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African Sovereign Debt: The Private Sector Paradox

By SIMIO VELEPINO

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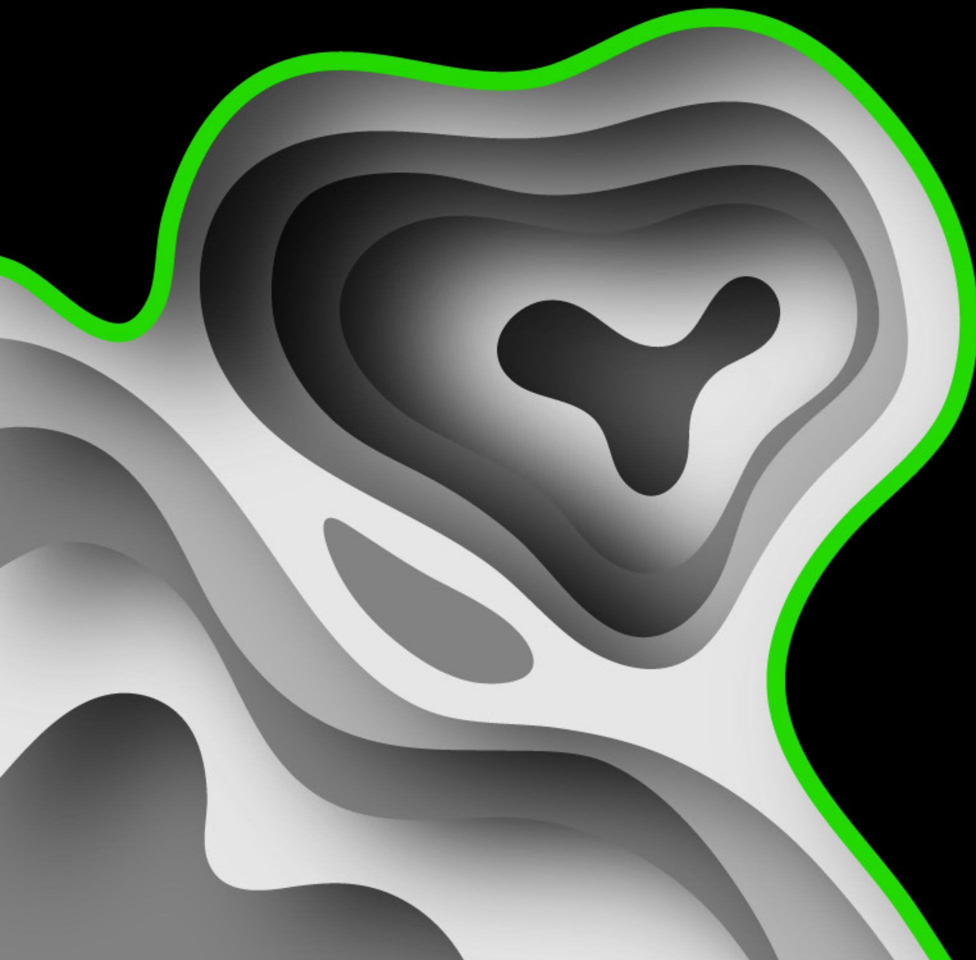

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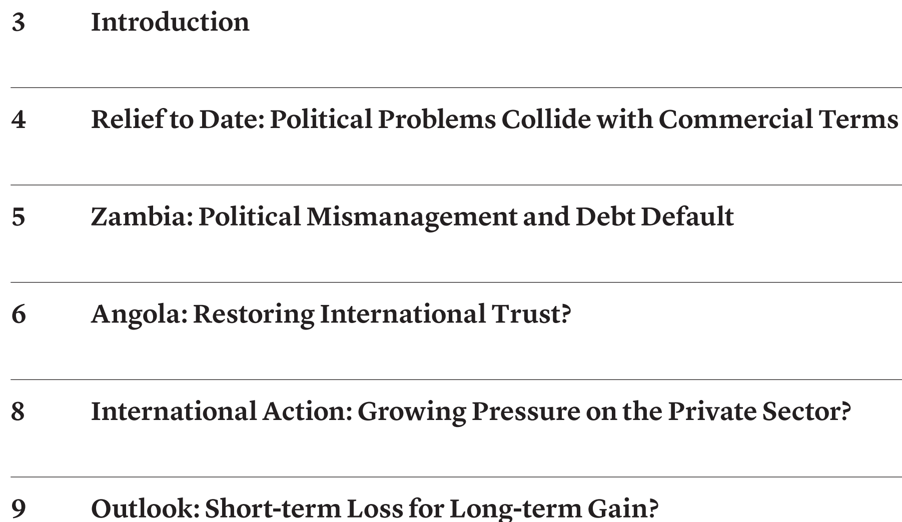

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Introduction

As we mark one year since the start of the worst effects of COVID-19, Africa is tentatively emerging from the initial economic shock of the pandemic. Many economies are undergoing a rapid recovery, with most countries retaining only light-touch public health restrictions in a bit to restart economic activity and encourage investment. Although concerns of a major continental debt crisis have somewhat abated, debt servicing obligations, and wider debt liabilities, pose a serious obstacle to the continent regaining firmer financial footing.

While international action to stem the risk of a debt crisis has been available — notably through the Paris Club/G20 Debt Service Suspension Initiative (DSSI), to which 43 African countries have so far subscribed and the IMF's Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI), which supported liquidity — action beyond a simple postponement of payments has been less forthcoming[1]. Much of the difficulty lies in the simple fact that, while debt servicing payments pose a growing hinderance to sustainable economic recoveries, most African countries remain some distance from sovereign default. Given the growth in commercial lending to African governments — with the number of African countries issuing Eurobonds more than doubling to over 20 in the past decade — African governments will be hard-pressed to find the fiscal breathing space needed to allow for a full economic recovery in the short term.

Relief to Date: Political Problems Collide with Commercial Terms

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To date, just three DSSI eligible countries have approached private sector bondholders to request relief[2]. Private creditors have largely maintained that African governments knew the risk of bond issuance — and to simply change repayment terms is to both short-change their own investors, and create an evident moral hazard for future borrowing, given it is just 15 years since the G7 launched its landmark debt cancellation deal. The DSSI — and parallel negotiations with Chinese state-backed creditors — can only reach so far in managing the problem, particularly in those countries that have relied heavily on Eurobond issuances. The clear question in delivering comprehensive restructuring to those sovereigns in greatest distress, therefore, is how the private sector can be brought on board.

Crucial to this is recognising that the threat of a debt crisis in the medium term is as much a political problem as an economic issue. Much of the proceeds of Eurobond issuance have been wasted by political mismanagement; and investors subscribing to bond prospectuses had clear historical visibility of the questionable record of several sovereigns in accountable and sustainable spending. As such, and as the divergent actions of Africa's most distressed states — Zambia and Angola — show, building momentum for restructuring and relief is keenly reliant on political transparency and action. Critically, these two countries highlight the risks of private sector inflexibility to prospective sustainable debt restructuring.

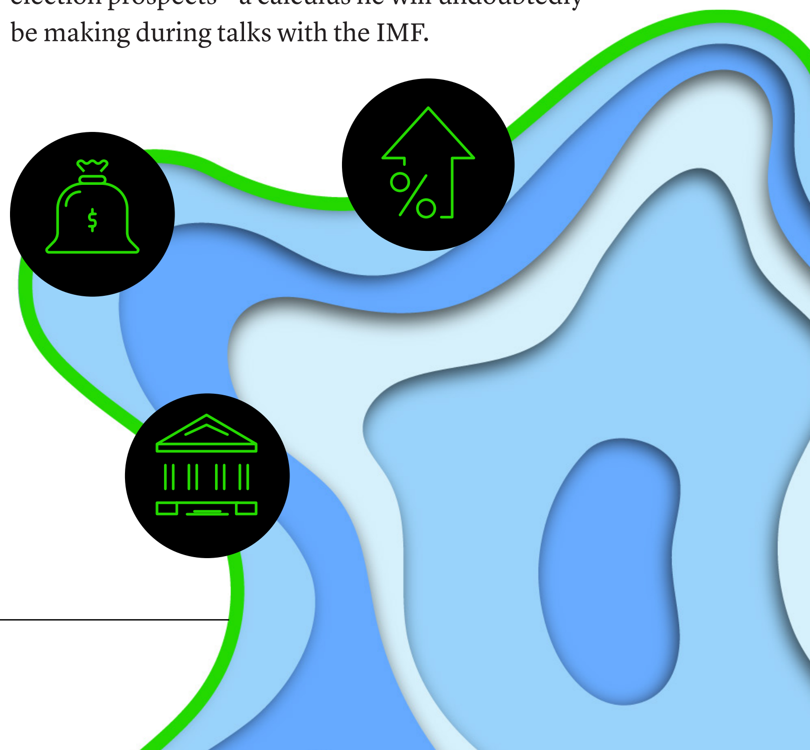
Zambia: Political Mismanagement and Debt Default

Zambia, which recently became the first African country to default since the onset of the pandemic, has been at the centre of discussions about a potential African debt crisis, but is largely an outlier to the continental norm in its approach to restructuring. Zambia's debt problems long pre-date the pandemic; government debt has, since 2011, risen from 21 percent of GDP to exceed 120 percent[3]. Zambia's aggressive borrowing — much of which has taken the form of 10-year Eurobonds, with an average interest rate of almost seven percent — was intended to address a chronic infrastructure gap, with booming copper prices expected to facilitate smooth repayment. Rather than tempering the ambitions of the Zambian government, the bursting of the global commodities bubble in 2014 prompted a doubling down of this borrowing strategy, prompting the IMF to repeatedly warn of a growing risk of debt distress[4].

In this context, COVID-19, and its consequent damage to demand for Zambia's vital copper exports, has accelerated an inevitable reckoning on the country's debt burden. In May 2020, the Zambian government hired Lazard to advise it on restructuring — a move intended to demonstrate a commitment to a consensually negotiated settlement with holders of USD 3 billion in Eurobonds. Since then, however, negotiations have stalled. Engagements with the IMF have gone nowhere and, in late August 2020, Lungu fired respected central bank governor Denny Kalyalya, replacing him with close ally Christopher Mvunga. None of this has engendered confidence in the Zambian government's ability to utilise debt relief to place the country on a firmer financial footing.

The key sticking point for Zambia, however, has been transparency. The country's Eurobond exposure is similarly matched by Chinese lending, often on opaque terms. Speculation has swirled for years over the attachment of Zambian state-owned assets as collateral to Chinese loans — notably focused on electricity utility ZESCO — and Zambian authorities have not been forthcoming to bondholders over any approach to restructuring these obligations. However, in September 2020, the Zambian government presented an effective "take it or leave it" offer to Eurobond holders — proposing a deferral of interest payments to April 2021 — while offering little visibility on either parallel negotiations with Chinese creditors or the country's full debt picture. The Zambian government has since been unwilling — or unable — to heed creditors' calls for transparency.

With two-thirds of Zambian Eurobonds lacking modern collective action clauses —[5] opening the door for creditors to sue for payment on a bond-by-bond basis — it therefore came as little surprise that bondholders opted to reject the plan, prompting the November 2020 default. Time is running out for the Zambian government to finalise a loan programme and debt relief with the IMF. Parliament will be dissolved in May, ahead of the scheduled August presidential and legislative elections. The ability to strike a deal and the conditions associated with the loan programme will be a defining feature of President Edgar Lungu's first term in office and directly influence his re-election prospects – a calculus he will undoubtedly be making during talks with the IMF.



Angola: Restoring International Trust?

Angola, a similar focus of international concern, has adopted a more conventional approach to its debts. Since 2014, the country has been mired in economic difficulties, driven by the falling price of oil, which accounts for over 90 percent of national foreign exchange earnings. Angola's economic fundamentals are, in many respects, in even graver distress than those of Zambia. Years of corruption and mismanagement under former president Jose Eduardo dos Santos have left the country with few non-oil alternative sources of revenue, while national debt is forecast to hit almost 130 percent of GDP by the end of 2020[6].

Unlike Zambia, however, Angola has made tentative progress towards a sustainable restructuring, and is likely to avert a sovereign default in the short term. In its latest review of Angola's pre-existing Extended Credit Facility, the IMF in September 2020 approved a further tranche of USD 1 billion in funding, noting the government's commitment to fiscal reform and progress in negotiations with major creditors[7]. Notably, the Angolan government has signalled concrete progress in talks with Chinese lenders — which account for around 45 percent of national debt —with deals reportedly reached in September 2020 with its largest creditors, China Development Bank, and Eximbank.

These deals have been broadly completed under the auspices of the DSSI, with Angola opting to target the bilateral and multilateral debt payments covered under the scheme. While the Angolan government has not provided full public disclosure of the terms of its renegotiation, its stance of broadly leaving Eurobond debt as a low priority for restructuring has allowed it to avert much of the acrimony seen in Zambian negotiations. Angola's willingness to directly tackle Chinese debt exposure, therefore, has largely allowed it to avoid antagonising commercial bond holders, leaving the option of a return to further Eurobond issuance open as a last resort.

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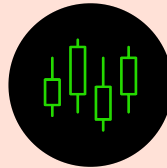
While Angola's debt profile remains distressed, the government's close cooperation with the IMF, decision to prioritise restructuring its major Chinese obligations, and wider commitment to fiscal consolidation — notably through its issuance of a supplementary budget height of the COVID-19 crisis in April 2020 — offer hope for averting a disorderly default. Crucially, these moves should strengthen Angola's case to receive a more comprehensive restructuring package in the new year, as international momentum on debt relief continues to build. With Angola increasingly demonstrating a commitment to avert the fiscal mistakes of the past, private creditors are likely to find maintaining an intransigent stance on relief an increasingly difficult position to sustain.



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International Action: Growing Pressure on the Private Sector?

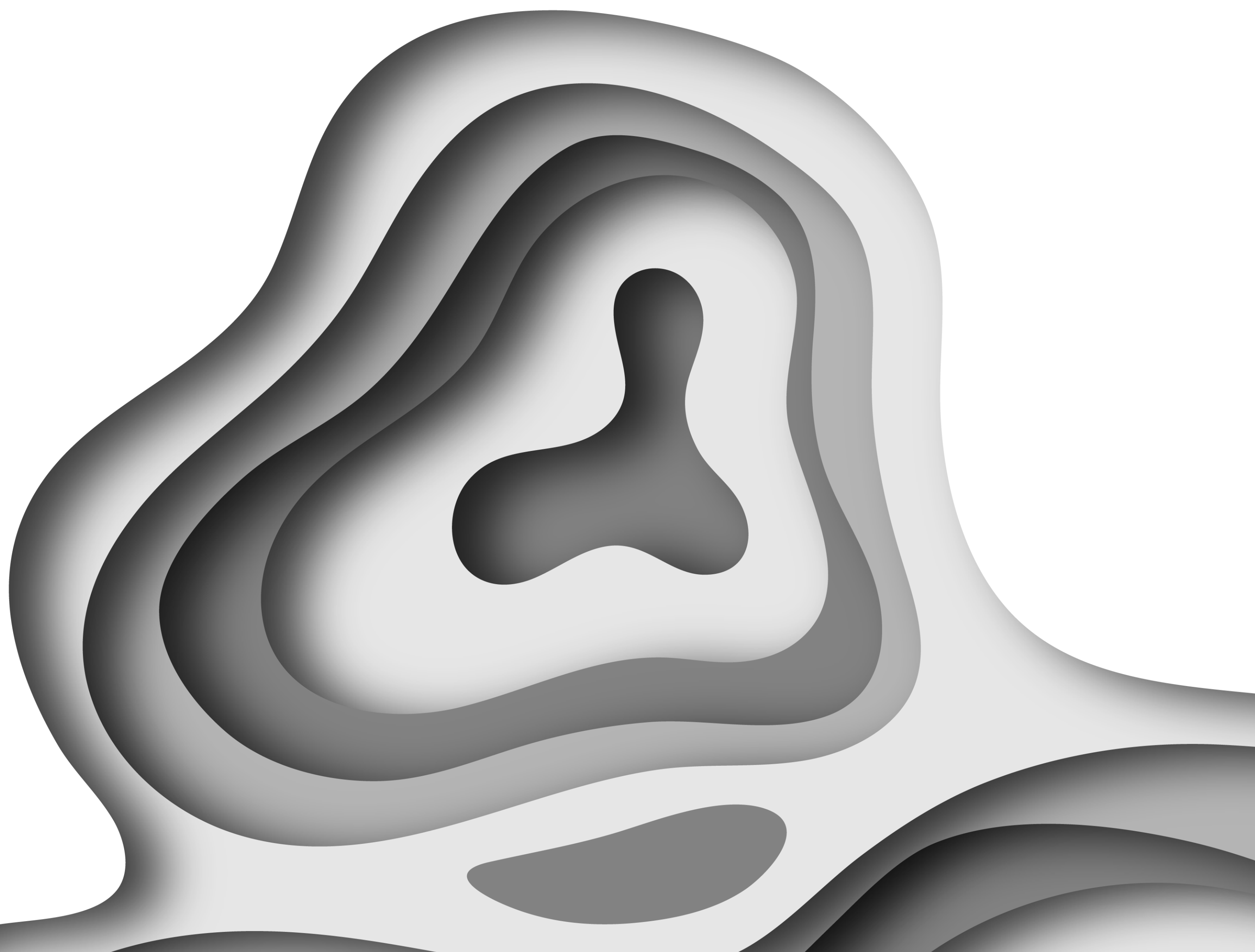
The almost complete absence of private creditors from participation in the DSSI to date has been the source of significant frustration for the IMF, and prompted the ire of anti-debt campaigners worldwide. At the heart of the impasse has been the fundamental tension between the commercial interests of these lenders in protecting their investments, and the clear economic questionability of such extensive commercial borrowing by sovereigns from the outset. In Zambia, the failure of political actors to signal a commitment to eschew opaque borrowing, and maintain confidence in the country's debt sustainability, left few options other than default. Angola's position, by contrast — demonstrating growing confidence in renegotiating Chinese lending and attempting to revitalise the political and commercial culture — raises the question of just how much action private creditors need to see before committing to relief.

The newly released G20 common framework on debt relief and restructuring, which aims to place private commercial and official creditors on a level playing field through providing greater transparency on restructuring arrangements, will further amplify pressure. The new initiative crucially involves Chinese state-backed lenders, with all creditors encouraged to fully set out the extent of their liabilities to debtor countries. The IMF and World Bank have both signalled a desire to initiate case-by-case sovereign debt-stock reduction in 2021, with neither institution likely to look favourably on 'free-riding' by private creditors on budgetary breathing space provided by more comprehensive international restructuring. While proposals recently put to the UN Security Council to initiate much greater protections for debtor countries are unlikely to come to fruition, private creditors must carefully consider the implications for future commercial lending opportunities if an inflexible approach to restructuring is maintained.

Outlook: Short-term Loss for Long-term Gain?

The Zambian and Angolan cases demonstrate a sharp divergence in approach to combatting the COVID-19 debt distress. Zambia, currently largely a stand-alone case, is home to a government focused on upcoming elections, where continued concessions to the heights of international finance are unlikely to play well with the electorate. It is an outlier in some respects and at this stage, no other sovereign is at imminent risk of joining it in the ranks of COVID-19 induced defaults.

Angola is in a significantly worse fiscal position than most of its counterparts yet the government's yet been forthcoming, private creditors must consider the long-term damage that continued intransigence will wreak in such circumstances. The announcement of the common framework, and its direct targeting of key creditor concerns, should substantially reduce creditors' transparency concerns. While taking a write-down on an investment is always a disappointing outcome, in the long run post-pandemic African economic growth will ultimately provide much greater financial opportunities — but to get there, private creditors will need to step up to the restructuring plate.



Simiso Velempino, Partner, Africa Matters

As the CEO of AML, Simiso leads the strategic direction and growth of Africa Matters. She has extensive consulting and advisory experience in sub-Saharan Africa and is frequently used as a sounding board by senior public and private sector leaders.

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