

REASSESSING RISK IN EMERGING MARKET LENDING: INSIGHTS FROM GEMs CONSORTIUM STATISTICS

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New statistics on lending to private companies from the Global Emerging Markets Risk Database Consortium (GEMs), covering three decades and about 15,000 loans across essentially all emerging and developing economies, reveal that the risks of investing in emerging market firms are lower than might have been perceived.

Emerging markets have long been viewed as high-risk destinations for investment, particularly investments in companies. Although macroeconomic and political stability risks are higher, this perception also reflects project-level risks, or uncertainty about repayment prospects. Investors, with limited historical data and lack of reliable metrics on likelihood of default and recovery rates, approach emerging markets with great caution.

Our research challenges this view. Newly released statistics from the Global Emerging Markets Risk Database (GEMs), a Consortium of 26 multilateral development banks (MDBs) and development finance institutions (DFIs) pooling their credit risk data, provides a way to analyze the risks in a more nuanced way. The statistics offer insights into default and recovery patterns for loans to emerging market firms over the past three decades, especially when investments are made alongside MDBs and DFIs. They also highlight the benefits of incorporating emerging market exposure into diversified investment portfolios.

Data coverage and scope

The GEMs credit risk statistics for private lending, published in October 2024, are among the most comprehensive of their kind.² Spanning the period 1994- 2023, the data include about 15,000 loans extended to approximately 10,000 private counterparties across essentially all emerging and developing economies. The total value of these loans exceeds half a trillion dollars. This coverage captures nearly 2,000 default events, providing a robust foundation for analyzing default and recovery rates. Comprised of loans issued by MDBs and DFIs, the GEMs data span all sectors the economy, including transportation and energy infrastructure, manufacturing, agribusiness, financial services, telecom, retail and wholesale, healthcare, and tourism. They differ from a typical purely commercial portfolio, however, in that MDBs and DFIs often provide advisory support for project development and implementation by local in-country teams.

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² The GEMs consortium pools credit risk data and publishes the resulting statistics as a resource for public use. It has evolved over time into a community that develops common approaches and data methodologies to record default and recovery frequencies. As a co-founder, along with the European Investment Bank, and the largest contributor of private lending data to GEMs, IFC remains committed to pooling data with our partners to optimize credit risk analysis of private sector players looking to invest in emerging markets.

Default rates: How risky are emerging markets?

Default rates are a guiding metric for investors, as they indicate the frequency with which borrowers fail to meet their financial obligations. Between 1994 and 2023, the average default rate in the GEMs portfolio was 3.6 percent.^{3,4} This is roughly comparable to average default rates observed in non-investment grade companies that receive a B credit rating from S&P (3.3 percent) and a B3 from Moody's (4 percent).⁵ The comparator group of corporates rated by S&P and Moody's covers firms across the globe, with heavy representation of advanced economies, whereas the sample covered by GEMs consists primarily of firms in emerging and developing economies. But the take-away is clear: although emerging market corporates on average are not investment grade, they are lower-risk than many high-yield corporate borrowers from advanced economies.

One of the key insights from the GEMs data is the diversification benefit of holding a portfolio that includes both advanced and emerging market assets. Default rates in GEMs portfolios are correlated with those of advanced economies, but the correlation is far from perfect. The correlation coefficient between GEMs default rates and those for S&P B-rated firms is 0.46, whereas the correlation for Moody's B3-rated firms is 0.33. This relatively low correlation indicates that emerging market defaults do not necessarily follow the same patterns as those in advanced economies, particularly during times of economic stress.

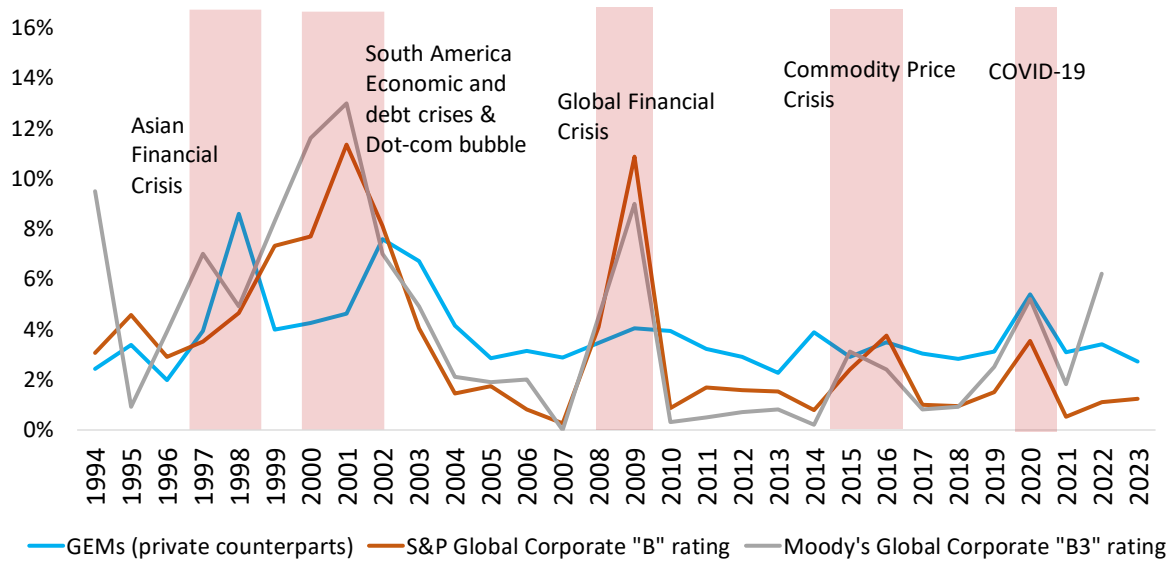
Figure 1 shows that investors with exposure to both advanced and emerging market assets can mitigate some of the risks associated with economic downturns in advanced economies. For example, during the 2008 global financial crisis, which originated in the advanced economies, defaults by emerging market firms were less pronounced than among their advanced economy counterparts. This suggests that advanced economy investors with portfolios including emerging markets reaped diversification benefits at a crucial time.

³ These patterns are also consistent with longer-run data from IFC, whose private sector portfolio had an average default rate of 4.1 percent from 1986 to 2023 (see [IFC Portfolio Default Rate Analysis, March 2024](#)).

⁴ S&P and Moody's publish annual default rates. Based on these statistics, the average default rate from 1994 to 2023 is calculated by taking a simple average of these annual default rates over the same period. The corresponding simple average from GEMs is 3.8 percent.

⁵ Credit rating agencies like S&P and Moody's use probabilities of default as a key input in their corporate credit rating scales. These agencies assign ratings based on the likelihood that a borrower will default on its debt obligations, with higher ratings (e.g., AAA or Aaa) indicating lower default risk and lower ratings (e.g., B or C) suggesting a higher risk of default. The implied probability of default is derived from historical default rates associated with each rating category. For instance, a company with a BB rating from S&P is expected to have a higher probability of default than a company with an A rating, based on the agency's historical data of defaults within each rating band. By analyzing past defaults and recovery outcomes, the agencies estimate these probabilities, which are then mapped to the credit ratings as a reflection of expected risk. As noted in the Annex, the definitions of default differ across data sources. In the S&P scale, the average default rate is 2.5 percent for B, 3.3 percent for B-, and 6.8 percent for B-. In the Moody's scale, the default rate is 2.5 percent for B2, 4.0 percent for B3, and 7.1 percent for Caa1.

Figure 1: Annual default rates, GEMs vs comparators

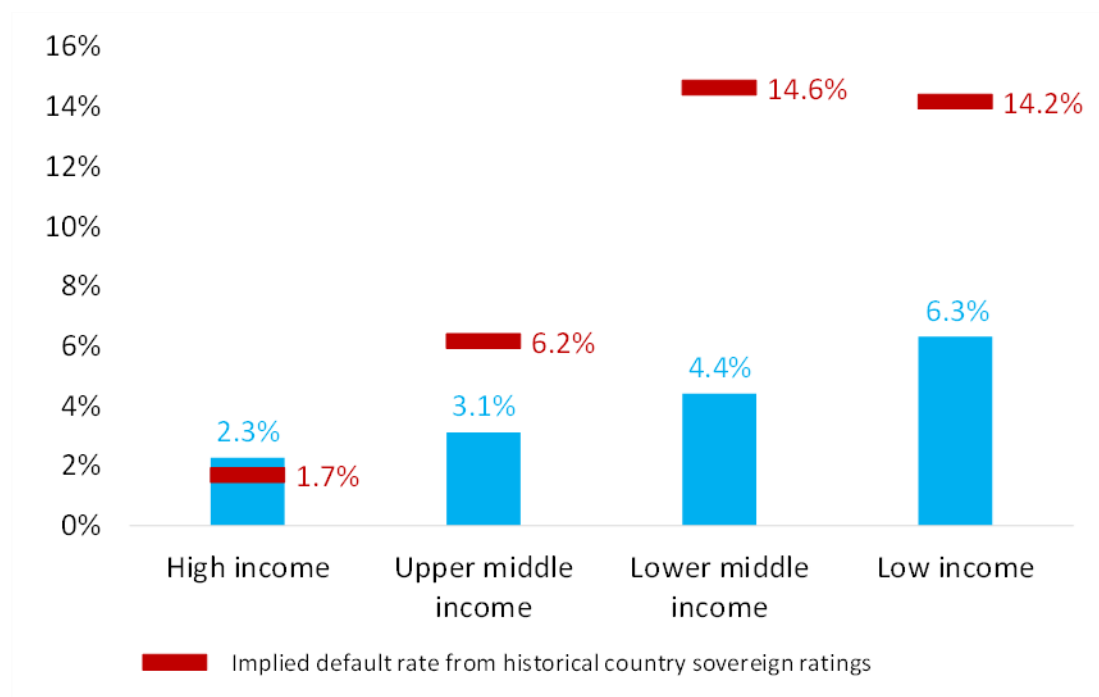


Note: Standard & Poor global corporate “B” rating is from Standard & Poor (2024): “Default, Transition, and Recovery: 2023 Annual Global Corporate Default and Rating Transition Study. March 2024”. Moody’s global corporate “B3” rating is from Moody’s (2023): “Default Trends – Global. Annual Default Study. March 2023”. The bars (in pink) display different crises during the sample period 1994-2023.

Country patterns: Does income level matter?

The GEMs statistics reveal interesting patterns when viewed by country income level. As expected, default rates are negatively correlated to income level. But the gap between advanced and lower-income economies is not as pronounced as one might expect (Figure 2).

Figure 2: GEMs average default rates and country ratings, by country income group



Note: The blue bars represent the average default rate in the GEMs sample (1994-2023) by country income group (from the 2024 World Bank Group country income classification). The red bars display average default rates implied from historical country sovereign ratings from 1994 to 2023 for the same country groups (subject to data availability). Historical default rates implied in country sovereign ratings are from Standard & Poor (2024): “Default, Transition, and Recovery: 2023 Annual Global Sovereign Default And Rating Transition Study. March 2024”.

In high income economies, the average GEMs default rate was 2.3 percent – slightly higher than the country credit rating (Figure 2). The default rate on private borrowers in the GEMs statistics increases as income level declines, reaching 6.3 percent in low-income countries. But except for high-income countries, the default rate in the GEMs sample was lower than would be expected based on the corresponding countries’ sovereign risk ratings. Comparing the default rates in the GEMs sample to those implied by the sovereign ratings, one can observe a small difference of -0.6 percentage points for advanced economies but a larger gap of 7.9 percentage points for low-income countries.

This finding challenges the conventional wisdom that investments in corporates or private sector projects in low-income countries are excessively risky, possibly due to factors unrelated to business performance, such as political instability or currency volatility. In practice, the GEMs statistics show that the risk is much lower than based on sovereign credit ratings. This may be because the GEMs data include loans from DFIs and MDBs, which may

be able to mitigate some of these risks through a combination of local expertise, in-country staff, project advisory, and active supervision during project implementation. Relying solely on sovereign ratings in this context would lead investors to overstate the risks of lending to firms in these markets.

Recovery Rates: What happens after default?

The GEMs statistics also reveal that recovery rates, which measure the amount of investment recovered after a default occurs, were higher than expected. On average, 72 percent of the value of defaulted GEMs consortium loans were recovered, compared to 70 percent reported for Moody's Global Loans, 59 percent at Moody's Global Bonds, and 38 percent at JPMorgan Emerging Market Bonds.

These relatively high recovery rates suggest that even in cases where defaults occur, investors in emerging markets are likely to recoup a significant portion of their investments. This relatively strong GEMs performance may be a result of MDBs and DFIs having a deeper understanding of local markets and stronger relationships with borrowers.

Conclusion: A reassessment of risk

These results suggest that investing in firms located in emerging markets is not as risky as might have been expected.⁶ GEMs statistics reflect the unique experience of multilateral development banks and development finance institutions, including more in-country staff than global commercial investors and detailed knowledge of the regulatory and political aspects of the market. Notwithstanding those caveats, the results presented in this note provide general encouragement for investors potentially interested in investing—directly, or alongside GEM participants—in emerging market businesses.

⁶ These patterns are also consistent with earlier research on IFC's equity investments, which over the previous four decades outperformed the S&P 500. See [Cole, Shawn, Martin Melecky, Florian Mölders, and Tristan Reed \(2021\): "Long-run Returns to Impact Investing in Emerging Markets and Developing Economies"](#), NBER Working Paper No. 27870.

Annex

Definitions of default differ somewhat across databases. According to the GEMs methodology, a default event can occur in six ways: (i) Non-payment within 90 days of being due, (ii) Specific provision raised for a contract, (iii) Write-off of an outstanding loan (either full or partial), (iv) Agreement to distressed restructuring, and (v) Client enters bankruptcy, and (vi) Realization of loan security.

S&P and Moody's differ from GEMs mainly on non-payment events. In S&P, a default event is recognized as soon as a debt payment is missed unless S&P believes that such payments will be made within five business days of the due date in the absence of a stated grace period, or within the earlier of the stated grace period or 30 calendar days. In Moody's, a missed or delayed disbursement of a contractually obligated interest or principal payment (excluding missed payments cured within a contractually allowed grace period) constitutes a default. Both S&P and Moody's are like GEMs in recognizing bankruptcy and distressed exchange default events.

Differences in definitions of default also matter for interpreting statistics on recovery rates. For example, a broad definition of default encompassing a slight delay in payment would likely be associated, other things equal, with a higher recovery rate.