Following the initial shock of the pandemic, the stress in financial markets eased rapidly, largely due to the massive and unprecedented scale of actions by major central banks, in particular the Federal Reserve and the ECB. Several large EM economies also eased their monetary policy stance. For example, several central banks have bought local currency government bonds to fight the effects of COVID-19, including Colombia, Indonesia, Mexico, Poland, South Africa, Turkey and the Philippines (Cantú et al., 2021[2]). In addition to central banks’ commitment to support market functioning, the global wave of fiscal stimulus and positive developments with regard to vaccines have helped improve the global growth outlook. Towards the end of 2020, yield spreads compressed significantly across EMEs, and fell down close to pre-pandemic levels. As investor risk sentiment improved, demand for emerging market sovereign bonds picked up. At the same time, investors increasingly differentiated countries based on their policy stability and availability of policy buffers to address market volatilities in addition to the COVID impact on their growth outlook. In this respect, financing conditions remained generally constrained for low-income countries (LICs) vulnerable to the COVID-19 shock. Within middle-income countries, the growth potential of countries that have dealt with COVID-19 outbreaks well and are less affected by the course of vaccine distribution (e.g. China and Thailand) were considered higher than that of countries particularly hard hit by the virus (e.g. Brazil, India, Mexico, and South Africa).

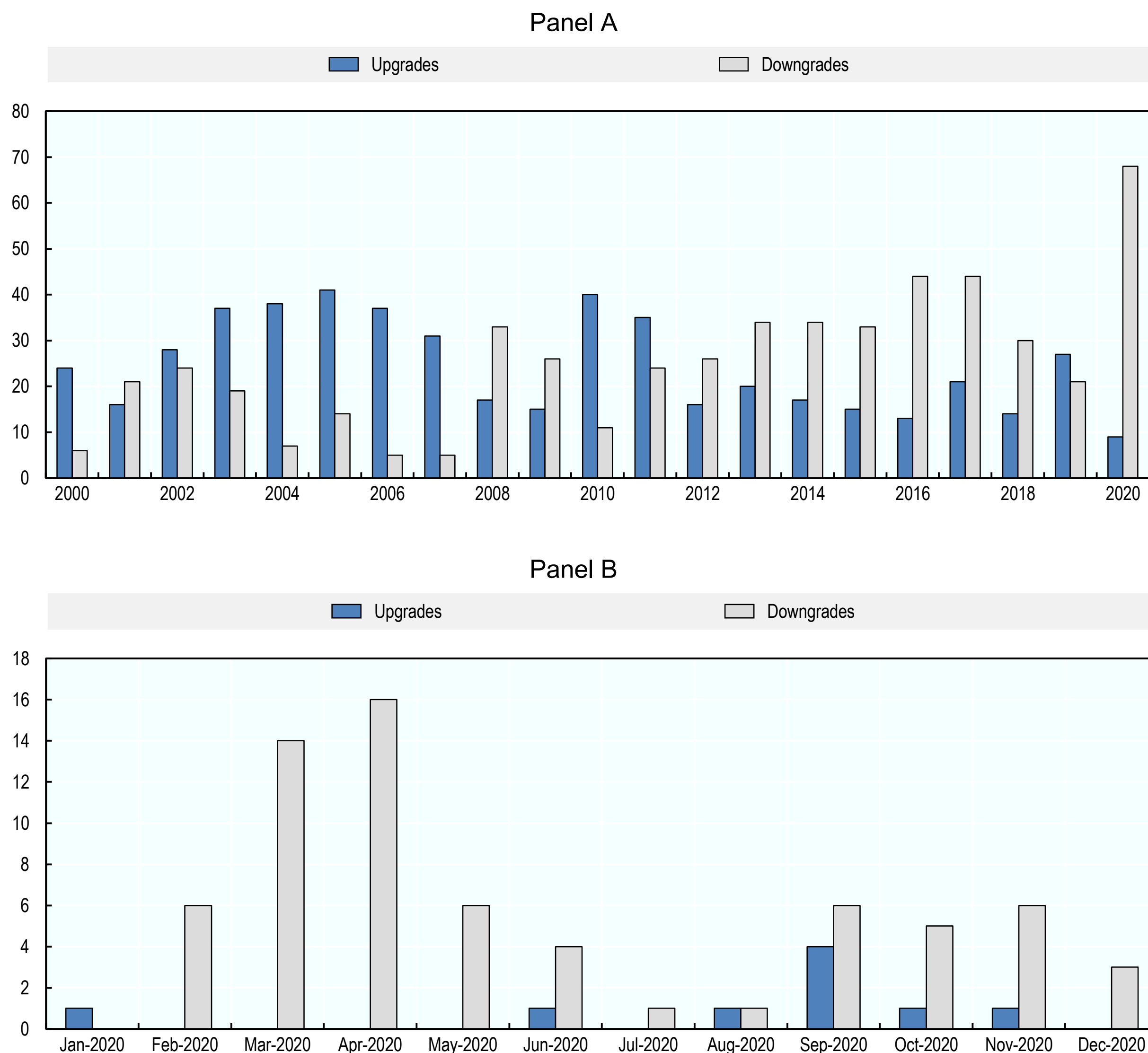
Reflecting a surge in the perceived risk associated with investing in EM debt, an unusually high number of emerging market economies were downgraded in 2020. This is particularly important for sovereigns that rely on foreign investors, as the inclusion of bonds in benchmark bond indices is mainly driven by credit ratings. In terms of sovereign credit ratings, more than 30 countries were downgraded in 2020, the majority of which took place in the initial stage of the crisis. In total, there were 68 downgrades, more than 50% higher than in the most recent spikes of 2016 and 2017 (Figure 3.3).[2] The downgrades largely stemmed from the worsened macroeconomic outlook, amid the pandemic. It is important to note that the majority of credit rating changes have occurred in the non-investment category in the wake of the COVID-19 crisis,

leaving several middle-income countries including Angola, Belize and Zambia deeper into highly speculative territory.

Figure 3.3. Changes in EM sovereign credit ratings

Panel A: Number of ratings changes in each year between 2000 and 2020

Panel B: Number of ratings changes in each month of 2020



Notes: Above ratings are based on Moody's, S&P and Fitch and observed on a monthly basis. Aa change in rating by one agency is counted as 1 in the above chart, meaning that if all three agencies change their ratings in one month, it is counted as 3. When there is more than one change per agency in a month, the lower rating has been chosen, except in the case where the lowest rating is a default rating.
Source: OECD calculations based on data from Refinitiv.

While sovereign issuers survived the initial shock, they are still exposed to global risks that could trigger a sudden change in investor sentiment. A particular risk stemming from rising US interest rates could trigger a reversal of capital flows and sharp currency depreciations, as experienced during the "taper tantrum" of 2013. This could pose a significant challenge especially to middle- and low-income countries with large

external financing needs and high debt levels. In this regard, stronger-than-expected inflation due to US fiscal stimulus would also heighten such risks (OECD, 2021[3]). While the dependence of most EM economies on external financing is currently lower than in 2013, other factors such as the continued weakness of international travel and tourism, as well as rising commodity prices may put pressure on the external balances of commodity exporters and tourism-based economies. This environment makes EM debt yields more sensitive to global interest rate fluctuations, and amplifies refinancing risk for vulnerable borrowers.

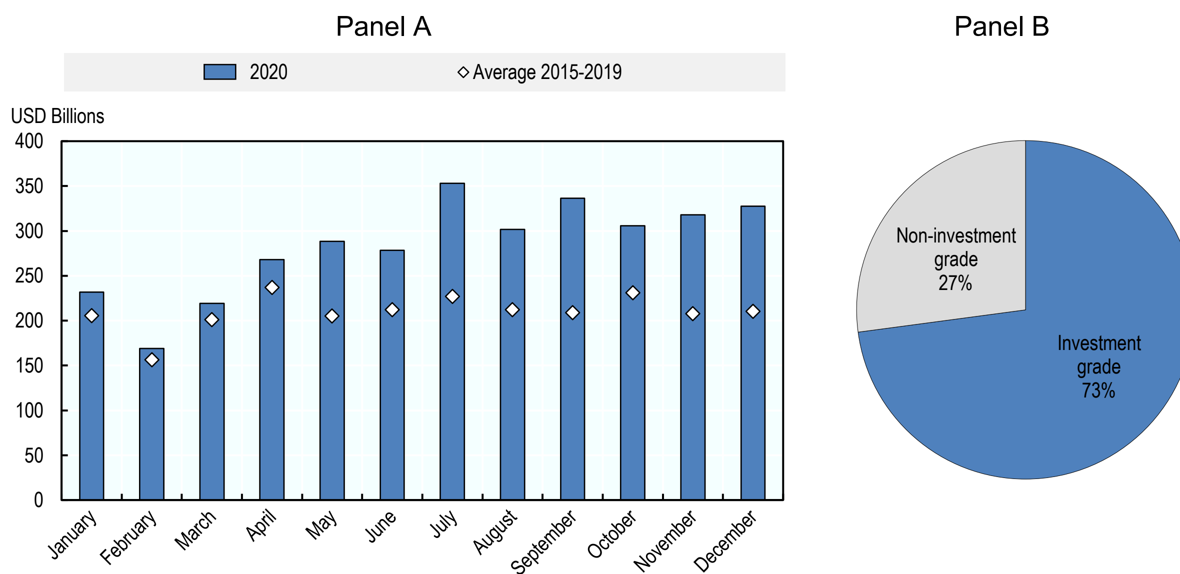
3.2.2. Debt issuance has picked up, though remained lower than historical averages in some regions

Sovereign funding needs of EMEs soared as a result of simultaneously declining fiscal revenues and increasing fiscal stimulus packages.[3] Sovereign debt issuance, which was slightly higher than the average of the last five years between January and April 2020, continued to pick up gradually amid relatively improved risk sentiments after the initial stage of the COVID-19 shock. In total, EM sovereigns raised more than USD 3.4 trillion in financial markets in 2020, over 35% higher than the previous five-year average (Figure 3.4). Investment-grade issuers accounted for almost 70% of the total issuance, up by 8 percentage points compared to the historical average.

Figure 3.4. Gross central government debt issuance by EMEs

Panel A: Monthly issuance in 2020, and average of 2015-2019

Panel B: Issuance in 2020 by investment grade category



Source: OECD calculations based on data from Refinitiv.

Emerging Asia remained the largest regional issuer, while many other regions lagged behind historical averages

As discussed in the 2020 edition of this publication, the regional composition of EM debt issuance had changed significantly over the preceding decade. In particular, as Emerging Asia became the largest regional issuer, the relative size of debt issuance by the Latin America and the Caribbean, MENA and Sub-

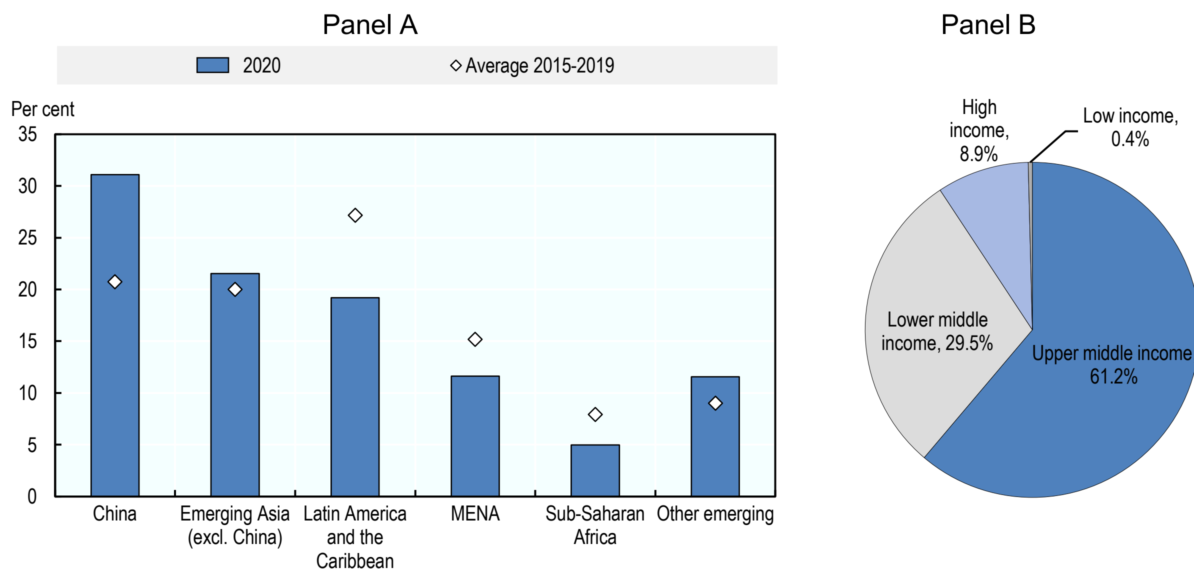
Saharan Africa regions reduced significantly (OECD, 2020[1]).[4] The COVID-19 crisis has only strengthened these patters. In 2020, Emerging Asia remained the largest regional emerging market issuer, accounting for more than 50% of the total issuance (Figure 3.5 Panel A). Even excluding China, issuance capacity of the Emerging Asia region has recovered well from the COVID-19 shock, and debt issuance exceeded the previous five-year average. Most countries in this region have weathered the pandemic relatively well, supported by sound macroeconomic fundamentals, developed local-currency bond markets, as well as timely and effective public health measures (OECD, 2021[3]). Similarly, emerging countries in Europe including Hungary, Poland and Romania significantly increased their borrowings from the market largely due to increased government spending to address the economic consequences of the COVID-19 crisis on businesses and households.

Market-based financing remained constrained for some countries with weak fundamentals. In terms of share of debt issuance, Latin America and the Caribbean, MENA and Sub-Saharan Africa regions fell short of the historical averages (Figure 3.5 Panel A). In particular the Sub-Saharan Africa region, where debt issuance in markets was increasing from very low levels in the pre-pandemic period, was affected most by the crisis. As discussed in the following sections, access to international markets has weakened for many African countries, causing not only the amount of borrowing from the market to decrease, but also the shortening of the maturities.

Figure 3.5. EM sovereign debt gross issuance by regional and income categories

Panel A: Regional composition of debt issuance

Panel B: Issuance by selected income categories

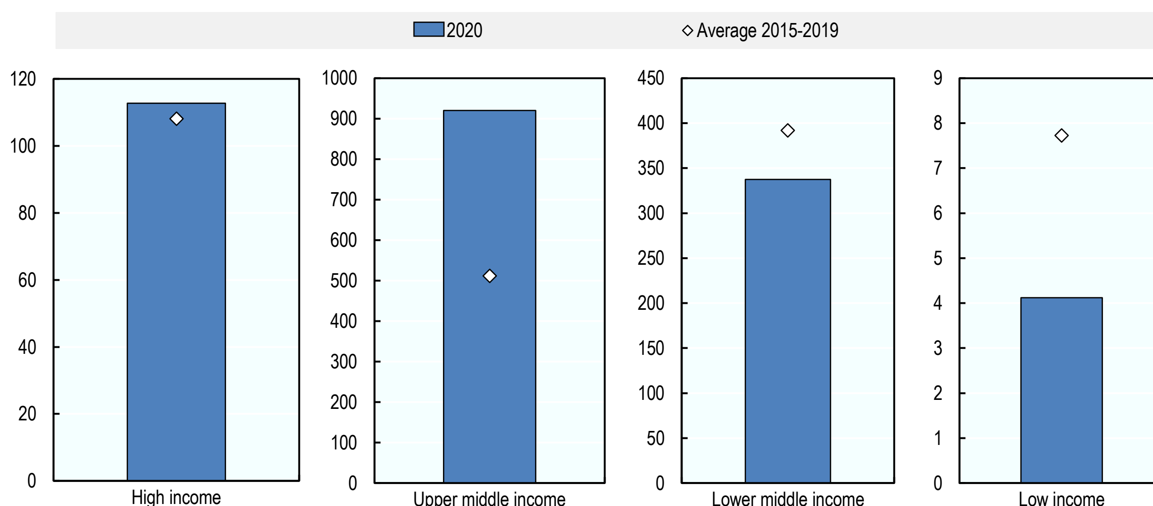


Source: OECD calculations based on data from Refinitiv.

Upper-middle-income countries maintained an upward trend despite the pandemic, thanks to accommodative monetary policies

In 2020, upper-middle-income countries (UMICs) who would have high financing needs and developed institutional frameworks, represent the majority of the total debt issuance according to the income criterion (Figure 3.5 Panel B). The ability to finance budget deficits at reasonable cost and desirable maturities requires, above all, a well-functioning, stable and liquid local currency bond market. A majority of middle-income countries meet their financing needs from the markets with regular issuance programmes. As demand for EM sovereign debt recovered from the initial impact of the COVID-19 shock in the second half of the 2020, debt offerings from middle-income countries have enjoyed strong demand, which allowed them to issue new debt to finance increased fiscal spending and to refinance existing debt (Figure 3.6). The LMICs and the LICs, on the other hand, have decreased their new borrowing. Furthermore, net debt issuance by LICs was even negative for a few months of 2020. This means that they were unable to rollover some of their scheduled debt repayments, let alone raise new borrowing in the markets. These countries with shallow domestic debt markets or, constrained market access, are often more vulnerable to changes in market conditions than other EM countries. Consequently, during 2020, they relied heavily on aid, grants and concessional financing from multilateral institutions.

Figure 3.6. Net debt issuance by selected income categories (billions USD)



Source: OECD calculations based on data from Refinitiv.

Low levels of net debt issuance in LMIC and LICs imply that the compounded nature of the COVID-19 shock has significantly damaged governments' ability to service their debt while also hampering their response to the pandemic and their ability of making the investments necessary for the economic recovery. The fiscal situation has been particularly dire in these economies, where the impact of COVID-19 has aggravated pre-existing high debt levels and hampered local currency bond markets. The international financial community's efforts through various facilities have helped to ease these countries' liquidity constraints and prevented a potential debt crisis since the onset of the COVID-19 crisis (Box 3.1). Although significant efforts have been made in this direction, the international community has recently highlighted the need for more support in light of the uncertain global outlook (OECD, 2021[4]). Particularly, the possibility of disorderly rise in bond yields in the advanced economies, and especially in the United States, may put pressure on funding costs in EMEs.

Box 3.1. International efforts to support debt resilience and improve debt transparency

In April 2020, the G20 nations offered to suspend debt service payments owed by 73 low- and lower-middle income countries, and invited private creditors to follow the suit. The Debt Service Suspension Initiative (DSSI) is for a limited period (initially from May to December 2020, then extended until the end of 2021 following the meeting of Central Bank Governors and Finance Ministers in April 2021). As of February 2021, more than 60% of the eligible countries have requested debt service suspensions, while about USD 5 billion worth of debt service was suspended in 2020. This facility primarily aims to address immediate liquidity needs, but not debt sustainability problems.

When debt is unsustainable, an orderly debt restructuring is often the most viable solution for both borrowers and investors. Debt restructuring can help to limit market disruption and spillovers. With these considerations in mind as well as the need for deeper debt relief in some cases, the G20 and Paris Club countries agreed on a Common Framework for Debt Treatments in November 2020. This framework takes a case-by-case approach applied to the countries eligible for the DSSI, excluding middle-income countries. In practice, only a few countries (e.g. Chad, Ethiopia, and Zambia) have applied for debt treatment under this framework, largely due to the uncertainties linked to its implementation, fears of losing hard-earned market access, and of potential ratings downgrades. At the same time, the International Monetary Fund (IMF) provided financial assistance and debt service relief to numerous countries with its USD 1 trillion lending capacity.

These measures created some breathing space for the countries that were able to benefit from them in 2020. Despite these concerted efforts, daunting development challenges remain. In 2021, more support from the multilateral organizations and private creditors will be needed not only for low-income countries, but also for middle-income countries. Hence, the IMF has recently proposed a new Special Drawing Rights allocation of USD 650 billion to provide additional liquidity to the global economic system. In addition, G20 bilateral official creditors agreed to a final extension of the DSSI through end-December 2021. Further policy actions which have been considered are: i) adjustment of the common framework to broaden eligible countries; ii) raising ODA commitments and optimizing Multilateral Development Banks' concessional financing.

Against this backdrop, the OECD supports improving the liquidity and resilience of public debt for solvent but vulnerable countries; streamlining debt restructuring processes when necessary; and across all borrowing countries, improving debt management capacity and transparency. Called upon by the G20, and with the support of the UK government, the OECD has recently launched a Debt Transparency Initiative to collect, analyse, and report on debt levels of low-income countries in alignment with the Institute of International Finance's (IIF) Voluntary Principles on Debt Transparency. This initiative brings together multilateral institutions, central banks, finance ministries, civil society organisations, and commercial banks through an Advisory Board for Debt Transparency, which will be established under the Committee on financial Markets. The project aims to shed new light on previously opaque bilateral lending to low-income countries by providing stakeholders with more comprehensive and accurate public debt data.

Source: IMF COVID-19 Financial Assistance and Debt Service Relief, Remarks by Angel Gurría, Secretary-General at High-Level Meeting with Heads of State and Government on the International Debt Architecture and Liquidity on March 29, 2021, The Bretton Woods Committee report titled 'Sovereign Debt: A Critical Challenge', and OECD Debt Transparency Initiative.

3.3. Currency and maturity structure varied widely among country groups

The maturity and currency composition of debt portfolio matters in terms of potential exposures to market and refinancing risks. A portfolio with long average maturity and a low share of foreign currency-denominated debt can help minimise the magnitude of external and domestic shocks on the sovereign borrower.

In view of the importance of having a deep local currency bond market, some emerging economies have developed sophisticated capital markets and were able to issue most of their debt in domestic currency before the pandemic. On average, domestic currency issuance by EM sovereigns accounted for 90% of total issuance between 2000 and 2019, which varied significantly between countries, largely depending on the state and functioning of local currency bond markets (OECD, 2020[1]). In particular, local currency share of borrowing has increased substantially in Emerging Asia, where sudden reversals of capital flows have depressed sovereign balance sheets facing currency mismatch and caused several debt crises in the past.

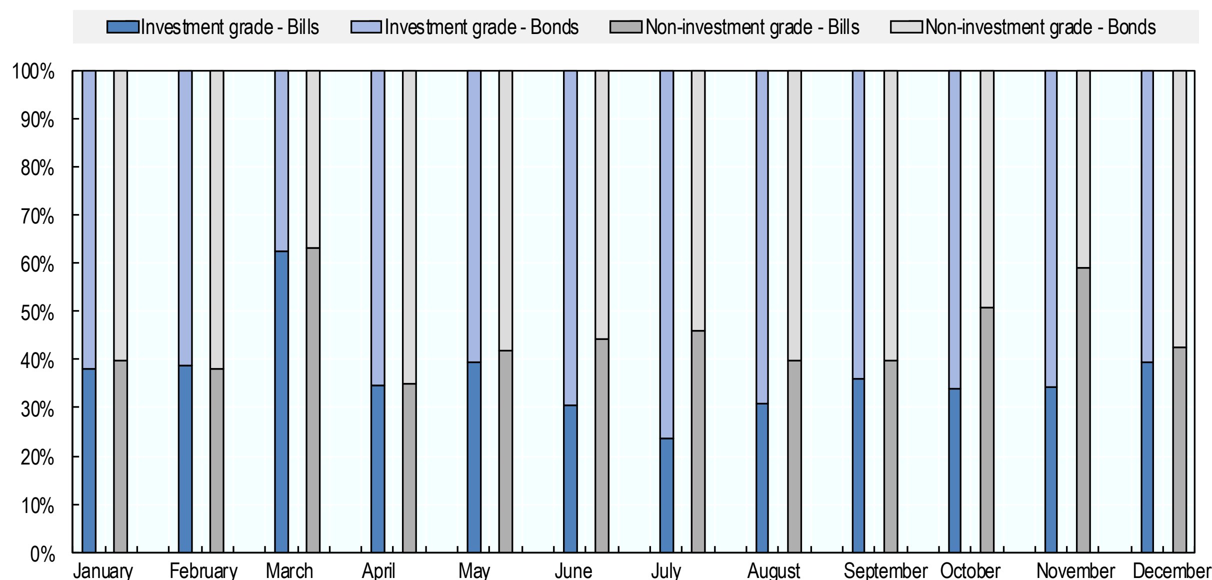
Maturity of borrowing is mainly determined by market forces in EMEs. Investors' tolerance for risk, long-term financial objectives and market liquidity determine the cost of borrowing at different maturities, and so the trade-off between cost and risk of different borrowing strategies. During the period from 2000 to 2019, EM investment-grade sovereign issuers managed to lengthen the average maturity of their issuance to over eight years; while the average maturity of non-investment grade borrowing declined from 5.8 to 4.5 years over the same period (OECD, 2020[1]).

In some cases, market demand for longer-term maturities may be insufficient, unstable, or offering too costly terms. As discussed in Chapter 2, strong and sustainable demand from institutional investors such as insurance companies and pension funds that tend to have long-term investment horizons enables sovereigns to issue longer-dated bonds on a regular basis. This is the case for advanced economies (e.g. Germany, Japan, France and the UK). However, for many EMEs, with low domestic savings and few institutional investors, the capacity to issue long-term debt in local currency bond markets is limited, even in normal times. In this regard, bond issuance in international markets with relatively longer maturities allows EM sovereigns to reduce their exposure to rollover and interest rate risk and diversify their investor base. On the other hand, heavy reliance on external funding can increase country's exposure to 'sudden stops' in international capital markets. The COVID-19 crisis has greatly affected currency and maturity structure of EM sovereign debt, in particular for issuers with underdeveloped local currency bond markets and weak fundamentals.

3.3.1. T-Bill issuance by non-investment grade issuers has increased

Given the uncertainty about future spending needs and the severe liquidity problems faced by sovereign issuers, many EM governments have turned to money markets to raise funds to meet their current obligations and to build a cushion for future economic shocks. Affected by swings in investor sentiment, market demand for long-term instruments became less stable and more costly for emerging market and developing economies in 2020. As a result, the prevalence of shorter-term T-Bill issuance has increased. In March 2020, at a time of acute market distress, the share of local currency T-Bills surged dramatically, accounting more than 60% of total issuance by both investment and non-investment grade categories. In the following months, however, issuance by investment grade countries, benefiting from benign financing conditions, has shifted towards longer-term bonds. On average, T-Bills accounted for 34% of the total issuance by investment grade issuers between May and December 2020. For non-investment grade issuers, the ratio stands around 45% on average, noticeably elevated around the US election and the second wave of Covid-19 built up.

Figure 3.7. Maturity composition of debt issuance by investment and non-investment grade categories in 2020



Source: OECD calculations based on data from Refinitiv.

3.3.2. The pandemic is spurring the issuance of new instruments

In order to support raising funds to face the current COVID-19 crisis and to diversify their investor base, several EM sovereigns have introduced new instruments such as saving bonds, social bonds, infrastructure bonds and green bonds (e.g. Ecuador, Egypt, Hungary, Mexico, and Thailand). Depending on their maturity and currency structure, new instruments can be useful to moderate the exchange rate, interest rate and rollover risks of debt portfolios. Often, saving bonds, attracting domestic retail investors, are issued in local currency with long-dated maturities. Social bonds, infrastructure bonds and sovereign green bonds, to finance projects with different objectives, also carry long maturities (from 5 to 30 years). In terms of the currency choice, EM sovereigns often issue these bonds in international capital markets in USD to attract a broader investor class.

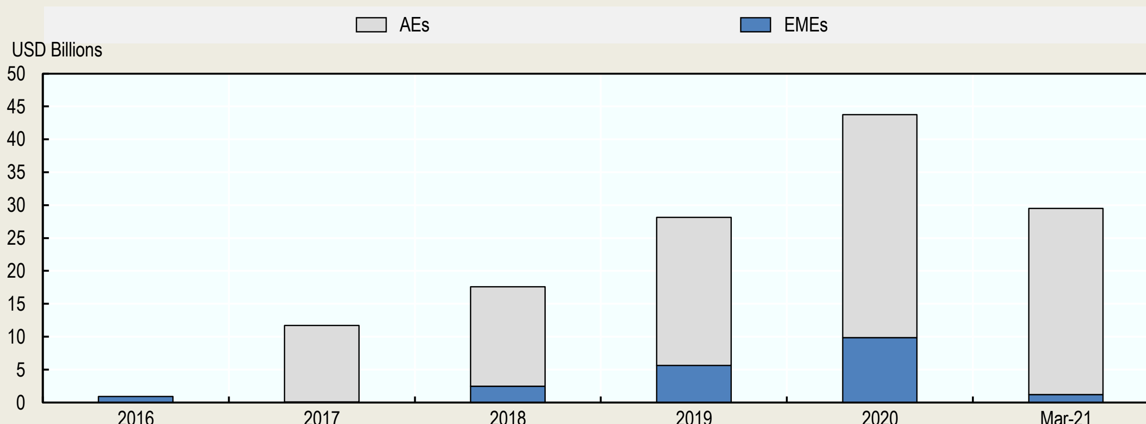
In addition, the issuance of social, green infrastructure and other green bonds helps achieve the climate goals set at the Paris Agreement and the SDG goals related to infrastructure, poverty and climate challenges. Of particular interest is the acceleration in green bond issuance by EM governments to meet long-term climate and infrastructure targets in recent years (Box 3.2). As of March 2021, total issuance of green bonds by EM governments reached USD 11 billion, more than half of which has been issued since 2020.

Box 3.2. Sovereign green bond issuance accelerated in 2020, helping to promote green growth

Among the alternative investment products tailored to low carbon transition that have emerged, green bonds have been preferred by sovereign issuers as well as environmentally conscious investors. They feature broader benefits to the financial market by promoting the development of a domestic market for green bonds, and enabling market participants with different investment horizons to find a green, transparent, high-quality investment opportunity at their disposal.

Sovereign green bond issuance has exceeded USD 130 billion globally since Poland and France kicked off four years ago. Amid the rising imminence of sustainability issues, such as the climate change, increased borrowing needs due to the COVID-19 pandemic have widened the scope for green bond issuance. Hence, sovereign green bond issuance by both advanced and emerging market economies accelerated in 2020, which helped to promote green growth. 40% of the outstanding sovereign green bonds consists of debut issuance in 2020 by countries including Germany, Hungary and Thailand (Figure 3.8). Looking forward, this momentum is expected to continue in 2021 with prospective issuers including Brazil, Canada, Colombia, Mexico, Slovenia, Spain and the United Kingdom.

Figure 3.8. Sovereign green bond issuance by advanced and emerging market economies



Source: Refinitiv, national authorities' websites and OECD calculations.

In terms of maturity structure and size, sovereign green bonds vary significantly: Maturity of bonds varies from 5 to 30 years, with a weighted average maturity of 18-years, and size of bond issues (including re-openings) ranges from USD 15 million to above USD 30 billion. While euro area issuers account for around 75% of outstanding sovereign green bonds, the number of EM issuers is growing fast. Hence, the share of total annual issuance by EMEs increased to 23% in 2020.

Issuing a green bond entails specific features

Green bond issuance entails specific requirements in terms of coordinating the various line ministries responsible for extracting project information required for monitoring and reporting purposes as well as special marketing and reporting exercises. These idiosyncratic requirements can deter many EMEs with limited resources and limited capacity from issuing green bonds. In addition, it might prove challenging for many small EMEs lacking investment grade to appeal international investors, in particular institutional investors, despite the fact that an issuer can have the bond and framework rated by a specialised research provider or rating agency.

In view of challenges with regard to the issuing process and the capacity gap, potential EM issuers may benefit from other countries' experiences as well as international financial organisations such as the World Bank Group in terms of preparing the policy framework, leveraging media interest, market intelligence and project screening (International Finance Corporation, 2018[5]). Fiji, for example, benefited from the World Bank Group in preparation and implementation of the policy framework in 2017. Similarly, Nigeria whose sovereign green bond was rated "GB1", the highest possible rating by Moody's, received support from international bodies like the IFC (International Finance Corporation) and the UN Environment Programme (UNEP).

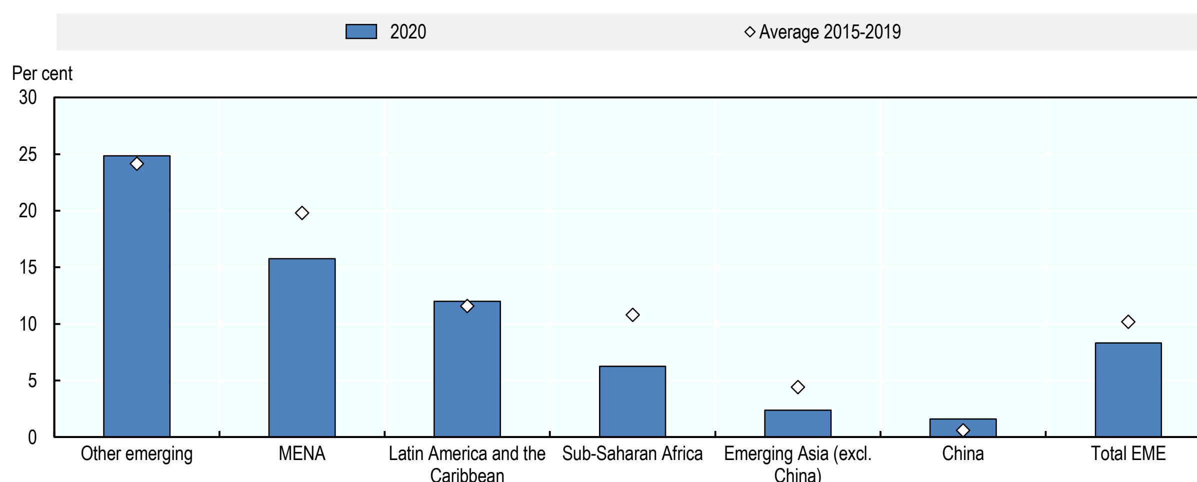
3.3.3. Domestic currency securities continue to dominate EM issuance, while some issuers faced challenges in regaining access to international markets

Overall, domestic currency securities continued to dominate EM issuance in 2020, suggesting deepening of local currency bond markets and an improvement in currency risk exposures in EMEs. On average, domestic currency issuance accounted for 92% of total issuance by EMEs in 2020, slightly higher than historical averages. At the regional level, in Emerging Asia, where local currency bond markets have become relatively developed in recent years, domestic currency debt issuance constituted 97% of total issuance in 2020. The ratio is lower in emerging countries in Europe, as a number of EU countries that are not in the euro area including Bulgaria, Croatia, Hungary, Poland and Romania benefit from access to euro markets.

Overall, FX-denominated issuance varied widely among EMEs in 2020. While high-grade issuers returned to the market rapidly from April 2020 onward, issuers with weak fundamentals faced significant challenges in regaining market access after the initial months of the crisis. In a few countries including Turkey, FX-denominated debt issuance in domestic markets increased significantly.[5] FX-denominated issuance in Sub-Saharan African and MENA countries (where foreign currency financing increased notably before the pandemic), was particularly weak, reflecting a loss of international market access (Figure 3.9). Between March and October 2020, there was no FX-denominated issuance from Sub-Saharan African countries.

Middle-income issuers with established track records of good economic performance and positive medium-term outlook continued to tap the international capital markets in 2020. The largest issuers were investment-grade issuers, including Mexico, Poland, Saudi Arabia and Qatar. Of particular interest is that China, for the first time, issued USD- and euro-denominated bonds in international capital markets and Peru sold USD-denominated ‘century bonds’ to soften the economic fallout from the coronavirus crisis. In addition to investment-grade issuers, several non-investment grade issuers including Albania, Belarus, Jordan, El Salvador and Ukraine, issued debt in international capital markets. It is important to note that a handful of LMICs, including Benin, Honduras, Mongolia and Uzbekistan, which are classified as income-eligible for the G20 Debt Service Suspension Initiative, issued Eurobonds post-COVID-19.

Figure 3.9. Foreign currency denominated debt issuance within emerging market groups



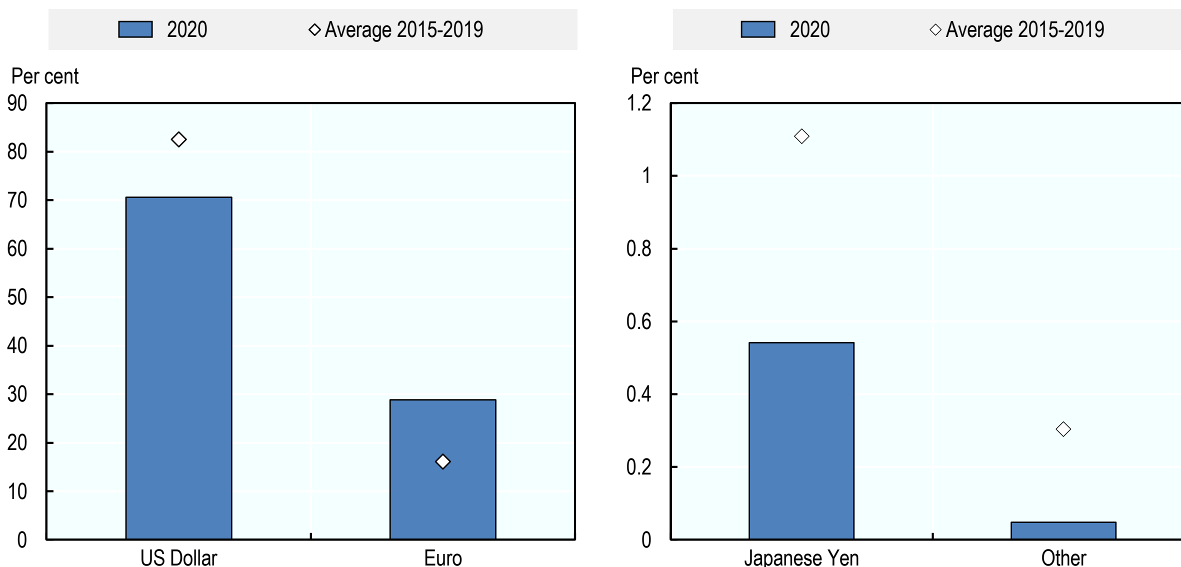
Source: OECD calculations based on data from Refinitiv.

In addition, a few countries with already elevated debt levels, including Argentina and Ecuador, conducted debt restructuring operations in the second half of 2020. These recent examples of debt restructuring have shown that Collective Action Clauses can help facilitate renegotiation with bondholders, and in turn, an orderly restructuring process (Ian and Dimitrios, 2021[6]).

3.3.4. USD remained the most popular foreign currency of debt issuance

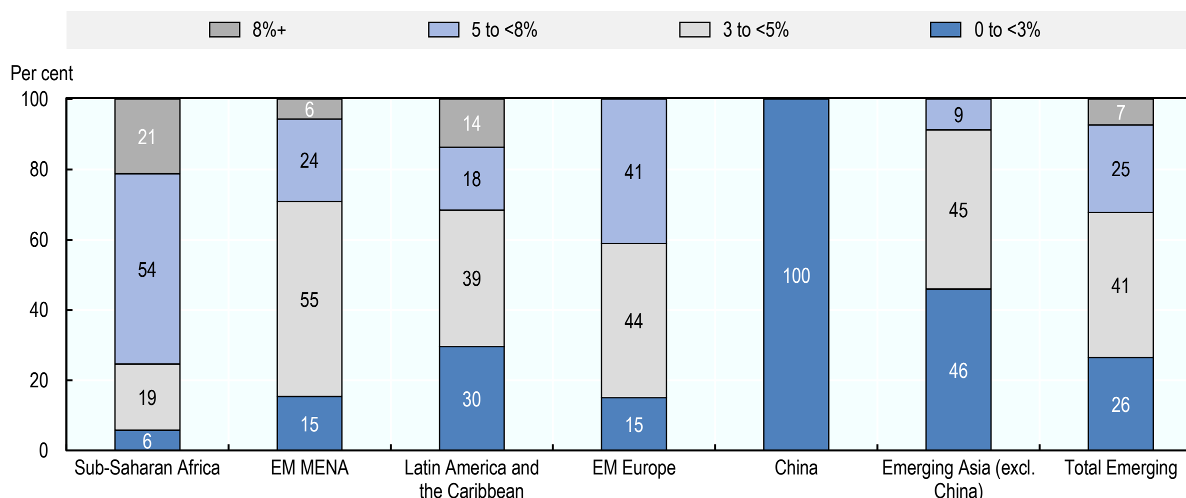
Compared to the historical averages, the share of USD- and Japanese yen-denominated issuance in total FX-denominated debt issuance declined in 2020 (Figure 3.10). By contrast, the share of euro-denominated bond issuance increased on the back of increased issuance by emerging countries of Europe, including Romania, Poland, Hungary and Serbia. Nevertheless, USD-denominated issuance, accounting for more than 70% of total FX-denominated debt issuance, remained the most popular foreign currency for international debt issuance by EME sovereigns in 2020.

Figure 3.10. Composition of foreign currency denominated debt issuance



Source: OECD calculations based on data from Refinitiv.

Figure 3.11. Volume share by yield group of fixed-rate USD denominated bond issuance by EMEs in 2020



Source: OECD calculations based on data from Refinitiv.

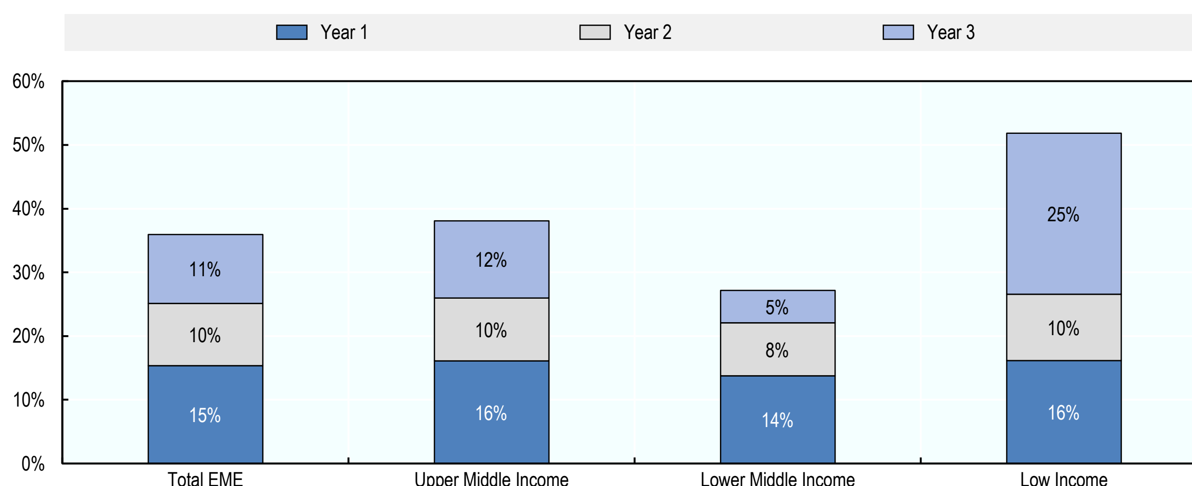
The volume share by yield group of fixed-rate USD denominated bond issuance has also shown variation among regions in 2020 (Figure 3.11). About one quarter of the total fixed-rate USD-denominated government bonds were issued with less than 3% yield in 2020; 41% between 3 and 5% yield, and 32% with more than 5% yield in the primary market. Looking at regional groups, the cost of USD-denominated bonds was relatively favourable for Emerging Asia issuers. Emerging Africa, on the other hand, issued USD denominated debt with the highest average costs as reliance on commodities, tourism and remittances has made some of these countries' finances particularly vulnerable to the COVID-19 shock (e.g. Angola for oil prices, Seychelles for tourism) (IMF, 2021[7]). In this region, three quarters of total USD debt was issued with higher than 5% yield, one third of which was even higher than 8%.

3.4. Increased financing and shorter maturities amplified medium-term refinancing needs

The COVID-19 crisis has increased government debt to be repaid by EMEs, largely due to increased borrowings to finance various measures to mitigate the social and economic impacts of the pandemic. In addition, the average maturity of issuance by EMEs shortened from 7 years in 2019 to 6.4 years in 2020. Average maturities shortened more drastically in some countries where the COVID-19 virus hit hard. For example, in Brazil, federal debt held by the public due within the next 12 months increased from 18% in December 2019 to above 28% in December 2020.

Higher rollover risk is reflected in increasing rollover ratios for the coming years. 15% of outstanding EME government securities is due in 2021, and 21% within the subsequent two years (Figure 3.12). Of particular interest is that the impact on maturities was more pronounced in countries where foreign holdings of domestic debt declined sharply as in many cases non-resident investors favour the longer maturity spectrum during risk-off episodes. For example, in Indonesia, the share of 10-year bonds in outstanding government debt declined from 39.2% in 2019 to 35.1% in 2020, as the share of foreign holdings fell from 38.6% to 25.2% during the same period.[6] Similarly, in Thailand, where the share of foreign holdings decreased from about 17% in 2019 to 13.6% in 2020, debt due within three years has increased by USD 19.6 billion (equal to 10% of total government debt) over the same period.

Figure 3.12. Outstanding government debt due within the next 3 years (by selected income groups)



Source: OECD calculations based on data from Refinitiv.

Compared to middle-income countries, refinancing needs are much higher in LICs where debt due in the next three years was 51% in 2020. Higher near-term debt repayments imply a higher refinancing risk and pass-through impact of interest rate changes on government interest costs, which in turn would further increase borrowing needs and tighten overall domestic financial conditions.

3.4.1. Emerging market issuers should be vigilant amid continued global uncertainty

Credit ratings downgrades and rising debt levels on the back of higher refinancing needs amid the pandemic have not translated into consistently high funding costs for EM sovereigns, largely due to ultra-accommodative monetary policies deployed by major advanced economies. In total, EM sovereigns issued about USD 3.4 trillion of debt in financial markets in 2020, 35% higher than the average of previous five years. Additionally, increased borrowing in shortened maturities has raised financing pressure in the near future.

Looking forward, a number of risk factors could put strong downward pressure on EM sovereign funding conditions including rising inflation expectations and weak economic recoveries due to slower distribution of vaccines, and renewed waves or new variants of the COVID-19 virus. Such potential risk scenarios call for greater attention to refinancing risks in EMEs. A particular risk for EMEs is that rising US bond yields could trigger a reversal of capital flows and higher currency volatility, similar to the 'taper tantrum' of 2013. A re-evaluation of inflation risks in the context of large monetary and fiscal support, or earlier-than-expected withdrawal of policy support in advanced economies would heighten such risks. In particular, countries with high external financing needs and high near-term rollover ratios are more susceptible to changes in the market sentiment.

In view of the still-high risk tolerance in global financial markets, a prudent means of managing public debt would require lengthening of maturities to limit short-term refinancing risk and limit potential future issuance volatility. In addition, these countries may benefit from building-up contingency buffers through pre-financing programmes.

LICs with weak fundamentals, on the other hand, are the most vulnerable to global risks, as they have a relatively low level of reserves and with limited financial buffers and other contingency safety nets. In addition, LICs' external financing needs are expected to increase. The average annual amount of external debt service falling due in 2021-25 is more than twice the pre-crisis average (2010-19) (International Monetary Fund. Strategy, Policy, & Review Department, 2021[8]). While market access may remain limited for LICs with very elevated debt levels in the near term, official sector grants and loans such as ODA grants, multilateral credits and lending from IFIs will help ease their financing constraints. In cases where necessary, further debt restructuring might be necessary to avoid disastrous spending cuts.

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Annex 3.A. Methods and sources

Primary sovereign bond market data and country groupings

Primary sovereign bond market data are based on original OECD calculations using data obtained from Refinitiv that provides international security-level data on new issues of sovereign bonds. The data set covers bonds issued by emerging market sovereigns in the period from 1 January 2015 to 31 December 2020 and includes both short-term and long-term debt. Short-term debt ("bills") is defined as any security with a maturity less than or equal to 367 days. The database provides a detailed set of information for each bond issue, including the proceeds, maturity date, interest rate and interest rate structure.

The definition of emerging markets used in the present report is the IMF's classification of Emerging and Developing Economies used in the World Economic Outlook. The regional definitions are also those used by the IMF, while the income categories used (high income, low income, lower middle income, upper middle income) are defined by the World Bank according to GNI per capita levels.

A number of bonds have been subject to reopening. For these bonds the initial data only provide the total amount (original issuance plus reopening). To retrieve the issuance amount for such reopened bonds, specific data on the outstanding amount on each reopening date for the concerned bonds have been downloaded from Refinitiv. In order to obtain the issuance amount on each relevant date, the outstanding amount on a given date has been subtracted from the outstanding amount on the following date. The reopening data only provide amounts outstanding in local currency. The calculated issuance amounts are converted on the transaction date using USD foreign exchange data from Refinitiv. To ensure consistency and comparability, the same method is used for all bonds, including those which have not been subject to reopening.

Exchange offers and certain bonds in the dataset have been manually excluded when they did not have any identifier (ISIN, RIC or CUSIP) and when they have not been able to be manually confirmed by comparing with official government data.

The issuance amounts are presented in 2020 USD adjusted by US CPI.

Credit ratings data

Refinitiv provides rating information from three leading rating agencies: S&P, Fitch and Moody's. For each country that has rating information in the dataset, a value of 1 to the lowest credit quality rating (C) and 21 to the highest credit quality rating (AAA for S&P and Fitch and Aaa for Moody's) is assigned. There are eleven non-investment grade categories: five from C (C to CCC+); and six from B (B- to BB+). The ratings data are observed on a monthly basis. If a country has received several ratings in one month, the lowest one is used, except when that is a default rating (SD or D for S&P and RD or DDD for Fitch).

The rating in question is then assigned to each relevant bond issued by that country. In the case that there are ratings available from several agencies, their average is used. When differentiating between investment and non-investment grade bonds, if the final rating is higher than or equal to 12 it is classified as investment grade. If the final rating is below 12 but higher than or equal to 11 and at least two agencies have given a rating higher than or equal to 12, it is also classified as investment grade. All other bonds are considered non-investment grade.

Notes

[1] Despite growth in recent years, local currency bond markets which can help absorbing sudden movements in foreign capital flows continue to remain relatively small compared with advanced economies ((IMF and World Bank, 2021[9]).

[2] Several EM countries including Argentina, Costa Rica, Oman and Zambia were downgraded more than twice in 2020.

[3] Compared to advanced economies, support in emerging markets and developing economies has been generally more limited, reflecting limited fiscal space in many of these economies. The demand-supporting spending and revenue measures were much smaller in low-income developing countries (about 2% of GDP on average) than in middle-income emerging market economies (about 6% of GDP) or advanced economies (nearly 24% of GDP) (IMF, 2021[7]).

[4] Emerging Asia region increased its debt issuance share from 19% in 2000 to 44% in 2019 (OECD, 2020[1]). During this period, China nearly tripled its share of total EME debt issuance. Even excluding China, where the debt build-up has been particularly pronounced, debt issuance in Emerging Asia has risen to record highs.

[5] In Turkey, the share of foreign currency denominated debt issuance in total domestic market debt issuance increased from 26% in 2019 to 39.5% in 2020 (Public Debt Management Report, MoF, Turkey).

[6] In Indonesia, despite the decline in the 10-year bonds share in total issuance, ATM of government debt remained high around 8.5 years in 2020, partly because of the Indonesian central bank's purchases of long-term government bonds.

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