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MARKET COMMENTARY

Ashmore

Missing the big picture on IMF lending

By Jan Dehn and Gustavo Medeiros

In a recent opinion piece in the Financial Times, Ousmene Mandeng makes the point that the lending programmes of the International Monetary Fund (IMF) are defective.[1] He is right. No one wants to surrender control of economic policy to the global financial policeman. But Mr Mandeng's call for new types of IMF lending programmes, while laudable, misses the bigger point that the IMF can *never* be the real solution to financial vulnerability in EM countries.

The only way to truly end financing vulnerability is for Emerging Markets (EM) countries to develop their own domestic bond markets. Asia was able to escape vulnerability to external shocks precisely by becoming financially self-sufficient. Thailand, for example, obtains all financing domestically and does not even issue external debt. Local bond markets were also critical in limiting the fallout from last year's Covid-19 crash in a large number of EM countries, where local bond yields actually fell for the first time in a global crisis (Figure 1). The way to end financial vulnerability in EM countries is staring us in the face – as long as countries run their economies well *and* have domestic bond markets they can cope with almost anything that global markets throw at them.

Fig 1: **Local bond yields fell during the 2020 Covid-19 financial crisis (base on JP Morgan's GBI-EM GD)**

Source: Ashmore, JP Morgan, Bloomberg. Data as at 2 March 2021.

Which begs the question: if local bond markets are so effective in preventing financial crises in EM countries why have International Financial Institutions (IFIs) not placed their development at the very top of the policy agendas, even made them part of the conditionality in their lending programmes?

One possible reason is that the top management in many IFIs simply does not understand the real significance of local markets. Alternatively, they understand all too well that local markets could reduce materially their own role in managing financial risks. Turkeys do not vote for Christmas.

Regardless of the reasons, Mr Mandeng inadvertently makes the point clearly by reminding us that Italy has not tapped IMF money since 1977. Exactly the same thing is happening in more and more EM countries as they develop their local bond markets. Local bond market development is a good thing because it ends crises, it could happen much faster if only the IMF and other IFIs genuinely wanted to see an end to financial crises in EM.

[1] See: https://www.ft.com/content/9de8e963-850c-47ce-97f1-b0bf29b2b751

Ashmore

Contact

Head office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE

T: +44 (0)20 3077 6000

@AshmoreEM

www.ashmoregroup.com

Bogota
T: +57 1 316 2070

Dubai
T: +971 440 195 86

Dublin
T: +353 1588 1300

Jakarta
T: +6221 2953 9000

Mumbai
T: +9122 6269 0000

New York
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