SPECIAL REPORT:

AFRICA LOBBIES FOR DEBT SWAP TO AVOID WAVE OF SOVEREIGN DEFAULTS

Despite rating agency resistance, Africa wants to convert some of its debt into longer-term instruments in order to head off any risk of default. The extreme instance of Zambia demonstrates the urgency for debt distressed African countries to join a continental effort to restructure loans. Without such an approach, some of Africa’s largest economies will almost certainly default this year.

The United Nations Economic Commission for Africa (UNECA) is suggesting that some African countries may seek to exchange their sovereign debt for new concessional paper to avoid using funds needed to battle the fast-moving coronavirus to pay private creditors. UNECA, the African Union (AU), and a group of African finance ministers are designing a special-purpose vehicle for the swap. The mechanism would be underwritten by a triple-A-rated multilateral lender like the International Monetary Fund (IMF) or the World Bank, or one of the bigger G-20 economies, and used to convert commercial debt into longer-maturity paper with a five-year grace period and lower coupons.

The key people leading the proposal are UNECA executive secretary Vera Songwe and AU special envoys for the pandemic response Ngozi Okonjo-Iweala (a former Nigerian finance minister) and Tidjane Thiam (a former CEO of
Credit Suisse Group). They are working closely with Ghana’s Finance Minister Ken Ofori-Atta and South Africa’s Tito Mboweni, both of whose countries face escalating debt service obligations over the next five years. World Bank president David Malpass showed interest in the idea when Songwe discussed the proposal with African finance ministers during the Washington lender’s spring meetings in April.

The potential debt exchange could be similar to the 1989 Brady Plan that converted bank loans, mostly owed by Latin American countries, into new paper backed by US Treasury bonds. The initiative, proposed by then Treasury secretary Nicholas Brady, was tied to economic reforms in debtor countries. Under the new African initiative, the new bonds might include a five-year grace period and lower interest rates. The US government is unlikely to guarantee the new instrument, but the World Bank and IMF might jointly guarantee the bonds with US consent. In the absence of global leadership, the multilaterals have taken the lead in the response to coordinating Africa’s response to the pandemic, as EXX Africa explained in previous analysis (See SPECIAL REPORT: MULTILATERALS TO THE RESCUE IN AFRICA).

Stalled debt relief momentum

On 15 April, the Group of Twenty (G-20) countries offered a limited standstill on bilateral payments. However, the G-20 offer would postpone just USD 12 billion of payments due this year, well short of the USD 44 billion debt relief that the AU envoys and African finance ministers are seeking. The G-20’s offer of a limited standstill on debt repayments is only valid for this year and the accumulated interest would still be payable in 2021-22. The proposed African bond scheme would require support from G-20 finance ministers, currently chaired by Saudi Arabia’s Mohammed al Jadaan. However, African debt relief proposals have received little support from Saudi Arabia which has relegated the topic on the G-20’s priority list. Under Al Jadaan’s leadership, the G-20 has lagged behind other international agencies in its response to the pandemic.

Instead, France and Germany have been among the strongest voices internationally for a debt moratorium, yet they will not act alone. European Union Foreign Affairs chief Josep Borrell has also stated that the bloc will not act unilaterally on a debt moratorium. Other European Union states may support Europe’s cancellation call, yet China and the United States oppose it for differing reasons. The US remains determined to block any proposal that would require expanding the IMF’s Special Drawing Rights. The management of China’s loans is done through state agencies such as its national development bank or the Belt and Road Initiative (BRI), rather than the IMF forum, which undermines the consistency of a unified platform on debt relief.

Meanwhile, the African proposal to create a special purpose vehicle to convert some African debt into longer-term instruments has been viewed with scepticism by the main credit ratings agencies. With bondholder agreement, the rating agencies warn that any attempt to renegotiate payments on sovereign bonds would be
classed as a default. As a result, any offending country would be locked out of the markets for several years. Lacking G-20, US, Chinese, and rating agency support, the African initiative seems set to fail.

**Multilaterals to push ahead with debt deferments**

Nevertheless, African finance ministers are moving ahead with their proposal and have co-opted multilaterals like the IMF and World Bank to their cause. The IMF has already offered debt relief to 25 of its poorest member countries using the Fund’s revamped Catastrophe Containment and Relief Trust, through which it provides grants to cover their debt obligations to the IMF for six months. So far, the IMF has deferred USD 213 million worth of repayments, presumed ability to access market financing are excluded from the debt standstill.

However, countries with a presumed ability to access market financing are excluded from the debt deferments – these include Algeria, Angola, Egypt, Kenya, Libya, Morocco, South Africa, and Tunisia. Several of these markets are some of Africa’s most debt-distressed, like Angola as EXX Africa assessed in previous analysis (See **ANGOLA: FIVE YEARS OF RECESSION SPIKE DEFAULT RISKS**). Debt servicing distress is also likely in Kenya (See **KENYA: POLITICS AND ECONOMIC POLICY TO DETERMINE IMPACT OF CORONAVIRUS**).

The IMF and World Bank have each already mobilised USD 18 billion to support Africa’s response to the coronavirus and direct economic support. Their funding amounts to two thirds of the USD 57 billion that official creditors have already mobilised for Africa in 2020. Private creditors could add another USD 13 billion if they support proposals for the deferral or restructuring of debt payments. IMF Managing Director Kristalina Georgieva believes that Africa would need an estimated USD 114 billion in 2020 to manage the coronavirus, thus leaving a financing gap of around USD 44 billion.

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**Zambia default looms large**

In January, Zambia’s Finance Minister Bwalya Ng’andu requested a funded programme from the IMF. Since then, the IMF has said that the country would not qualify for such access to funding because Zambia’s government has continued borrowing beyond the Treasury’s control, while accusations of fraud, embezzlement, and inflated contracts – even in the healthcare sector – are mounting. Instead, the country has so far received USD 145 million from other multilateral lenders (World Bank and AfDB), as well as the UK and US, to help fight the coronavirus. In late April, Zambia also borrowed an undisclosed sum from China to purchase personal protective equipment and other medical supplies.

Zambia is arguably the developing country facing the biggest debt crisis in the era of the coronavirus. General gross government debt is set to exceed 100 percent of GDP this year, as economic output shrinks, and new obligations are confirmed. External debt may also soar this year to above 60 percent of GDP (if not much higher).
from 54 percent at the end of 2019. Meanwhile, Zambia’s economy will contract by 3.5 percent in 2020, from growth of 1.5 percent last year. Nearly half of the country’s tax revenues go towards debt service, while the public wage bill accounts for much of the balance. In 2019, Zambia’s budget deficit was already 10.9 percent of GDP.

Investors are now pricing Zambia’s sovereign bonds for default. The country’s Eurobonds have been among the world’s worst performing this year and its currency has depreciated by 23 percent against the dollar. Credit rating agencies have warned Zambia’s debt is at high risk of default. However, there is little scope for a coordinated
approach for debt restructuring – about 30 percent of Zambia’s debt is owed to China, 25 percent to bondholders, and 19 percent to foreign banks. The World Bank, IMF, and Western governments hold a relatively small share. Some USD 10 billion in Chinese project finance loans have been authorised but do not yet show up in official figures. Any restructuring of Zambian debt to China may include the underlying asset as collateral.

The unsustainable nature of Zambia’s current debt profile may complicate its appeal for help from the IMF. The government’s frustration of the mining sector, as illustrated by a recent arbitrary detention of a Glencore manager, as well as spiralling corruption and mismanagement do not bode well for Zambia’s appeal to the IMF. The Financial Intelligence Centre estimates that the value of money-laundering and opaque transactions leapt to USD 520 million in 2018 from USD 382 million in 2017. Zambia is proceeding with a new loan with Israel’s the defence electronics firm Elbit Systems, while the government is finding a new way to acquire a second presidential jet after Russian aircraft manufacturer Sukhoi cancelled a deal for a VIP version of the Sukhoi 100 amid concerns over Zambia’s ability to pay. Earlier this year, Denmark’s Missionpharma suspended medical equipment supply over payment arrears of USD 10 million and unfair tender practices. The IMF has twice before rejected Zambia’s appeal for funding support – it may do so again even in current extreme circumstances (See ZAMBIA: ONSET OF CORONAVIRUS MAY BE THE FINAL DROP FOR PANIC-STRICKEN NATION).

INSIGHT

Zambia is not the only regional country grappling with mounting debt and a wave of African sovereign defaults is becoming increasingly likely. Angola had its credit ratings slashed and the yield on the struggling oil producer’s dollar Eurobonds jumped to more than 30 percent in April. Nigeria, Ghana, Gabon, and Cameroon all have Eurobonds that traded at spreads of more than 1,000 basis points over US treasuries, the point above which the securities are considered to be distressed debt. According to the latest available data, South Africa, Angola, Ghana, Kenya, Ethiopia, Nigeria, and Cote d’Ivoire have debt service obligations of more than USD 1 billion on public and publicly guaranteed external loans.

The current G-20 proposal offers only a hiatus on repayment of this year’s debt servicing to official creditors. The proposal simply pushes little more than USD 12 billion in debt interest payments to next year. Africa’s biggest spike in Eurobond redemptions is not due until 2024-25, although several substantial principal payments on African sovereign debt fall due between 2020 and 2022. Failure to agree on debt relief is illustrated by the complexities of debt structures compared to 2005, when G8 nations wrote off billions in developing country debt.
Since then, Africa has since gone through several rounds of unsustainable borrowing. The continent’s external debt payments doubled from 2015 to 2017 to 11.8 percent. Debt-service obligations range from dollar-denominated Eurobonds and Chinese countertrade deals to bilateral project loans and trade credits, as well as obligations to the IMF and World Bank. Although the bulk of Africa’s debt is now owed to governments and multilateral institutions, the IMF will play a key arbiter role in the negotiations. Some countries like Mozambique, Zambia, and Republic of Congo have purposefully not disclosed massive opaque borrowings which has tarnished their creditor reputation. The US also opposes any debt relief for countries that have borrowed heavily from China, with US Secretary of State Mike Pompeo accusing Beijing of using loans for political control in Africa.

Of Africa’s overall debts of around USD 365 billion, around a third is owed to China. China’s government, banks, and companies lent about USD 143 billion to Africa between 2000 and 2017, much of it for large-scale infrastructure projects. Chinese lending now dwarfs World Bank loans in Africa. China makes up 33 percent of external debt service in Kenya, 17 percent in Ethiopia and 10 percent in Nigeria. China refuses to deal within the IMF structure in regards to its lending practices.

Moreover, in contrast to 2005, when the issue was public debt, today 32 percent of total external debt and 55 percent of external debt service payments are estimated to be commercial. Also, unlike during global financial crisis in 2008-09, when Africa’s economies had larger buffers than now to protect against a downturn, this time round Africa has a more complex set of debt liabilities, including a higher proportion of commercial debt, less concessional debt, as well as substantial amounts of hidden or under-counted domestic obligations.

As the prospect of coordinated debt relief fades, the African proposal seeking to set up a common facility, a special purpose vehicle to convert the debt into longer-term instruments. However, bondholders would need to agree to the restructuring, while at least one major multilateral would need to guarantee the new bonds, which is unlikely without US sanction. If the proposal fails, some of Africa’s largest economies are set to default later this year and beyond.

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**General Government Gross Debt : 2020**

Percent of GDP

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Source: IMF/WEF/latest Dataset

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