

Navigating Debt Challenges in an Uncertain World

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October 2026



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Three Questions

1 What is the current debt challenge?

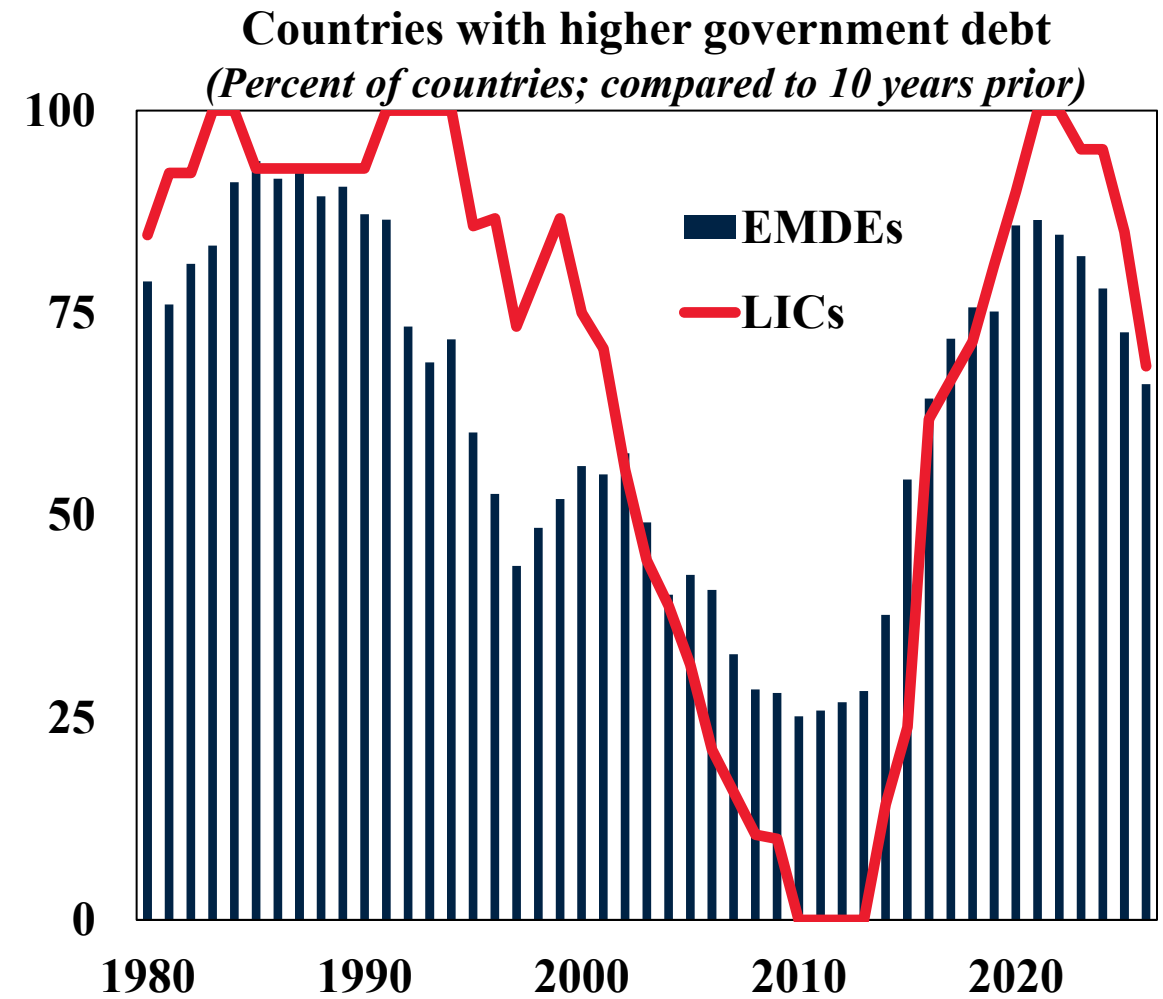
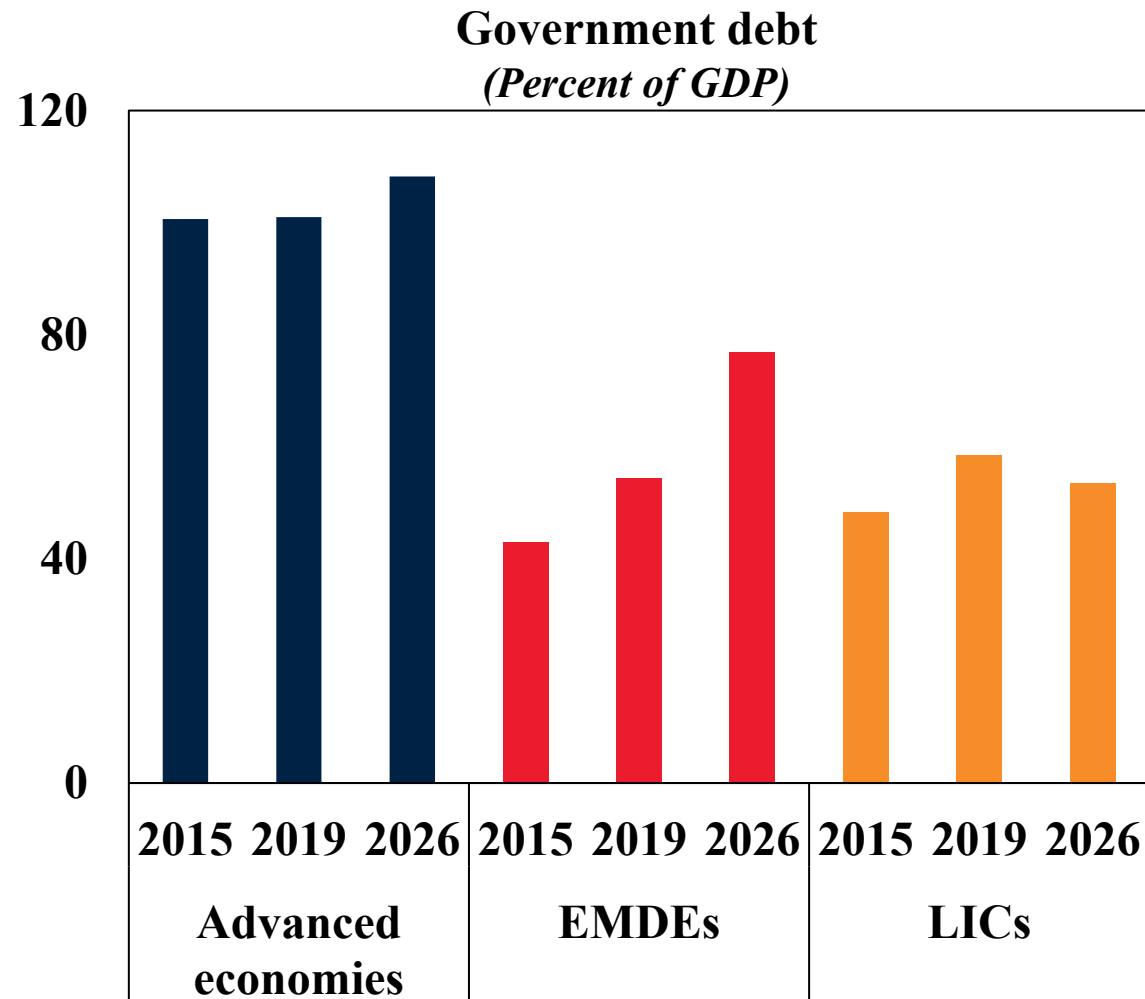
2 How have countries historically reduced government debt?

3 What lessons can EMDEs draw from past debt reduction episodes?

* *EMDEs=Emerging Market and Developing Economies*

Government Debt Accumulation

Higher Stock of Government Debt in Majority of EMDEs



Sources: International Monetary Fund; Kose et al. (2022); World Bank.

Notes: LICs = low-income countries. Left Panel. The aggregates are computed with weighted averages using nominal GDP in U.S. dollars as weights. Data for 2026 are forecasts. Sample includes up to 42 advanced economies and 152 EMDEs, including 22 LICs. Right Panel. The percent of countries with higher government debt-to-GDP ratios compared to 10 years prior in respective country groups. Last observation is 2026, based on forecasts. Sample includes up to 150 EMDEs, including 21 LICs.

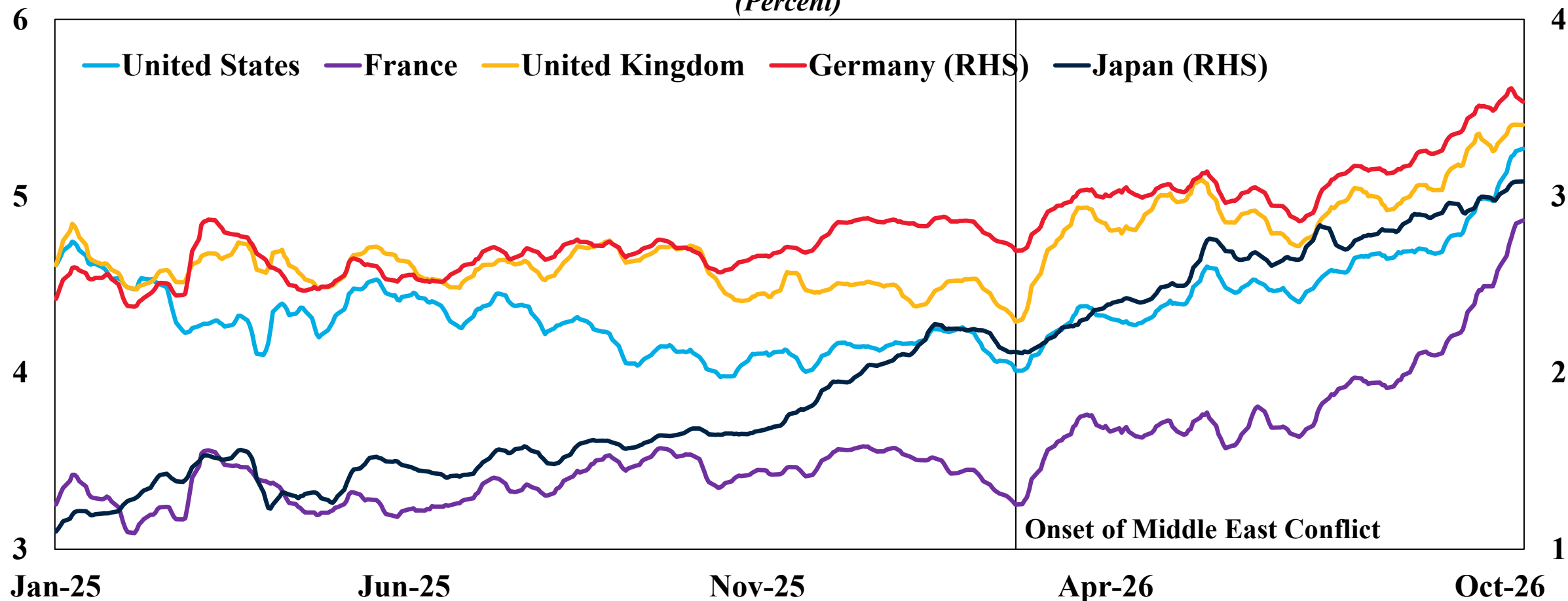


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Advanced Economy Bond Yields

Sharp Increase in Long-Term Yields in 2026

10-year nominal yields in major advanced economies
(Percent)

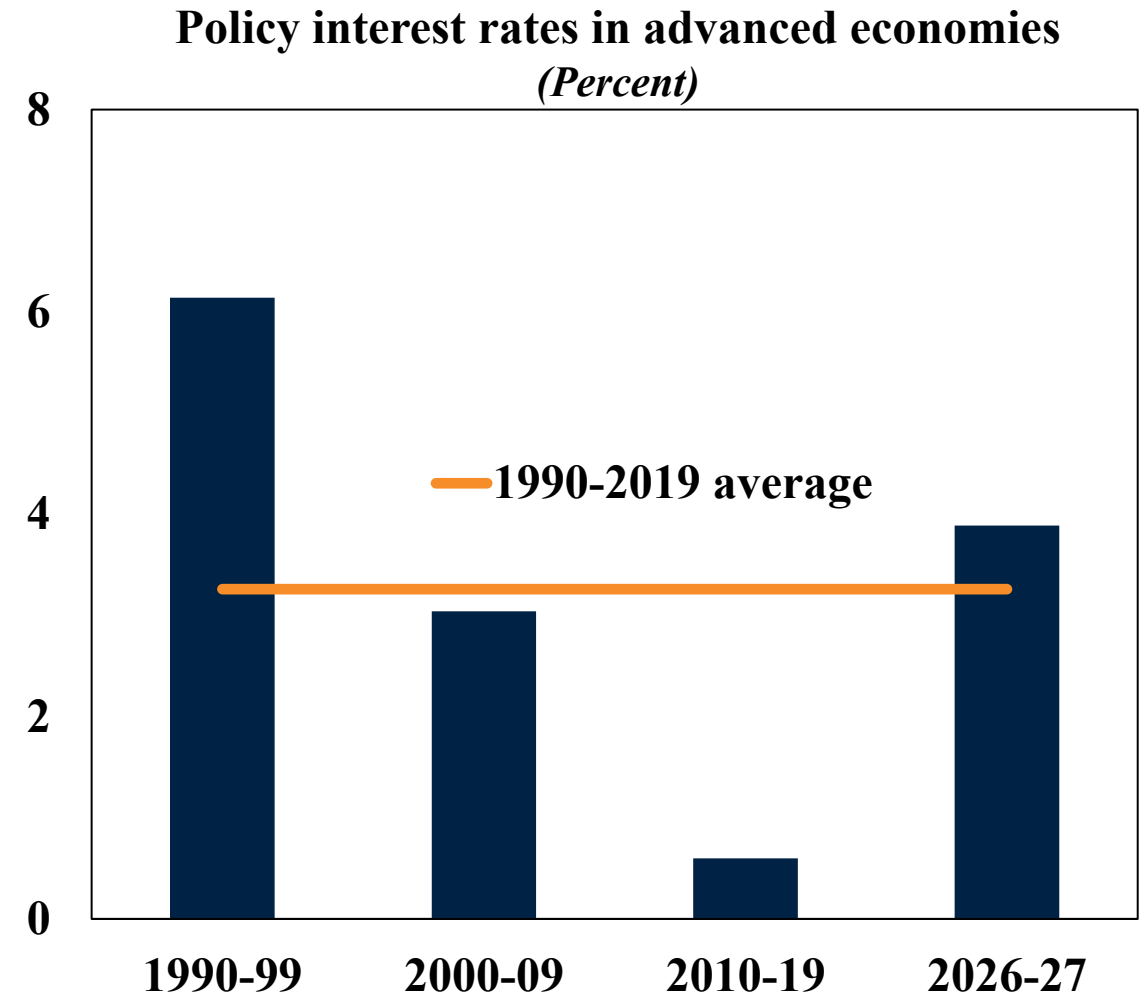
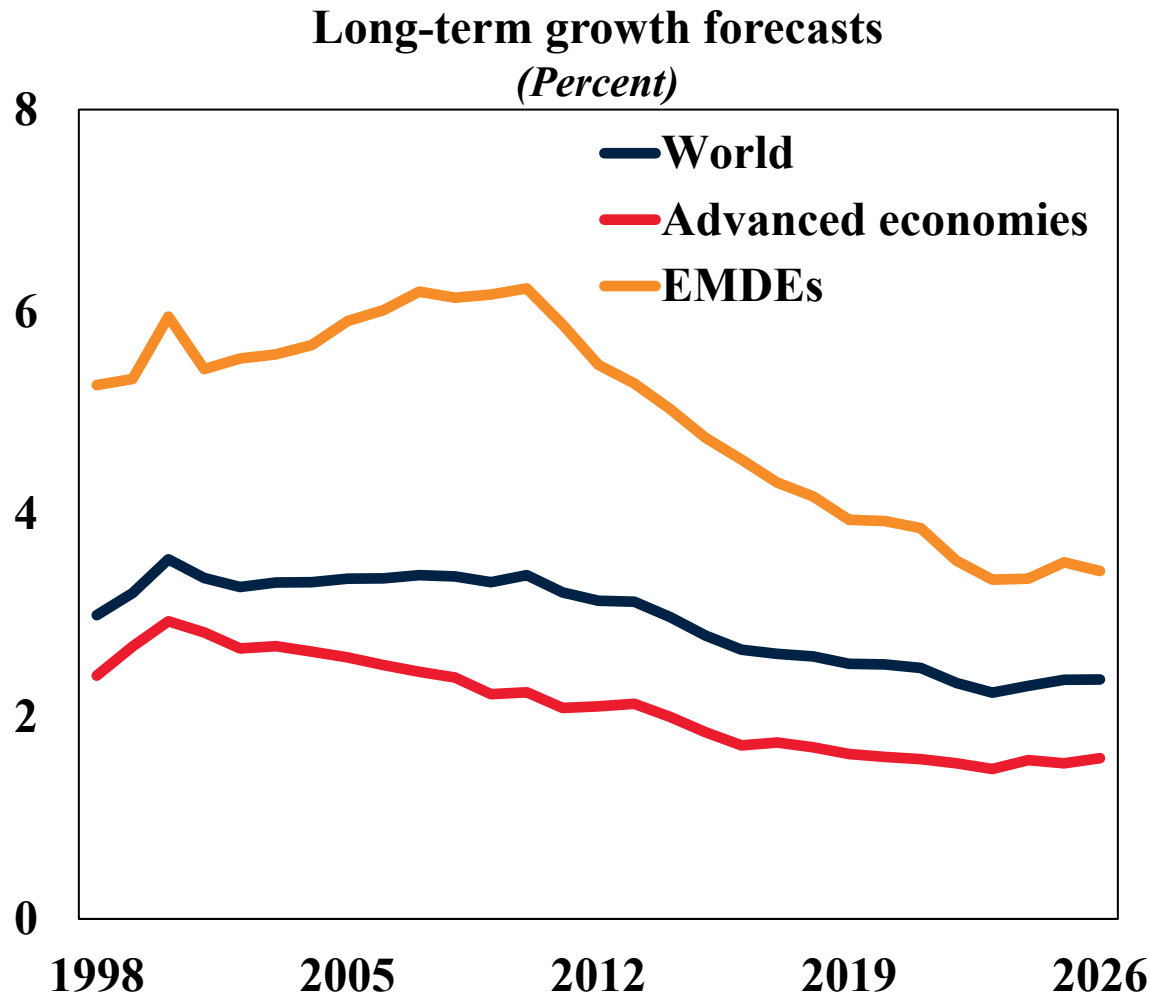


Sources: Bloomberg; World Bank.

Note: RHS = right hand scale. 5-day moving averages. Latest observation is October 5, 2026.

Growth and Interest Rates

Weaker Growth Expectations and Higher Interest Rate Projections Than in the 2010s



Sources: Bloomberg; Consensus Economics; Haver Analytics; World Bank.

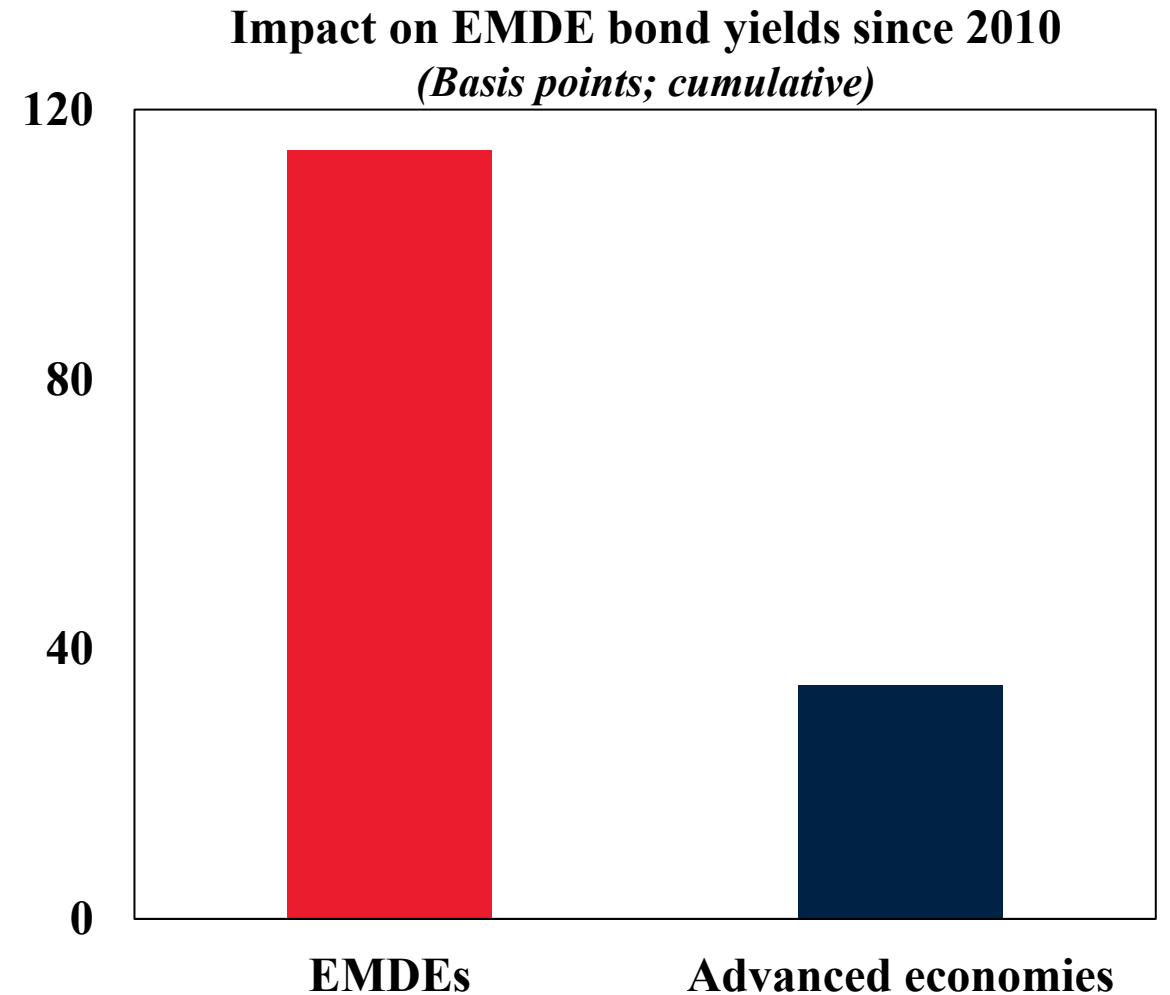
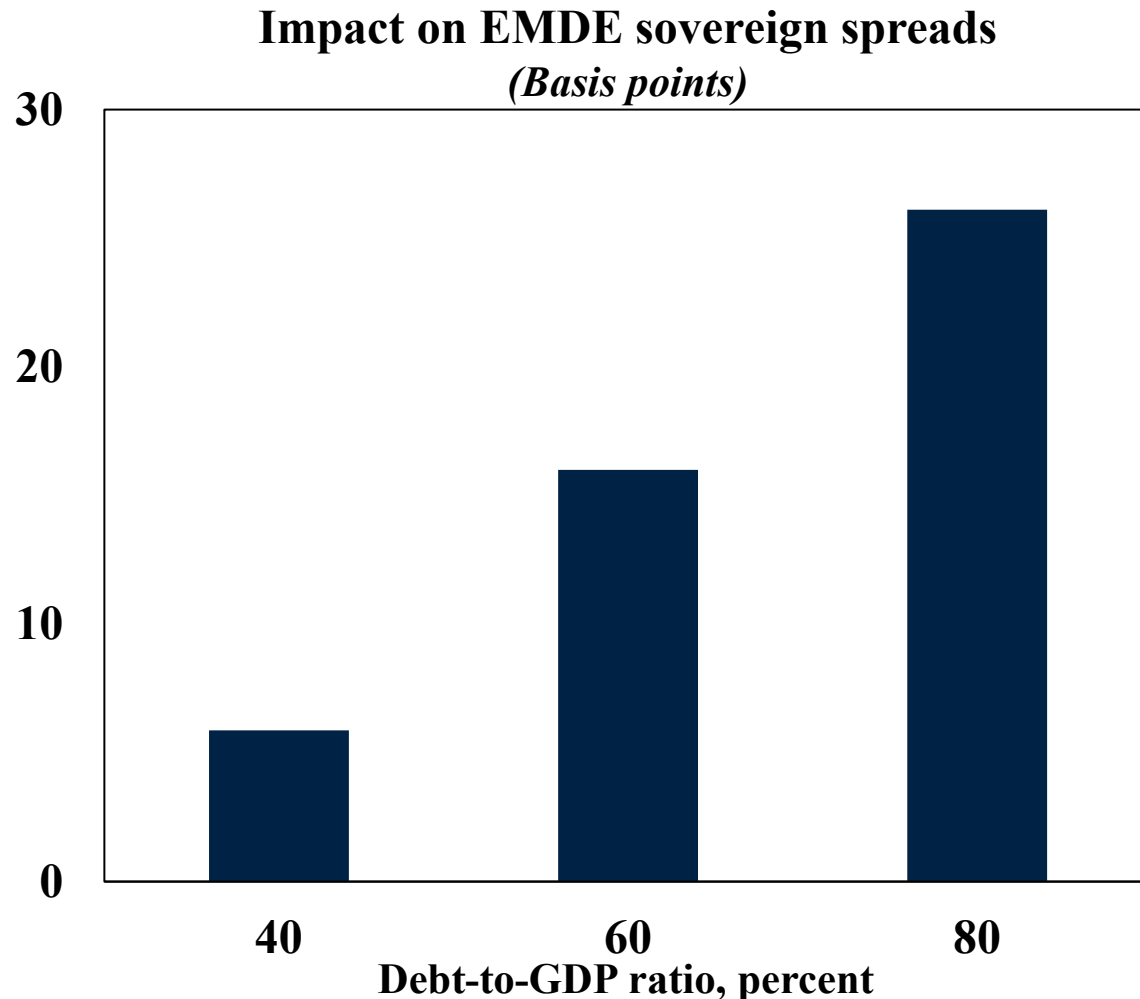
Left Panel. Average growth forecasts over 6 to 10 years, based on the latest surveys in each year by Consensus Economics. Aggregates are calculated using real U.S. dollar GDP weights at average 2010-19 prices and market exchange rates. Data for 2026 refer to surveys in July 2026. Sample includes up to 87 countries, including 35 advanced economies and 52 EMDEs. Right Panel. Average annual policy rates. Aggregates are calculated as GDP-weighted averages of the policy rates and policy rate expectations (for 2026-27) for the United States, the euro area, and the United Kingdom. Policy rate expectations are based on futures curves observed on October 6, 2026.



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Government Debt and EMDE Borrowing Costs

Additional Debt Raises Borrowing Costs More at Higher Debt Levels



Sources: Haver Analytics; International Monetary Fund; J.P. Morgan; World Bank.

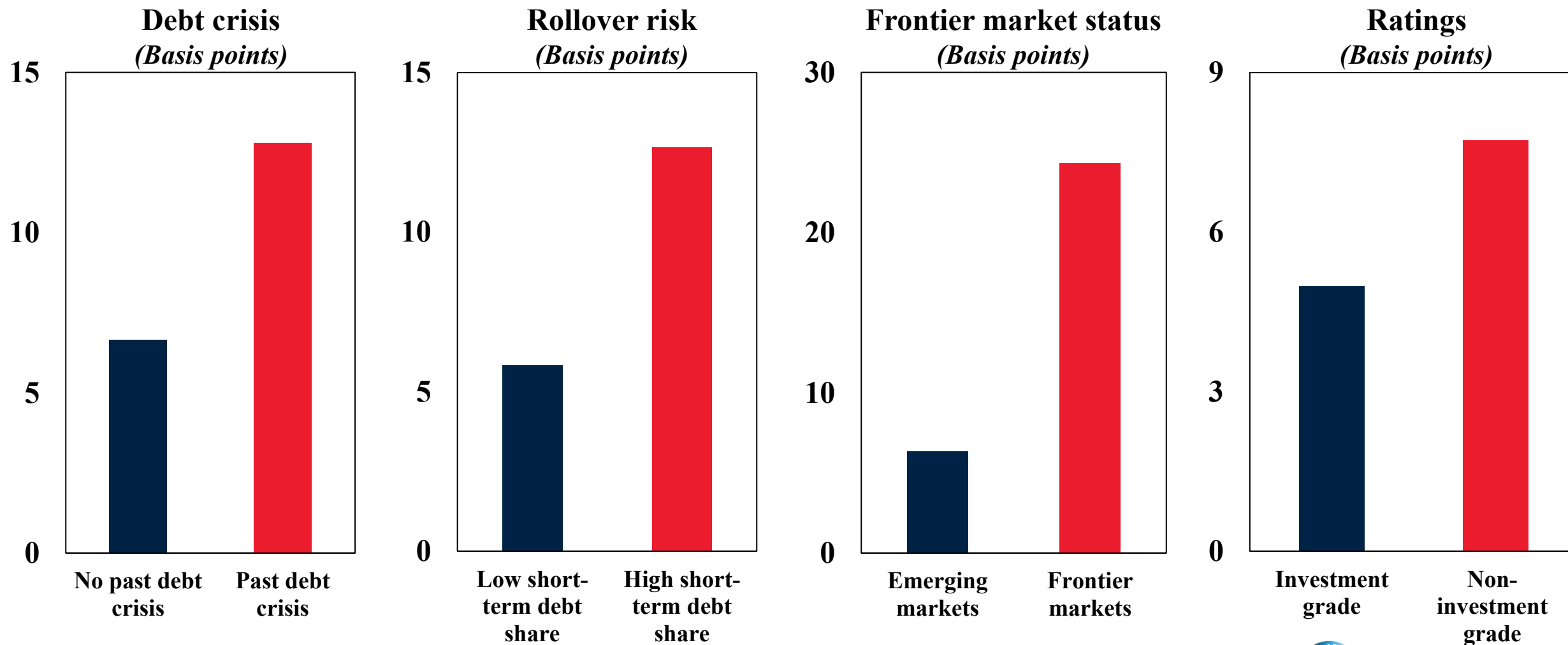
Left Panel. Effect on interest rates of a 1-percentage-point rise in the ratio of debt to GDP at different initial levels of the debt ratio. Right Panel. Cumulative impact of rising debt in EMDEs and advanced economies on EMDE dollar-denominated sovereign yields.



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Debt and Borrowing Costs in Different Groups

Greater Sensitivity in Economies with Higher Rollover Risk and Weaker Credit Profiles



Sources: Haver Analytics; J.P. Morgan; Nguyen, Castro, and Wood (2022); World Bank.

Note: Impact of 1-percentage-point increase in the government debt-to-GDP ratio on sovereign spreads. Left Panel. Debt crisis means a country experienced a crisis in the last 10 years, excluding the most recent year. Based on an updated debt crisis indicator in Nguyen, Castro, and Wood (2022). Center Left Panel. Low/high indicators reflect levels below and above the median. Center Right Panel. Frontier classification based on 2026 MSCI market classification. Right Panel. Based on the average of foreign currency long-term sovereign debt ratings by Moody's, Standard & Poor's, and Fitch Ratings.

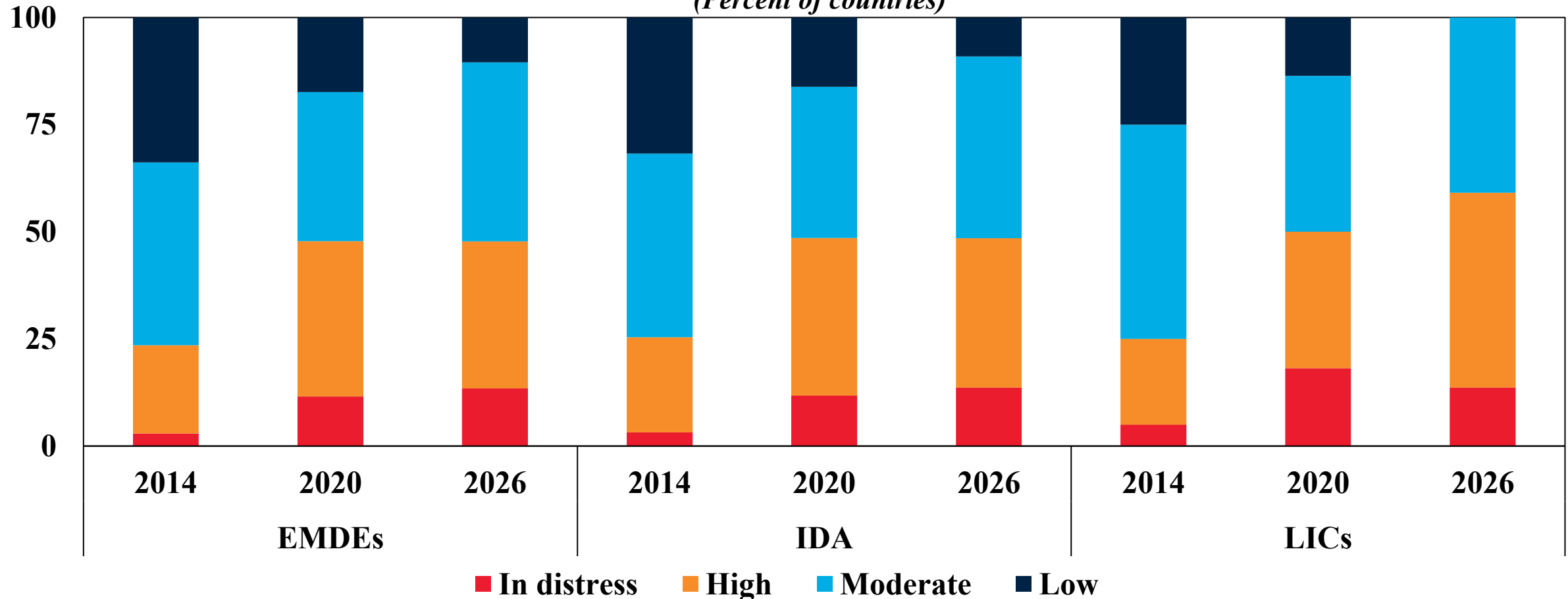


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Debt Distress in EMDEs

Nearly Half of Assessed at High Risk or in Debt Distress

Countries in, or at risk of, debt distress
(Percent of countries)



Sources: International Monetary Fund; World Bank.

Note: Percent of countries in, or at risk of, debt distress, based on the list of LIC DSAs for PRGT-eligible countries as of March 6, 2014, April 30, 2020, and March 31, 2026. The information is available for 68, 69, and 67 EMDEs, 63, 68, and 66 IDA-eligible countries, and 20, 22, and 22 LICs for 2014, 2020, and 2026, respectively.



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Three Questions

1 What is the current debt challenge? *Government debt remains elevated, while weaker growth prospects and higher borrowing costs make debt harder to manage. High debt also increases sensitivity to financing conditions, including spillovers from advanced economies.*

2 How have countries historically reduced government debt?

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Government Debt Reduction Episodes

Identification of Turning Points; Large Sample of Episodes

Debt reduction episode =

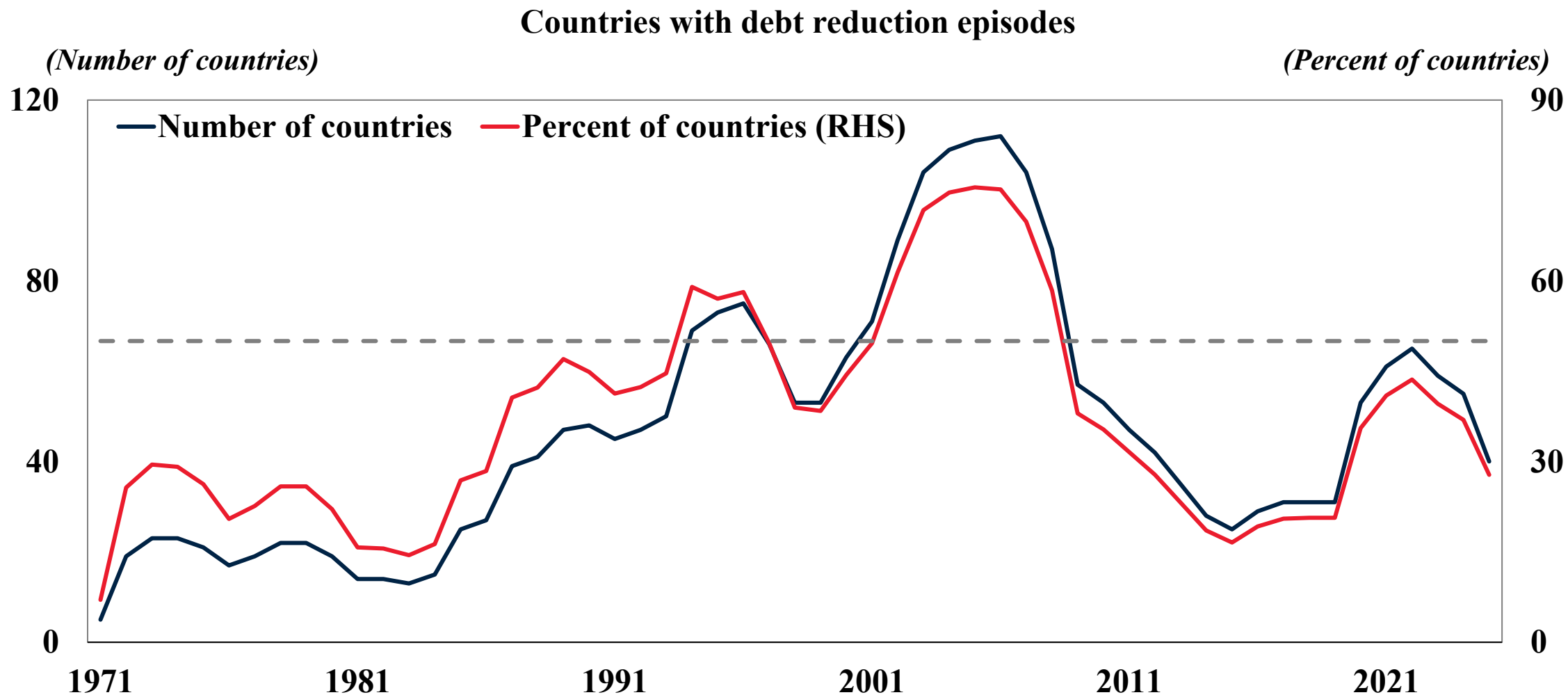
- A peak-to-trough period of declines in debt-to-GDP ratios (where peaks and troughs are the turning points defined as in Harding and Pagan 2002):
 - minimum phase length = 2 and minimum cycle length = 5
 - that exceeded 1 ten-year rolling, country-specific standard deviation
 - that started no earlier than 1971 and ended no later than 2024

371 episodes in 181 countries, of which 298 episodes occurred in 142 EMDEs

52 ongoing episodes as of 2025, of which 40 were EMDEs

Government Debt Reduction Episodes in EMDEs

Debt Reduction Most Widespread in the Mid-2000s

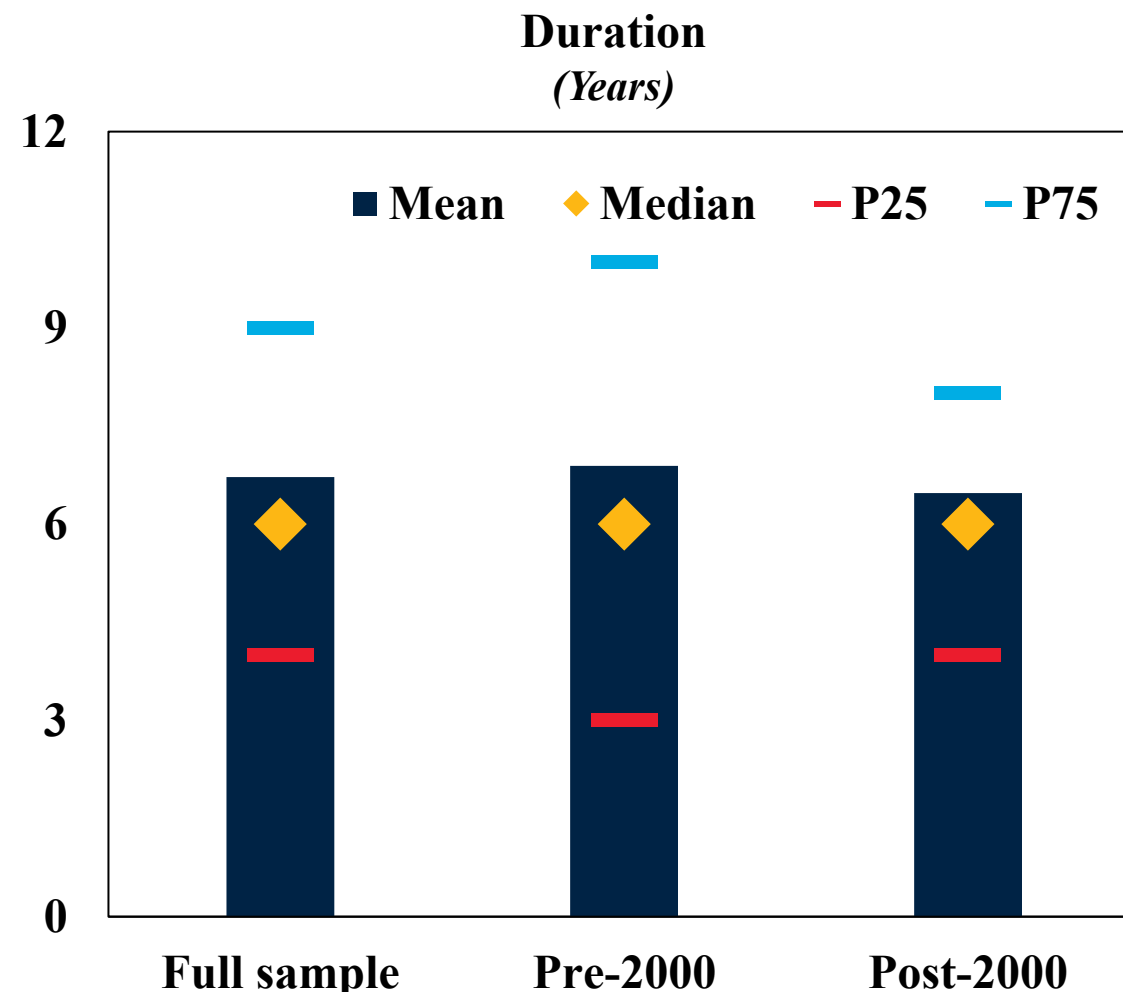
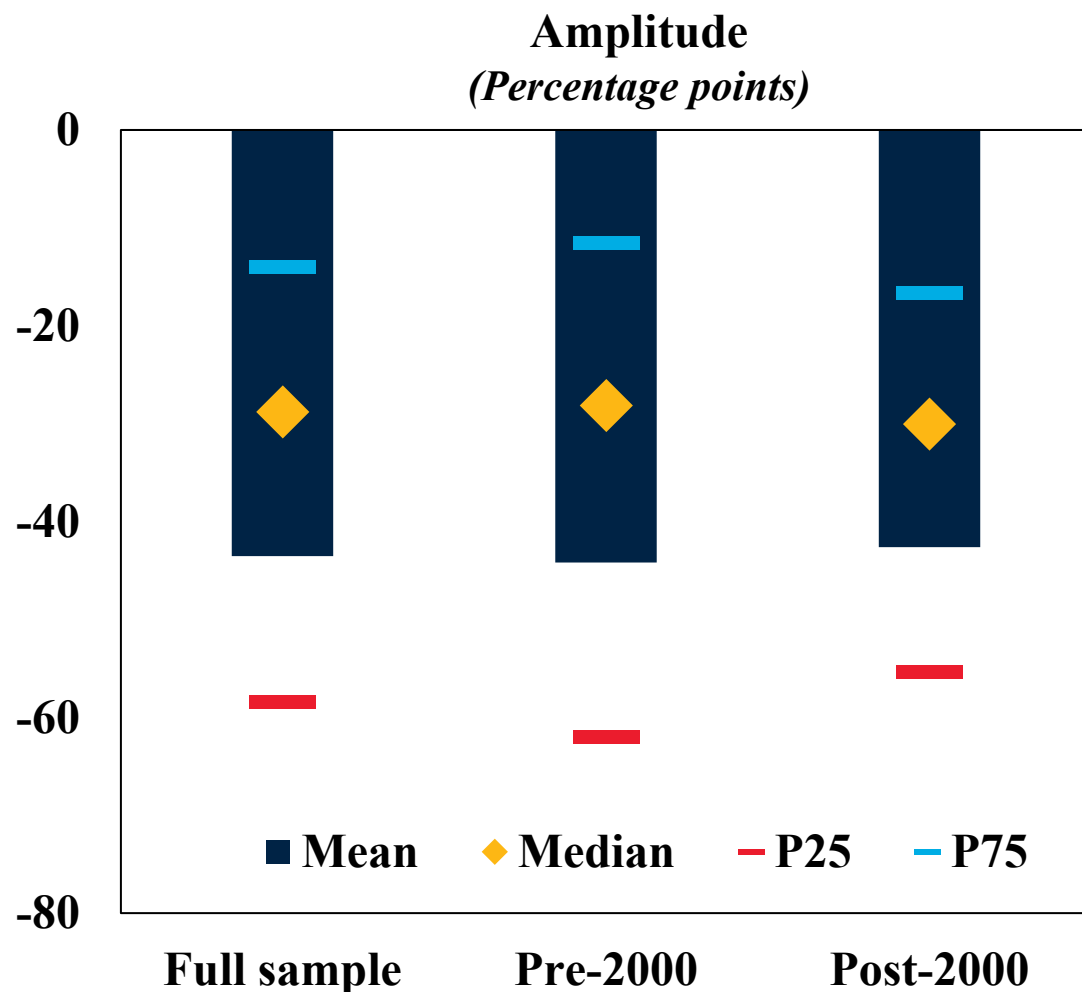


Source: World Bank.

Note: Government debt reduction episodes in EMDEs in a given year. Dashed line denotes 50 percent.

Size and Duration of Debt Reduction Episodes

Typical Episode in EMDEs: 30 ppt Decline in Debt Over 6 years



Source: World Bank

Note: Amplitude and duration of government debt reduction episodes in EMDEs, for the full sample, starting between 1971 and 1999, and starting and ending between 2000 and 2024.

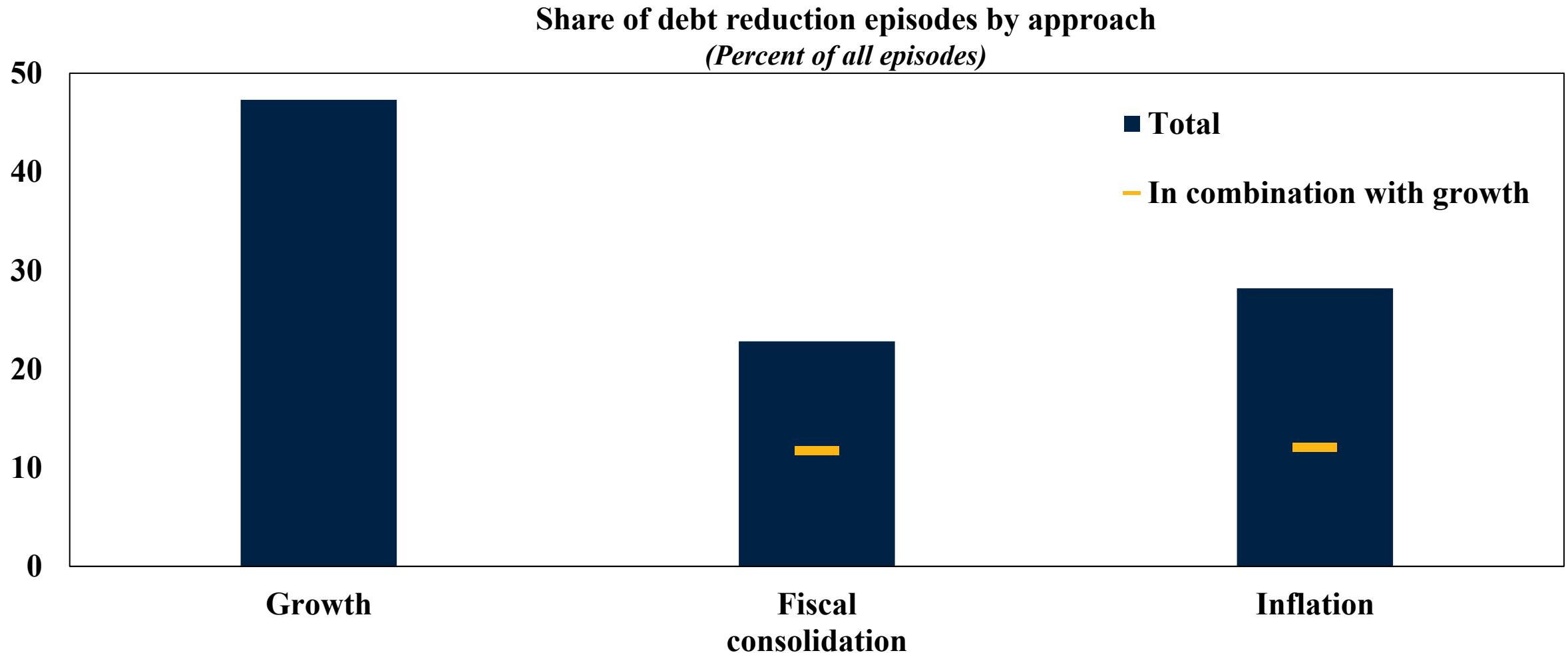
Government Debt Reduction

Three Approaches

- **Growth:** cyclical component of $\log(\text{GDP}) \geq 1$ country-specific standard deviation in at least 1 year
- **Fiscal consolidation:** cyclically-adjusted fiscal balance ≥ 1 country-specific standard deviation in at least 1 year
- **Inflation:** inflation > 20 percent in at least 1 year (Reinhart and Rogoff 2008) and > 1 country-specific standard deviation

Government Debt Reduction Episodes by Approach

Growth the Most Common, Often Accompanying Other Approaches



Source: World Bank.

Note: "Growth" indicates an increase in the cyclical component of real GDP in excess of 1 standard deviation for at least one year during the episode. "Fiscal consolidation" indicates a cyclically-adjusted fiscal balance greater than 1 country-specific standard deviation in at least 1 year. "Inflation" indicates inflation in excess of 20 percent (as in Reinhart and Rogoff 2008) and greater than 1 country-specific standard deviation for at least one year during the episode.



Three Questions

2

How have countries historically reduced government debt? *Strong growth is the most common feature of debt reduction episodes. Fiscal consolidation and inflation also feature, often in combination.*

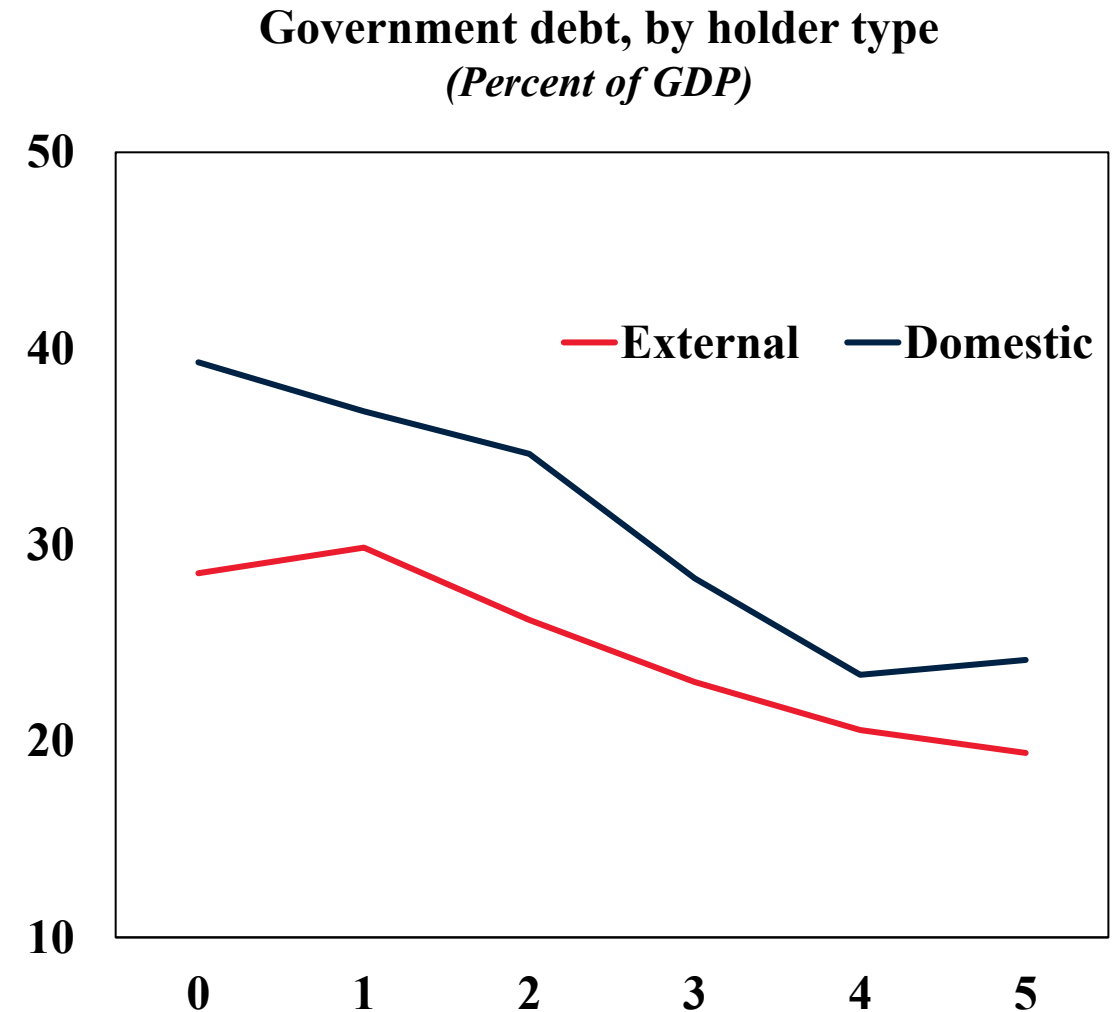
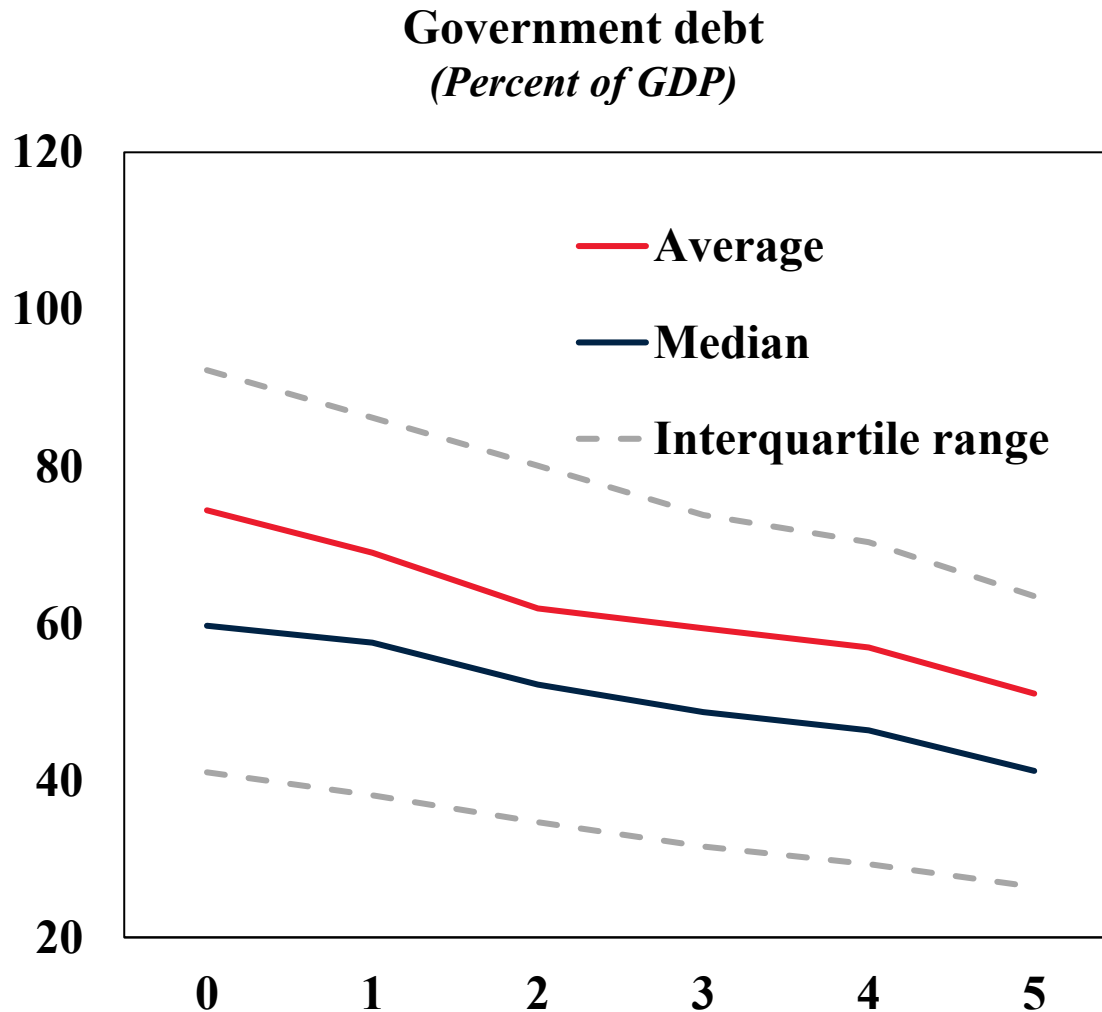
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What lessons can EMDEs draw from past debt reduction episodes?

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Government Debt During Reduction Episodes

Lower Debt Ratios, including External and Domestic

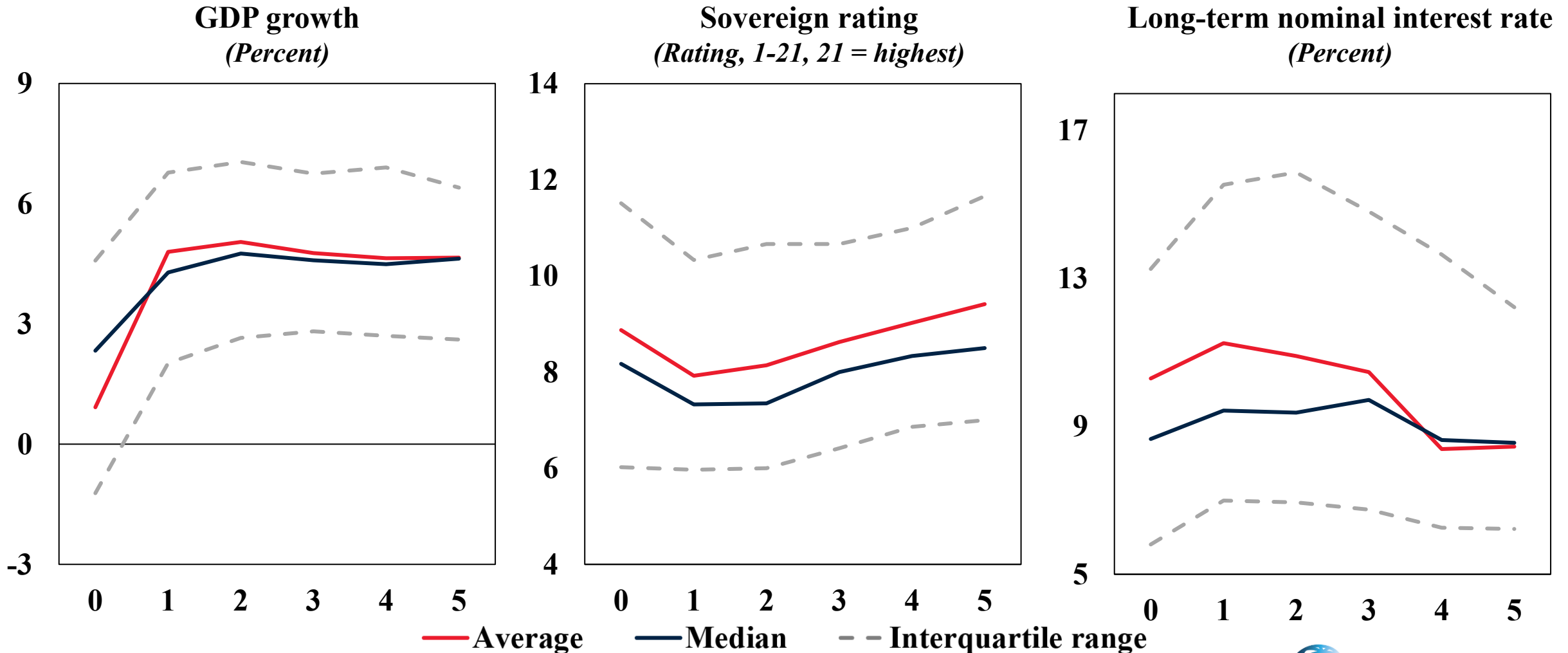


Sources: International Monetary Fund; Kose et al. (2022); World Bank.

Note: The x-axes are in “event-time”, where $t = 0$ is the start of a debt reduction episode and $t = 1-5$ are the years after the episode starts. Left Panel. Average, median, and interquartile range of government debt in percent of GDP. Right Panel. Median external and domestic government debt in percent of GDP.

Macroeconomic Performance During Debt Reduction Episodes

Improvements in Growth and Investor Sentiment



Sources: International Monetary Fund; Kose et al. (2022); World Bank.

Note: Average, median, and interquartile range of GDP growth, sovereign ratings, and long-term nominal interest rate for EMDEs. The x-axes are in “event-time”, where $t = 0$ is the start of a debt reduction episode and $t = 1-5$ are the years after the episode starts.



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Policy Priorities

Supporting Growth, Improving Fiscal and Debt Management, Strengthening Global Cooperation

1

Support growth while restoring fiscal sustainability. *Protect productive investment and essential spending, strengthen revenue mobilization, and pursue reforms that raise productivity and private investment.*

2

Improve fiscal institutions and debt management. *Improve debt transparency and risk monitoring, manage refinancing and currency exposures, and establish credible medium-term fiscal frameworks.*

3

Strengthen international support. *Provide concessional financing and technical assistance, and facilitate timely restructuring where debt is unsustainable.*

Three Questions

- 1 What is the current debt challenge?** *Government debt remains elevated, while weaker growth prospects and higher borrowing costs make debt harder to manage. High debt also increases sensitivity to financing conditions, including spillovers from advanced economies.*
- 2 How have countries historically reduced government debt?** *Strong growth is the most common feature of debt reduction episodes. Fiscal consolidation and inflation also feature, often in combination.*
- 3 What lessons can EMDEs draw from past debt reduction episodes?** *Debt reduction episodes are associated with stronger growth, improving credit ratings, and lower interest rates. Policy priorities are to support growth, strengthen fiscal and debt management, and secure international support, including restructuring where necessary.*

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