Recent Developments in Official Capital Flows

Net official lending to developing countries has declined dramatically over the past few years while net private lending has surged. This briefing note provides an overview of recent trends in net official lending, along with prospects over the short term. The three main messages are as follows.

- Net official lending has declined sharply over the past three years and will likely continue to decline in 2006, mainly due to large prepayments to the Paris Club (almost $32 billion), the IMF (over $17 billion) and the World Bank and Inter-American Development Bank (over $9 billion).
- Russia completed paying off its Soviet-era debts with a $22 billion prepayment to its Paris Club of creditors, drawing on its abundant oil-export revenues.
- Large prepayments by other countries have been financed by drawing down ample stocks of foreign reserves and by borrowing from private creditors in international capital markets on favorable terms.

Net official lending declined sharply over the past few years while net private lending surged

Net official lending fell from $27 in 2001 to -$71 billion in 2005, a swing of almost $100 billion, while net private lending surged from -$29 billion to $192 billion (Figure 1). In 2005 net (official and private) debt flows increased by only $1 billion as a $44 billion increase in net private lending was offset by a $43 billion decline in net official lending. The dramatic shift in the composition of net debt flows reflects countries’ ability to finance prepayments to official creditors (the Paris Club and the IMF in particular) by borrowing in private capital markets on favorable terms and by drawing down ample stocks of international reserves. These trends have continued into 2006 with net private and official lending expected to remain close to levels attained in 2005.

Source: World Bank Debtor Reporting System (DRS) and staff estimates.
Gross disbursements by official creditors outstripped principal repayments by a cumulative total of $112 billion over the past three years. The sharp decline in net official lending largely stems from a dramatic fall in net lending by the IMF and by official bilateral creditors (Figure 2). Net lending by the IMF declined from a high of $19.5 billion in 2001 to -$41.1 billion in 2005, a swing of $60 billion, while net lending by official bilateral creditors fell from -$6.1 billion to -$32.6 billion, a $25 billion swing. Net lending by other official multilateral creditors (besides the IMF) has also declined over the past few years, but to a lesser extent.

The sharp decline in net lending by bilateral official creditors in 2005 was due to a $28 billion increase in principal repayments. Gross disbursements increased slightly in 2005 reaching $16.4 billion, up from $12 billion in 2003-04, but remain below the average $23.6 billion level over the 1990s (Figure 3). The $28 billion increase in principal repayments was mainly due to large prepayments to the Paris Club by the Russian Federation ($15 billion), Poland ($5.6 billion) and Peru ($2.0 billion).

The dramatic decline in net lending by the IMF over the past few years was due to an increase in repurchases and a decline in purchases (Figure 4). Purchases declined from a high of $34.4 billion in 2002 to a low of $4.0 billion in 2005, while repurchases increased from $20.4 billion to $45.0 billion. The decline in purchases over the past few years reflects a marked improvement in international financial stability supported by the favorable global economic and financial conditions, along with improved fundamentals in most emerging market economies. The increase in repurchases reflects large repayments on emergency assistance loans made to Indonesia and the Russian Federation in 1997-98, and to Argentina, Brazil, and Turkey in 2001-02. In December 2005 Brazil prepaid its entire outstanding obligations to the IMF amounting to SDR 15.5 billion.
Large prepayments to official creditors have continued into 2006

Net official lending has continued to contract in 2006, mainly due large prepayments to bilateral and multilateral official creditors. This includes a total of almost $32 billion in prepayments to the Paris Club by the Russian Federation ($22 billion), Algeria ($8 billion) and Brazil ($2 billion), over $17 billion in prepayments to the IMF by Argentina ($9.6 billion), Indonesia ($6.9 billion) and Uruguay ($0.9 billion), and $9.4 billion in prepayments to the World Bank and the Inter-American Development Bank by Mexico ($9.0 billion) and Uruguay ($0.4 billion).

Net lending by the IMF continued to decline in 2006 as repayments outstripped payments by $25 billion over the period January to September, compared to $40 billion over the entire year 2005.1 IMF credit outstanding has declined from a high of $100 billion in 2003 to $23 billion in early October 2006, half of which is owed to just one country—Turkey. Turkey accounts for almost 80% of the projected payments to the IMF over the balance of 2006 and 70% in 2007 (on an expectations basis). Turkey is not likely to prepay any of its outstanding IMF obligations under the current economic and financial conditions, characterized by mounting inflationary pressures, high domestic interest rates and a widening current account deficit.

In contrast, net lending by the World Bank (IBRD and IDA) is projected to increase in 2006 (Figure 5).

Russia: Prepayment to the Paris Club

In June 2006 Russia signed a deal with the Paris Club to repay its entire Soviet-era debt of about $22 billion. Under the terms of the agreement, Russia agreed to pre-pay $21.3 billion ahead of schedule, the largest prepayment ever made to Paris Club creditors, the remaining $700 million was repaid on schedule (in August). Just over half of the $21.3 billion prepayment involves floating-rate debt, which will be repaid at the nominal rate. The remaining fixed-rate debt will be repaid at the market value, which entails a premium of about 4.8% or about $1 billion, $700 million of which will go to Germany.2 The early repayment will save Russia a total of $7.7 billion on interest payments by 2020 ($1.2 billion in 2007, $1.1 billion in 2008 and $1 billion in 2009).

The pre-payment was financed by drawing down foreign reserves, which have been accumulating at an average monthly rate of $12 billion over the period January to September 2006. After the $23 billion prepayment to the Paris Club, the stock of foreign reserves reached $259 billion at the end of September (18 months of import cover), up from $156 at the end-September 2005 (10 months of import cover).
general government’s external debt has declined from a high of over 70% of GDP in 1999 to less than 5%.

**Algeria: Prepayment to the Paris Club**

In May 2006 the Paris Club creditors accepted an offer by Algeria to prepay $7.9 billion of its obligations at par. The prepayment operations are expected to be completed by November 2006, after conclusion of bilateral agreements with each of the Paris Club creditors. The prepayment is likely to be financed by drawing down foreign reserves. Algeria has not issued any sovereign bonds over the past year; foreign reserves have increased from $47 billion at end-June 2005 to $66 billion at end-June 2006.

**Argentina: Prepayment to the IMF**

In January 2006 Argentina prepaid of its outstanding obligations to the IMF amounting to about $9.6 billion. The prepayment was financed by drawing down foreign reserves, which declined from $27 billion at end-December 2005 (10.7 months of import cover) to $19 billion at end-January 2006 (7.2 months of import cover). Reserves have subsequently cumulated to $28 billion at end-September (8.5 months of import cover). External debt declined from 117% of GDP in 2004 to under 60% following its debt restructuring agreement in June 2005, which entailed a record 75% debt stock write-down (in present value terms including past interest due), and strong growth – real GDP growth averaged 9% in 2004-05. Argentina has issued $2 billion in global bonds so far this year, more than half of which was purchased by Venezuela.

**Indonesia: Prepayment to the IMF**

Indonesia repaid all of its outstanding obligations to the IMF in 2006, with a $3.7 billion repayment in June, followed by a $3.2 billion repayment in October. Foreign reserves totaled $40 billion at end-August 2006 (7.3 months of import cover), up from $33 billion at end-2005 (6.9 months of import cover). Indonesia has been able to access international bond markets over the past year at favorable rates, with a $2.0 billion sovereign bond issue in October 2005 (with a spread of 311 basis points), following by a $1.5 billion issue in March 2006 (spread of 213 basis points). Indonesia’s external debt burden is projected to decline to 39% of GDP in 2006, down from a high of 94% in 2000 and foreign reserves projected to increase to almost 140% of short-term debt at end-2006.  

**Uruguay: Prepayments to the IMF, the World Bank and the IaDB**

Uruguay prepaid $430 million to the IaDB and the World Bank in February and $630 million to the IMF in March. The government has announced that it would prepay $0.9 billion to the IMF coming due through August 2007, reducing its IMF obligations to about $1.1 billion. The prepayments were funded by a combination of drawing down foreign reserves and borrowing on international bond markets. Foreign reserves have increased since the beginning of the year, despite the prepayments, reaching $3.5 billion at end-June (8.2 months of import cover), up from $3.1 billion at end-December 2005. Uruguay has issued a total of $2.0 billion in global bonds since July 2005. Uruguay’s external debt burden has declined significantly over the past few years, reaching an estimated 78% of GDP in 2006Q1, down from almost 100% in 2004, but remains a concern on the part of investors. This has been reflected in volatile bond spreads, which declined from 470 basis points in April 2005 to a low of 225 in March-April 2006, before widening to over 300 basis points in June.

**Mexico: Prepayments to the World Bank and the IaDB**

In August the Mexican government announced that it would prepay $9 billion to the World Bank and the Inter-American Development Bank (IaDB), which would reduce Mexico’s debt to the two international institutions to $4 billion. After the repayment, foreign reserves totaled $83 billion (3.7 months of import cover), up from $74 billion at end-December 2005 (3.7 months of import cover). Mexico sold a $0.9 billion global bond issue in June 2005 (spread of 180 basis points) and a $3.0 billion issue in March 2006 (spread of 140 basis points). Bond spreads rose to 155 basis points in the wake of market turmoil in May-June 2006, but subsequently declined to 125 basis points at end-August 2006. Mexico’s external debt burden has declined significantly over the past few years, reaching an estimated 14% of GDP, down from 21% in 2004.
Notes
1 Official IMF financial statistics are converted from SDRs to $US using period averages.
2 This is the first time the Paris Club has used a combined plan of this kind. The plan was proposed by Germany to take into account the Aries bonds that it issued in 2004, which were secured by Russia’s Paris Club debt owed to Germany. Germany sold the Aries bonds at discounts of 6-9% and demanded a penalty payment from Russia as compensation. Russia was obligated to provide the same terms for other creditors under Paris Club rules.
3 Projections are based on the IMF 2006 Article IV Consultation completed July 31, 2006.