IMF comes through with historic SDR allocation, but challenges remain

Tuesday's IMF approval of a $650bn allocation of Special Drawing Rights is a 'historic' distribution of monetary reserves and will provide a welcome boost to frontier markets. We take this opportunity to highlight our recent report on EM sovereign vulnerabilities and our heatmap graphics identifying the implications to sovereign external metrics

SDR release provides some breathing space

The IMF says this is the largest SDR allocation in its history and a 'shot in the arm' for the global economy at a time of unprecedented crisis. It says it'll particularly help more vulnerable countries struggling to cope with the Covid-19 crisis.

In our opinion, the SDR allocation will provide additional breathing space for countries with weak external balance sheets and reflects the willingness of the international community to extend support to lower-income countries. As can be seen in our heatmaps, the IMF SDR allocation will deliver a substantial improvement in terms of coverage of external financing needs.

Among them, Zambia's external financing needs/FX reserves ratio for 2021 will fall from 252% pre-SDR to 122% post-SDR while Pakistan and Tunisia will fall below the 100% threshold (109% to 94% and 102% to 93%, respectively). Risks would decrease further if high-income countries decide to on-lend or reallocate their SDR allocations to low- and middle-income countries. This channel looks particularly important since high-income countries, by nature of their IMF quotas, received 58% of this SDR distribution. All in all, for 2021 and into early 2022, this will ease external financing risks.

Looking further ahead, however, please see Trieu Pham's and Antoine Bouvet's detailed article on Emerging Market Sovereign Credit Vulnerabilities. Those countries with weak external balance sheets may well struggle as international financing conditions become less accommodative as 2022 progresses.

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