

SM/12/252
Correction 1

November 14, 2012

To: Members of the Executive Board
From: The Acting Secretary
Subject: **Global Risks, Vulnerabilities, and Policy Challenges Facing Low-Income Countries**

The attached corrections to SM/12/252 (10/10/12) have been provided by the staff:

Evident Ambiguity

Page 24, first bullet, line 1, footnote 23: added to read “The discussion only covers PRGT eligible members of currency unions (i.e., in the case of the ECCU for instance, four out of the eight members are PRGT-eligible). The calculation of reserve adequacy is then based on those members’ imputed share of union reserves.” Subsequent footnotes renumbered.

Typographical Error

Page 40, para. 1, line 2: for “in Section II.D.” read “in Section II.A.”

Questions may be referred to Mr. van Selm (ext. 38505) and Ms. Farhan (ext. 36964) in SPR.

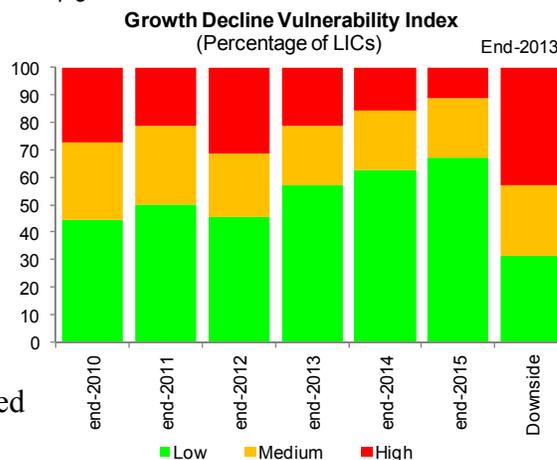
This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

Other Distribution:
Department Heads

sharp downturn in global growth in 2013 (a decline in global growth by about 2 percentage points). The number of LICs at high risk of going into recession would roughly double, with over 40 percent of LICs showing increased vulnerabilities to further exogenous shocks (substantially higher than the levels experienced at the height of the global crisis). The majority of countries would experience a pronounced worsening in external sector indicators vis-à-vis the baseline, and non-commodity exporters would suffer from worsened fiscal vulnerabilities (a reversal compared to the projected improvement in the baseline).

LICs' near-term vulnerability to a shock induced recession would increase sharply in the case of a sharp global downturn.

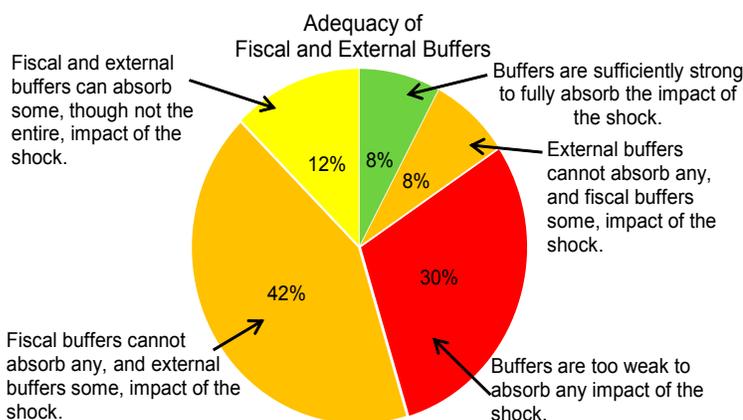


22. Macroeconomic buffers are much lower than prior to the 2008–09 global economic crisis and remain insufficient to address the risks facing many LICs, although vulnerabilities vary significantly across countries. In the current environment, with fiscal and external room for maneuver reduced after the global crisis, the ability to absorb the impact of global shocks would be limited:

- Under a *food price shock*, a third of LICs would not have any fiscal and external buffers to absorb the shock, while nearly 20 percent would have room to absorb the impact in full.
- Similarly, under a *fuel price shock*, a third of LICs would not have any room to absorb the shock, while just above 10 percent would be able to fully cushion the impact.
- Under a *sharp decline in global growth*, as with the other shocks, a third of LICs would be fully exposed (i.e., would not have any fiscal and external buffers to absorb the shock), while about one in ten would have room to absorb the impact in full.

Macroeconomic policy buffers of many LICs have not yet been sufficiently rebuilt to insulate against potential shocks.

Distribution of LICs' Ability to Absorb Impact of a Sharp Decline in Global Growth in 2013¹
(Percent of LICs)



¹ Based on simulated impact on fiscal space and international reserve coverage of the global risk scenario of a sharp growth slowdown.

- Looking specifically at **currency unions**,²³ the Central African Economic and Monetary Community (CEMAC) has adequate external buffers to accommodate the impact of a sharp decline in global growth and both commodity price shocks. Reserves at the Bank of the Central African States (BEAC) would remain above three months of imports, as in the baseline. In fact, with a number of large oil exporters in the CEMAC, reserve coverage increases significantly under an oil price shock. The West African Economic and Monetary Union (WAEMU) has adequate external buffers to accommodate the impact of both commodity price shocks. A sharp decline in global growth could push reserves at the Central Bank of Western African States (BCEAO) just below three months of imports. However, neither the BEAC nor the BCEAO would have adequate reserves to absorb, even partially, the impact of a protracted decline in global growth. Conversely, the East Caribbean Currency Union (ECCU) would not be able to cushion the impact of any of the shocks considered, given that reserve coverage at the Central Bank (ECCB) is currently below three months of imports and would be further reduced under all scenarios, with the largest impact seen under the oil shock (see Appendix III for details on methodology).

23. **A protracted global downturn would raise recession risks further in LICs.** The illustrative growth decline vulnerability index would increase significantly in both 2013 and 2014 and ease only slightly thereafter. Fiscal vulnerabilities for all LICs would increase sharply owing to permanent output losses. Similarly, weaker commodity prices would

²³ The discussion only covers PRGT eligible members of currency unions (i.e., in the case of the ECCU for instance, four out of the eight members are PRGT-eligible). The calculation of reserve adequacy is then based on those members' imputed share of union reserves.

countries as a group, only those countries with positive financing needs are included in the total LICs amount.

2. The following tables depict the main assumptions used in the global risk scenarios under the 2012 VE-LIC exercise, as provided by the IMF Research Department and consistent with the most recent WEO:

	Baseline		Downside		Difference	
	2012	2013	2012	2013	2012	2013
World	3.3	3.6	3.3	1.7	0.0	-1.9
USA	2.2	2.1	2.2	0.4	0.0	-1.7
Euro Area	-0.4	0.3	-0.4	-3.5	0.0	-3.8
Japan	2.2	1.2	2.2	-0.1	0.0	-1.3
Emerging Asia 1/	6.8	7.3	6.8	6.4	0.0	-1.0
Latin America 2/	3.2	4.0	3.2	3.2	0.0	-0.8
Rest of the World 3/	2.1	2.5	2.1	0.5	0.0	-2.0

1/ Includes: China, Hong Kong SAR, India, Indonesia, South Korea, Malaysia, Phillipines, Singapore, Taiwan Province of China, and Thailand.

2/ Includes: Brazil, Chile, Mexico, Colombia, and Peru.

3/ Includes: Argentina, Australia, Bulgaria, Canada, Denmark, Israel, New Zealand, Norway, Russia, South Africa, Sweden, Switzerland, Turkey, United Kingdom, Venezuela, and Bolivia.

	Baseline					Scenario				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
World	3.3	3.6	4.1	4.4	4.5	3.3	3.1	2.4	2.4	3.3
USA	2.2	2.1	2.9	3.4	3.4	2.2	1.7	1.2	1.6	2.8
Euro Area	-0.4	0.3	1.2	1.5	1.6	-0.4	-0.2	-0.6	-1.1	0.0
Japan	2.2	1.2	1.1	1.2	1.1	2.2	0.9	-0.2	-0.9	-0.3
Emerging Asia 1/	6.8	7.3	7.6	7.8	7.9	6.8	6.5	5.0	5.3	6.2
Latin America 2/	3.2	4.0	4.0	4.0	4.0	3.2	3.6	2.8	2.8	3.1
Rest of the World 3/	2.1	2.5	2.9	3.1	3.1	2.1	2.0	1.5	1.5	2.0

1/ Includes: China, Hong Kong SAR, India, Indonesia, South Korea, Malaysia, Phillipines, Singapore, Taiwan Province of China, and Thailand.

2/ Includes: Brazil, Chile, Mexico, Colombia, and Peru.

3/ Includes: Argentina, Australia, Bulgaria, Canada, Denmark, Israel, New Zealand, Norway, Russia, South Africa, Sweden, Switzerland, Turkey, United Kingdom, Venezuela, and Bolivia.

Appendix IV. Methodology for the Vulnerability Indicators

This appendix reports the definitions, thresholds, and data sources used for the vulnerability indicators discussed in Section II. [AD](#). Aiming at measuring LICs' relative idiosyncratic exposure to specific shocks, they can qualify and complement the growth decline vulnerability index and the scenario analysis.

Table 1. Vulnerability Indicators – Definitions, Thresholds and Data Sources

Indicator	Definition	Thresholds	Data Source
(i) Geography/Climate			
• Natural disasters ^{1,2}	<i>I = average annual disaster cost-to-GDP ratio in the past 25 years (i.e., 1987–2011)</i>	Thirtiles	EM-DAT, WEO
	<i>I = average annual people affected-to-population ratio in the past 25 years (i.e., 1987–2011)</i>	Thirtiles	EM-DAT, WEO
• Food price inflation ¹	<i>I = standard deviation of (domestic food price inflation weighed by the share of food in the CPI basket) over the past decade (i.e., 2000M1–2011M12)</i>	Thirtiles	VE-LIC questionnaire
(ii) External Linkages			
• Terms of trade (here: 1 st round income effect) ¹	<i>I = standard deviation of (ΔEXP price * EXP/GDP - ΔIMP price * IMP/GDP) over the past decade (i.e., 2002–2011)</i>	Thirtiles	WEO
• Cross-border claims	<i>I = consolidated foreign claims of BIS reporting banks by as a share of GDP (2010–2011 average)</i>	Thirtiles	BIS, WEO
(iii) Domestic Factors			
• Political stability and security	<i>I = WGI political stability and no violence indicator in 2010 (percentile rank of 213 countries)</i>	Thirtiles	World Bank
• Corruption	<i>I = corruption perception index in 2011 (rank out of 188 countries)</i>	Thirtiles	Transparency International
(iv) Macroeconomic Fundamentals and Financial Indicators			
• Debt distress	<i>I = latest available debt distress risk rating</i>	3 categories (0="no risk", 1="moderate risk", 2="high risk" or "in debt distress")	last available DSA (as of end-July 2012)
• Exchange rate	<i>I = latest available real exchange rate alignment assessment</i>	3 categories (0="equilibrium", 1="undervalued", 2="overvalued")	last available Article IV staff report (as of end-July 2012)
• Non-performing loans	<i>I = composite index of (R1=ratio of non-performing loans (NPLs) to total loans (%) and R2=ratio of provisions for NPLs to total NPLs (%) in 2011)</i>	3 categories (0="R1<=5 AND R2>=70", 1="R1>5 AND 60<=R2<70", 2="R1>5 AND R2<60")	VE-LIC questionnaire
• Credit-to-GDP	<i>I = percentage change of the private credit-to-GDP ratio between 2011 and 2008</i>	3 categories (0="R<=10", 1="10<R<=25", 1="R>20")	IFS

1/ Countries are excluded if data coverage is less than a third of the specified time period.

2/ Natural disasters include droughts, earthquakes, epidemic, extreme temperature, flood, insect infestation, mass movement (wet and dry), storm, volcano, and wildfire.

3/ There is no common definition of NPLs used here. Instead, data are collected from country desks reflecting each country's specific circumstances.