

# Bondholders need to forgive some African sovereign debt

Coronavirus pandemic has brought the continent's day of reckoning forward

By Moritz Kraemer (Financial Times, August 27<sup>th</sup>, 2020)

Africa looks particularly vulnerable as the coronavirus crisis continues to batter the global economy. The IMF forecasts sub-Saharan economies will shrink by 3.2 per cent this year — the continent's first contraction in three decades — and that government budget deficits will reach 7.6 per cent of gross domestic product, also a record.

At the same time, the debt service burden of many African sovereigns has been surging. Scarce resources are diverted to interest and principal payments. Even so, some governments will simply not have the foreign exchange reserves to service their debts. The IMF concluded that the crisis will wipe out almost 10 years of progress in development.

Recognizing those urgent challenges, G20 leaders agreed in April to allow some of the poorest countries to request suspension of their bilateral debt payments until the end of 2020.

A six-month moratorium on bilateral debt assumes two things: that the crisis is one of liquidity and will disappear by 2021, and that suspending bilateral debt service makes a meaningful difference.

The first assumption is overly optimistic, but for many over-indebted sovereigns, the second is simply wrong. Debt service suspension can only be the first step towards a more comprehensive strategy of debt reduction.

After the last round of official debt relief in the early 2000s, many African nations soon accelerated borrowing once more. But this time African leaders discovered that a cleaned-up balance sheet allowed them to raise large amounts of money issuing international bonds, without all the annoying strings attached to loans from official creditors.

Abundant global liquidity and yield-hungry investors enabled even sovereigns such as Mozambique and Angola with very weak fundamentals to tap capital markets. The issuance frenzy came to a sudden halt in early 2020 when coronavirus spread globally.

Several African countries face a crisis of solvency, not one of liquidity. In some cases, debt has reached ratios even beyond the levels prevailing before the last round of comprehensive debt write-offs. The difference now is that the debt is more expensive to service because cheap official debt has been substituted with much more expensive bonds.

Until about a decade ago, almost all financial liabilities of African sovereigns were with official creditors. According to data from rating agency S&P, 39 per cent is owed to private investors in 19 sub-Saharan sovereigns.

Since bonds carry higher coupons than the concessional interest on official debt, the share of commercial creditors in overall debt service is almost two-thirds. Most of that set of countries have foreign exchange reserves that are insufficient to cover even short-term external liabilities.

Nigeria, Ghana and Angola dedicate more than 40 per cent of government revenue to interest payments. Zambia and Kenya are not far behind. In 2014, all except Ghana showed ratios well below 20 per cent. The current level is not sustainable.

Africa's slide into a new debt crisis should not surprise anyone. IMF data show that in every year since 2015, sub-Saharan Africa's economies grew even more slowly than in 2009, the nadir of the financial crisis.

Rating agencies have been steadily downgrading African sovereigns for more than half a decade. Capital market pricing also reflected the high risks well before the pandemic: Ghana's benchmark 2030 bond yield has oscillated between 7 per cent and 9 per cent for years.

A high risk of default has been priced into African bonds. The warning signs have been clear for everyone to see.

The pandemic brought the day of reckoning forward. Bondholders now try to convince themselves, and others, that in the light of the unexpected external shock, they are doing their part by doing nothing. No new money, no relief.

They also argue that a restructuring of bonds would exclude African sovereigns from capital markets for many years. That is a self-serving argument and must be rejected. Investors have a history of lending to sovereigns after default. In June 2017 Argentina, a serial defaulter, sold a 100-year bond, only a year after the country had emerged from default.

Of course, Argentina has since defaulted again. In any case, sub-Saharan African sovereigns are shut out of the bond market already. No Eurobonds have been sold since February.

Nevertheless, the investor scare tactic seems to work. African governments appear extremely reluctant to bail in private creditors. African leaders should be bolder and more confident.

Official creditors must not accept that their debt relief will be used to bail out international investors that had knowingly taken big risks. The IMF classifies almost half of all sub-Saharan African sovereigns as being in debt distress or being at high risk of debt distress.

The list includes prolific issuers such as Ghana, Ethiopia, Zambia and Kenya. Depreciating currencies will add to the pressure. Given the weight of private sector creditors in many countries, any debt relief not including bondholders will ultimately fail.

Sparing financial investors is neither fair nor efficient. Official creditors must insist on comparable treatment. The sooner they do, the more human suffering can be avoided. Bondholders should stop procrastinating and accept reality.