Bloomberg Invest: Focus on Africa

Africa: The Path to Debt Sustainability

David Malingha: Thank you very much for everyone. We're going to shift gears a little bit and get into the debt issue that has become the Africa debt issue. I will give you just a few numbers before we get into it. These are from the IMF between 2015 and 2021. We saw that the number of countries in debt distress increased from two to six while the number of countries at a high level of debt distress increased from 6 to 14, those more than doubled.

The number of countries at moderate level of debt distress increased from two to six, and those at a low level of debt distress increased from six to nine. I won't give you any other figures. We'll be visualizing some on the board but just to take it off with you, Razia, when and how did we get from Africa rising a few years ago to now Africa debt distressed?

Razia Khan: That's a very good question, David. I think we need to put this in perspective. We know that African growth had been very robust since around 2001. We were seeing Africa outperforming a lot of other regions in terms of its growth trajectory. There's a lot of optimism about what could be done with structural transformation, the rise of the middle class, greater urbanization, productivity games.

None of those issues have really gone away, but we also know that debt is that much more of a preoccupation today given the increase in external borrowing that we had seen from the region, especially on more commercial terms. Now, I'm going to say something controversial. When we look at the history of debt crises, the origins of that can typically be found in excessive liquidity conditions in the credited countries, in the creditor locations rather than anything that changes dramatically on the part of the borrower.

What I'm saying essentially is look back at the global financial crisis. Look at what happened with QE1, QE2, QE3, the flood of liquidity, that wall of liquidity finding higher returns. That might explain a little bit of what we see today. Yes, commodity prices softened end of 2014, 2015, Africa's growth momentum did slow, suddenly the amount of debt that had been taken on looked more worrying. We've had the COVID crisis, we now have the Russia-Ukraine crisis.

This creates greater headwinds to growth in the region, but it would be wrong to only look at what borrowing we had seen from the region. Look at the excessive risk-taking, look at liquidity conditions elsewhere. Even now, what is the key trigger for the greater concern around the sustainability of African debt? It's the ease of being able to refinance what has already been borrowed. It's rising US treasury yields. It's how difficult and how much more this complicates the situation for African borrowers. We do need to look at it holistically.

David: I'll need to ask you about the entry of China. If you talk about the ease or not ease of borrowing and refinancing. Thanks, Ted. China came in in a big way into Africa's debt market. Although the landing has slowed a little bit from Beijing, it's still a very strong creditor to Africa. Take us through how things have evolved and how do you see us moving from here.

Razia: Here's the key point. China's role as a source of financing for Africa has been very much more politicized in recent years. We know that with the issues around the need for a DSSI, with now the common framework under consideration, everyone is focused on where China lends in the region. Actually, if you look at the numbers, China's lending to Africa, excluding Angola, had peaked as early as 2013, including Angola-China's lending to Africa peaked at around 2016.

It's not really the case that we've been seeing that much more, that great and increase in lending by Chinese entities. Yes, there are debt issues that need to be worked out now, but in overall terms, I think if we look at the financing need in Africa, the need to be able to secure concessional or semi-concessional long-term financing, there is still absolutely a role that China should be playing and we believe that China will continue to play in lending to the region.

David: Thank you. Gregory, you wrote a wonderful book. This is how it looks, *How Africa's Debt can be a Benefit, Not a Burden* and I just want to read a small exit from it. "Smart suits arriving in ad hoc financing or ministers flying solo to global financial centers should not drive borrowing and investment decisions. Instead, they should be guided by the process of active debt management or by well thought out strategies based on the results of a country's regular debt sustainability analysis." Now, this is your book, right? Does anyone take your advice?

Gregory: First of all, the book was written as a culmination of 15 years moving around the continent living, working, traveling and I picked up ideas from many different policymakers in many different countries. I feel when I'm writing, I'm summarizing some of the views of the continent as well as giving my own advice. What I'd say is we certainly need a move to better boring.

Among the 55 African countries, there are three typical cases I find. One is heads in the sand, complete ignoring the increasing debt risks, not making any steps towards improving it, but most common is a situation where I'm talking to really bright technical experts in central banks, ministries of finance, in businesses. They know the risks, they know what's happening, but there's a slight disconnect to those technical policymakers and the politicians who want to win an election in 18 months or a year down the line.

They don't want to hear about medium-term risks, they want to hear about what ribbons can we cut? What policies can we do? What taxes can we reduce in order to get votes at the next ballot? That is a difficult situation where the technical experts know what they're doing. We just can't get the message through to the politicians. Then there's a third type of country where it's all lined up. There's a wonderful mix of technical expertise and politicians wanting to do the right thing.

Last Friday, I was in Benin in Cotonou and that's one country where I think they've made some excellent decisions in the way they are managing their debt, in the way they're investing, and that they linking their use of proceeds on their bonds to sustainable ends by signaling, we're going to spend X and Y on these specific sustainable development goals.

David: Over the last five years, about five African countries, the debt-to-GDP has been over 100%, Greg, and it has become really a talking issue. In Nairobi where I know you were last week, there's an election coming up in August and it is a debt issue. Even when you meet ordinary folks in meeting rooms, on the street, they know their debt-to-GDP, they know how much debt has been taken on over the previous few years. Do you think African countries, for now, at least the ones that were worrisome, have hit rock bottom in terms of worrying indebtedness, or are we yet to see worse of situations and probably even more defaults?

Gregory: We've certainly got worrisome debt conditions in a number of countries. When I diagnose a debt crisis, I try and work out what is the root of the problem. It can be a revenue problem, that is a government not collecting enough tax. Its inability to tax its informal sector in order to service the debt. It could be an export problem. They're not earning enough foreign currency to service their external debt or it could be an investment problem where the right decisions haven't been made.

Debt's a really complex thing and that's why it attracts a vibrant debate and different numbers are thrown around. On my mind at the moment is driving through Nairobi traffic last week and seeing that massive highway up on stilts next to the road I've been using for years. That's an investment which if they can collect the revenues from tolls is a viable project. It's a PPP. It's something that pays for itself. If those tolls get wad by a politician like they have in South Africa, suddenly, it's a liability and something government will have to pay for.

We've got all sorts of this is underlying those debt problems in each country it's different and debt can move quickly. You can be in good territory and then quickly debt jumps through a large exchange rate depreciation, or it can come back down as in the case of Angola where these high oil prices have helped the Kwanza, and debt's moved quite rapidly in the other direction.

David: Razia, talk to us about the common framework. It was a well-intentioned program after the pandemic hit. A lot of countries' fiscus came under a lot of pressure. It looks like it did not exactly work out, as at least envision. For instance, why did China and the private creditors do more as earlier anticipated?

Razia: I think when we look back, and we look at the proposal of the DSSI in the immediate aftermath of the onset of the COVID crisis, that debt service suspension was supposed to free up the space for many borrowing countries. We know that the IMF and other multilateral lenders had a way of financing the debt service suspension that they were offering. For a lot of bilateral creditors, this came right out of their aid budgets. It was complicated in terms of private sector participation.

Ratings agencies suggested that anything that changes the original contractual terms of that debt obligation that results in a meaningfully different value being ascribed to that debt is a default. Now, for many African countries, Greg just mentioned that he'd come back from Benin, the issue was, is it worth going for the DSSI if we don't have access to financial markets to international capital markets? As a result, is the cost too high to pay, given the rather limited benefits?

There's a lot of controversy about this at the time. I think what was forgotten in that debate was the whole issue should have been, how do you crowd in more capital flows to borrowing countries at a time when we have seen because of greater risk aversion because of financial market volatility? We have seen the withdrawal of capital from emerging and frontier markets alike. This was not the right time to come up with a proposal that made it even more difficult to finance developments in African countries.

I think looking back at the experience of the DSSI, we'll all think with some amazement, how did anyone think this was a clever solution to actually make the situations of countries even worse, because of the potential risks involved? The common framework, of course, is supposed to evolve from that. It's the idea that some countries have debt situations that are so problematic, that they would do a lot better to just resolve that at the outset. This time around, that is a core requirement of comparable treatment of all creditors.

The problem is, as we know, it's been a slow process. It's been difficult to organize. Very few countries have actually held up their hands and said, "We want a common framework type restructuring," either because they haven't seen the benefits. There's a great reluctance to go down that route unless absolutely forced to. There's a lot that needs to be worked on still. Increasingly, some creditors are starting to think, "If a debt situation is clearly unsustainable, wouldn't it be a better action on the part of the debtor country or the debtor sovereign to seek common framework type restructuring at the onset, at the very start?"

Of course, to get to that point, we've got to see successful conclusion of a common framework restructuring. Here we are, May 2022, we haven't yet seen that.

David: What do you think is going to happen?

Razia: Much more coordination is needed. The IFIs have put out this idea that in order to encourage debtor countries to sign up for the common framework, maybe they need to be offered blanket debt service relief from the very outset when they request common framework type treatment. Maybe this will make it more attractive for those countries to think of the debt restructuring that is required.

Now, before we even get into that, let's learn from the lessons of the recent past. Is this going to be treated as a default? How will ratings agencies react? Is it really a workable solution? There is a much broader discussion still to be had on this.

David: [unintelligible 00:14:15] you talked about the rating agencies. It's a question that I wanted to follow up with. There have been some governments, some leaders, particularly Ghana, which has not been very comfortable with the way rating agencies have been assessing and later concluding on their status. Should there be a different way, in certain conditions, rating agencies shouldn't be assessing and making opinions on some of these sovereigns?

Razia: The argument of the government of Ghana is that they were about to embark on an even deeper fiscal consolidation, that there had been revenue measures that had been outlined, there was a willingness to cut spending, more than had been announced in the budget, and that this was about to be rolled out, but pre-empting that, they did suffer downgrades from some rating agencies and the Government of

Ghana clearly felt that that was a little unfair, that they should have been given more time.

The ratings agencies, on the other hand, were saying, "Ghana, look at the yields on the Euro bonds, you are locked out of any easy refinancing of your debt. You're locked out of international capital markets." The rating is essentially just a reflection of that situation. We could argue this point at length, I see you have brought up the charts of Ghana's Euro bond debt maturities and everyone will be able to see from this that Ghana does have some time to really go for it in terms of the fiscal consolidation.

If on the other hand, there isn't sufficient evidence that that consolidation is happening, that it's meaningful, then when it comes to refinancing some of those upcoming Euro bond maturities, look at what happens in 2025, there could be an issue. The broad consensus is Ghana can get through this year. It has relatively little external debt service, $2.6 billion, $2.7 billion, thereabouts. It's got the reserves to cover that. The bigger issue is what does Ghana need to do to regain the confidence of the markets? Are we seeing evidence that that is happening?

David: This is a question for both of you from Santos from the audience. It looks like the African debt is being put in sectors that do not provide returns for the country. Africa will still need the cash, and therefore increase the debts which can create a problem to its sustainability. Greg, do you want to start?

Gregory: Very quickly, clear use of proceeds. When people are boring, there's an articulate plan on what the money needs to be used for. Behind that plan is a robust framework for public investment management. We've had a wonderful 15 years for African countries' access to the global financial markets but what we haven't done is made steps in terms of really making solid investment decisions and that requires governments to step up with a framework, a pipeline of projects that are rigorously analyzed and a lot of scrutiny goes in publicly before projects are agreed to. I think with that robust investment framework of African countries can borrow much better.

David: Razia.

Razia: There is a need for greater debt transparency. What we've observed over the last decade or so is that when we have conditions of excess liquidity, excessive risk-taking some might argue with the benefits of hindsight, not enough attention is paid to the idea of debt transparency, exactly what is being borrowed? For whom? From whom? With what tenures? Where is it going? What are the use of those proceeds? Do the returns really cut it? Will you be able to repay the debt? I think with the benefit of the situation where we are today, hindsight always counts for so much. There's going to be a real push for greater debt transparency.

David: Greg, as your last word with all these uncertainties, Russia's war in Ukraine and some of the other conflicts, the externalities that they're bringing. We've seen coal in the Sahel, war in Ethiopia, in Somalia, the pandemic is still the pandemic. How can countries borrow safely?

Gregory: There's been a recent string of bad luck and there will be more bad luck to come and we just don't know when and exactly what. There's a huge amount of work, there's no silver bullet, there's not one thing you can say, this will make borrowing work. There's a huge amount of hard work to be done through modern debt management, through the design of strategies, through building a sustainable brand to attract financing.

I think the lessons from the '80s and '90s were African solutions weren't in the center and I think they need to be. I think the architects of the system need to be coming up with a plan that if several countries do need assistance, do default, that there is a way of supporting them through a framework. That is exactly where we need African solutions there and we need involvement of many different stakeholders.

We need a clear recognition, there are massive investment needs. That's the challenge, whether it's climate adaptation, whether it's delivering on the Sustainable Development Goals. Whatever solution we put in place, we need to ensure that it sows the seeds to attract that much-needed investment.

David: Razia, as your last word, briefly tell us about spreads and your outlook on that. I know there are very many factors including the global rising yields currently. Is it going to be bad or in the foreseeable future do we see a silver lining on the spreads?

Razia: It's an uncomfortable situation for many borrowers potentially when they look at the volatility in markets. When anyone looks at what has happened to US treasury yields, continues to happen even right now, the question is when is the calm restored? When does it all settle? I think on the part of borrowing sovereigns, a lot of thought needs to be given to how do you create more resilience around these conditions? We're seeing an increasing number of countries saying we're going to tap all of the concession sources of external financing.

First, it makes sense to do that, but to Greg's point about finding a way to do this sustainably, finding a way to do this safely, finding a way to be more resilient to this kind of financial market volatility, this remains a very important consideration. I'd just like to end. I know that we may be out of time, but with the comment. I come from a relatively small African economy, quite frustratingly, it hasn't borrowed much. We're talking today about all the countries that have borrowed, have seen growth on the back of it.

There is another side to this as well. The only thing I would leave the audience with is cautioning against too much of a generalization. When we're talking about excessive debt levels, what is our perspective exactly? What kind of growth can become possible if we see the borrowing happening in a sustainable, transparent way? This could be setting the scene for this space in the next 10 years.

David: On that note, thank you so much, Razia. Thank you, Greg, for all your insights. Thank you to the audience and thanks to Standard Chattered for sponsoring this session. Have a good rest of the afternoon. Thank you.

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