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Debt sustainability in Africa under the spotlight again

EXECUTIVE SUMMARY

Africa has been a major focus of attention since the pandemic and, more particularly, Russia's invasion of Ukraine. The twin shocks and their consequences – obstacles to the movement of people and goods, skyrocketing energy and food prices, plus monetary policy tightening – have revealed structural weaknesses of African economies, either by exacerbating them or manifesting them. In this respect, over-indebtedness and food insecurity – with their economic, political and social ramifications – are the chief hallmarks.

In 2020, during the first year of the Covid-19 pandemic, growth in the African economy receded on back of plummeting commodity prices and remittances, and the collapse of tourism in a number of countries. More generally, the unrelenting hindrances to external and internal mobility of persons and merchandise, on top of a disorganised international and domestic transport system, contributed largely to the recession.

On top of this were the effects of the war in Ukraine, which at times dovetailed with those of the pandemic, doubling the consequences. Cereal, oil and fertiliser supply glitches, along with spiking fuel product prices, harmed the financial situation of African states, especially amid global monetary tightening and US dollar appreciation. Commodity pressures also sparked inflation, which contributed widely to food insecurity, and sparked social and political unrest.

Fiscal and current account balances deteriorated as a result. These two problems harmed the continent's major economies, which had previously been robust, and highlighted the weaknesses in their growth models. Their heavy dependence on imports (food, energy, intermediate products and equipment), their reliance on abundant and cheap financing, and their low fiscal revenues have greatly contributed to these difficulties.

The instances of debt or a higher risk of over-indebtedness have increased across the continent, which houses more than half the cases witnessed worldwide. Despite adopting the G20's Common Framework for Debt Treatment (CF) in 2020, processing the continent's debt is being complicated by the growing number of creditors at the negotiating table since 2000, notably the arrival of China, bond debt holders and global trade operators. In order to ease their foreign exchange risk, certain governments have sought to issue debt in their own currency, but the move has been counterbalanced by investors demanding higher yields to offset their own exchange rate risk.

These situations have forced governments to turn to the IMF and other multilateral bodies in the attempt to obtain – at best – funding at concessional terms and at times to restructure debt. In return for IMF assistance and the like, governments must implement harsher economic policies that harm growth, worsen the cost of living problem and at the same time limit imports. African citizens have sometimes responded to these economic setbacks by staging protests (often violently) and *coups d'État,* instigating rebellion and committing criminal acts.

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FOR TRADE

Weakening fiscal and external situations across the continent

The financial picture of many of the 54 countries in the African continent was seriously eroded by the pandemic and later by the war in Ukraine, which exacerbated their structural weaknesses. Since March 2022, we have witnessed a succession of financing crises in Africa that have often occurred in larger economies. Egypt, Ethiopia, Kenya and even Ghana – all examples of the African dynamism in the past decade – are now battling economic crises that can be largely pinned to their weak public and external account balances. The end of a world with readily available and cheap cash is also calling into question their economic models that were once effective – at least as far as growth is concerned – but which are now unsustainable.

In the current economic backdrop, many African economies, whose growth is driven by public spending and strong dependence on imports, are facing an increase in both their domestic and foreign financing needs, and at the same time are dealing with diminishing and more expensive sources of financing. Put another way, the financing gap is widening. The need to tap foreign exchange reserves to balance the balance of payments – often to the point of critical thresholds – is drastically increasing the risk of a default on external debt repayments (see Egypt's example in Q1 and Q2 2022, **Chart 1**).

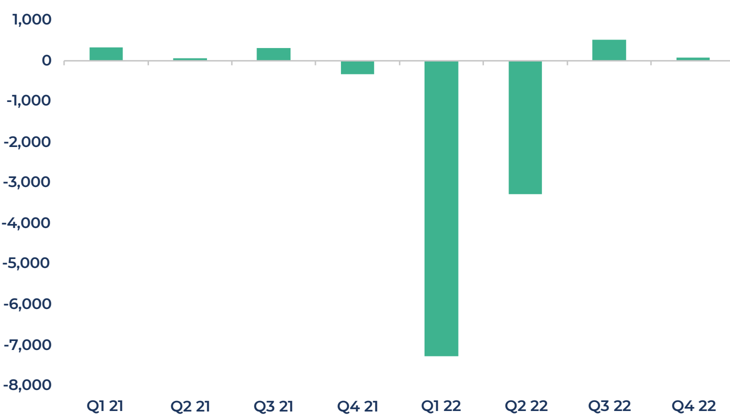
The consequences of the war in Ukraine triggered a sharp deterioration in the current account balances of most African economies, notably those which are heavily dependent on commodity imports (food and energy) or tourism (particularly Russian and Ukrainian visitors). Steepening prices for oil and basic agricultural products dented their terms of trade, as most countries on the continent are net importers of these commodities. Import costs were also pushed higher by depreciation of many African currencies, largely on back of general US dollar appreciation following the US Federal Reserve's rapid monetary tightening cycle. Accordingly, owing to the prevailing share of food in consumer spending, 45% of African nations recorded an inflation rate greater or equal to 10% at end-2022, with some countries exceeding even 30%, which was notably the case of Ghana and Ethiopia. Added to this is the increased foreign debt servicing expense following the end of the Debt Service Suspension Initiative (DSSI)[1] at the end of 2021 and interest rate hikes. Several local currencies nosedived, such as the Zimbabwe dollar, which fell 98% against the US dollar between 1 March 2022 and 23 June 2023, and the Ghanaian cedi, which gave up 40% of its value over the same period (**Chart 2**). By contrast, Mauritania's ouguiya and Algeria's dinar appreciated in value by a respective +5% and +4% owing to their exports, which were respectively stimulated by high oil and energy prices. Capital outflows from emerging economies towards their advanced counterparts triggered by newly-found competitiveness in investments in advanced economies grew on the back of prevailing uncertainty over the global economy, sending investors into risk-off mode. At best, where governments were able to secure financing, private lenders demanded bigger risk premiums, which were already higher on the continent than in other regions with equivalent sovereign debt ratings.

The rise in foreign public debt service payments traces the trend observed during the past decade related to the increased number of private creditors in sub-Saharan Africa. Issuance volumes by African nations – at least those with market access – increased steadily in the international capital markets, where interest rates are considerably higher than those charged by multilateral lender organisations or bilateral official partners. Accordingly, while African countries allocated an average 7% of their budget revenue on servicing their debt between 2012 and 2015, the share grew to almost 14% between 2015 and 2019, with gaping disparities depending on the country in question. Respectively, Nigeria's and Angola's share exceeded 80% and 60% in 2021.

Fiscal and current account balances of net importers of energy and food (**Chart 3**) and those countries heavily dependent on tourist revenues fell markedly. By contrast, countries that extract raw materials, such as Angola, South Africa, Algeria and Botswana, rode high on strong commodity prices. Revenues generated by their exports allowed them sufficient buffers to tackle food inflation and higher financing costs.

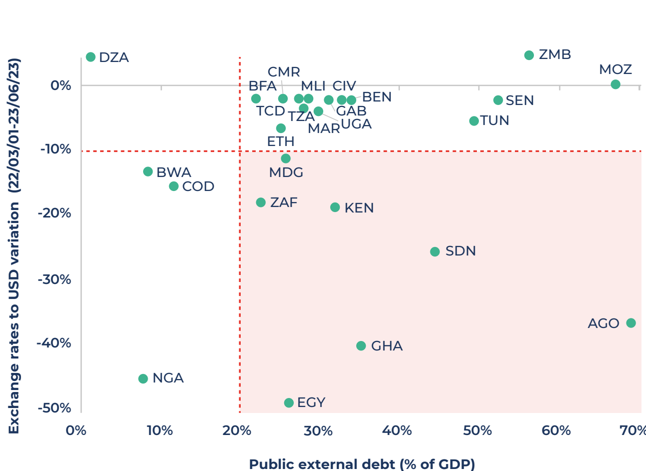
Budget revenues, which were already low relative to GDP (around 16.5% of GDP for public revenues in 2019) were squeezed even further by softening activity caused by the Covid-19 pandemic in 2020 (-2.1% for the entire continent) and later by the brake on post-pandemic recovery prompted by the war in Ukraine. African states were forced to implement support measures that dragged heavily on their fiscal accounts to offset the impact of the twin crises, mainly by subsidising prices of certain goods such as energy, food and fertiliser, and lowering taxes such as VAT and customs duties in certain sectors.

Chart 1 - Variation in Egypt's foreign exchange reserves (USD million)



Sources: CBE, Coface

Chart 2 - Change in exchange rates and public external debt



Sources: World Bank, Refinitiv Datastream, Coface

1 - The Debt Service Suspension Initiative was established in May 2020 by G20 members and coordinated by the Paris Club to allow certain countries to temporarily halt their debt service payments to official bilateral creditors.

More and more situations of over-indebtedness

These situations have underscored the continent's prevailing dependence on food, energy and equipment imports, which, coupled with weak fiscal resources that force countries to use debt to finance spending, increases the risk of over-indebtedness. On average, tax revenues represented 16% of GDP in 2020 for the 31 largest African economies, i.e., well below the average posted by OECD countries (33.5%) and Latin American countries (21.9%). Gaping disparities exist between countries: Nigeria, Niger and the Democratic Republic of Congo recorded percentages below 10%, compared with over 28% in Morocco and almost 33% in Tunisia. Corruption, smuggling, tax evasion, the weight of the informal sector and inefficient revenue collection are hindering consolidation and/or growth of the tax base.

Coupled with spiralling debt is the cost of servicing it, added to which is an almost across-the-board rise in interest rates to curb inflation. It has become difficult and sometimes even impractical to secure debt at both domestic and external level given its cost, thereby making access to less burdensome financing from multilateral organisations and bilateral official partners crucial.

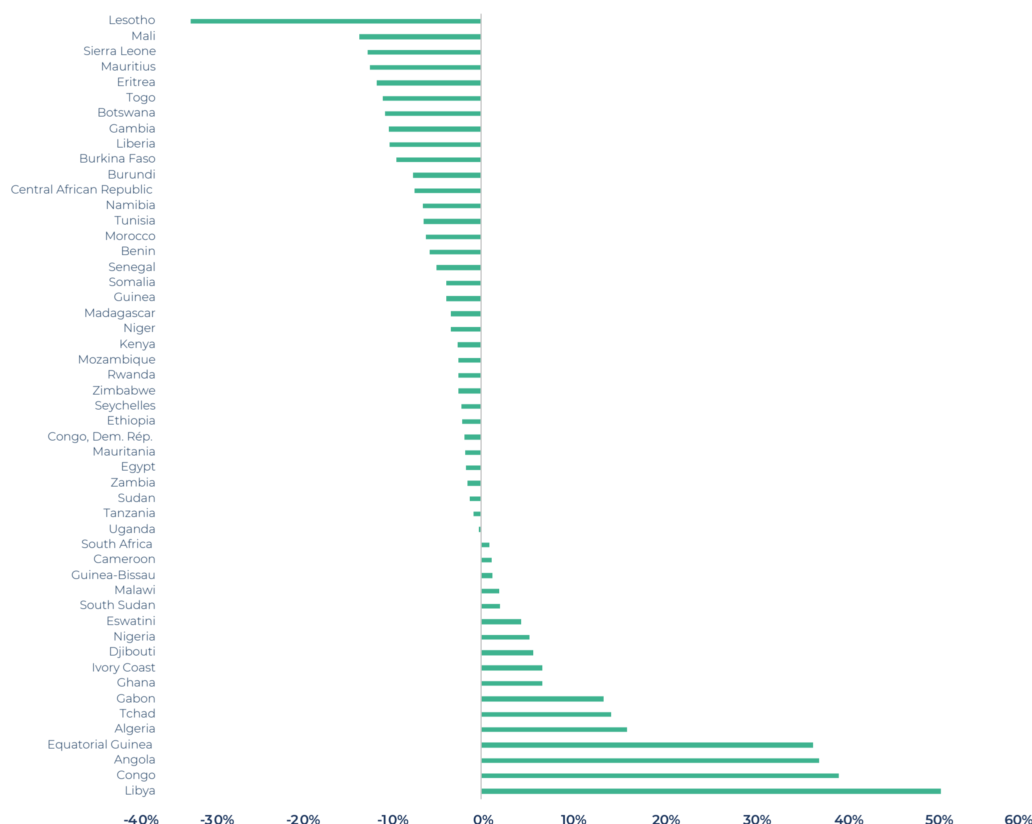
Accordingly, the accumulation of costlier debt amid a challenging economic environment has led to more cases of over-indebtedness and has triggered the downgrade of many sovereign debt ratings, with some governments defaulting on their debt repayments. While a third of the 36 African countries covered by an IMF debt viability study was already deemed to be in a situation of over-indebtedness or at risk of it prior to the pandemic, the two successive shocks took the share to 100%, with nine countries in particular in a state of proven[2] over-indebtedness[3] and 12 being at very high risk of it in May 2023.

External indebtedness takes a toll on currency reserves. This may result in controls and restrictions on imports to keep these currencies safe and on hand, which, for example, is the case for Egypt, Tunisia, Ghana, Algeria, Ethiopia and Kenya. That said, some African countries belong to monetary zones (WAEMU, CEMAC) whose currency is pegged to the euro and for which France ensures its convertibility. This enables these currencies to remain stable, at least against the euro, even in the event of a balance of payments shock, and to ease pressure on currency reserves as parity does not need to be sustained. Furthermore, pegging the currency enables regional central banks to model their own monetary policy on that of the ECB, which has remained relatively accommodative.

To limit issuing debt in foreign currencies, which is considered riskier, governments have increasingly resorted to financing in local currency, at least in countries that have a sufficiently developed financial market to raise debt in the local currency and whose money has sufficient clout. However, financing in local currency is more expensive than issuing debt in a foreign currency owing to the exchange rate risk borne by investors. This gap is likely to widen if debt issued in local currency, irrespective of whether it is held by domestic or foreign creditors, is included in debt restructuring mechanisms, which is the case of Ghana and constitutes a first in this respect.

However, although the debt-to-GDP ratio is a key indicator, to appreciate the short-term financial risk posed by a country, a country's financing requirements are also a consideration; this includes the annual public deficit (and hence interest payments) and the amortisation of the debt over the ensuing twelve months. The risk of debt non-renewal is lower if the creditors are multilateral and bilateral financing institutions.

Chart 3 - Dependence on energy and food products (balance of trade in food and energy products as % of GDP, 2021)



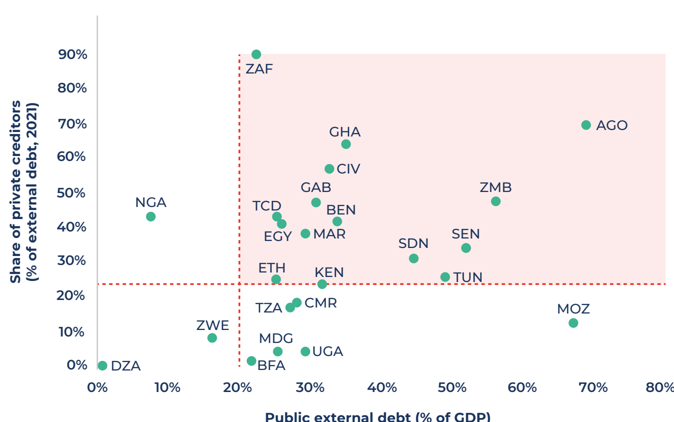
Sources: UNCTADstat, Coface

2 - Congo, Ghana, Malawi, Mozambique, São Tomé and Príncipe, Somalia, Sudan, Zambia, Zimbabwe.
3 - Burundi, Cameroon, Comoros, Djibouti, Ethiopia, Gambia, Guinea-Bissau, Kenya, Central African Republic, Sierra Leone, Southern Sudan, Chad.

Trends in the continent's debt structure: riskier components that also make restructuring efforts more complex

Over-indebtedness in African countries in the middle of the 2000s was principally tackled by the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). However, the increase and, above all, the change in the African debt structure observed since that time has heightened the risk of taking on too much debt, making the problem more complex. New official creditors have appeared – China, often as part of its Belt and Road Initiative (BRI), as well as India and the Gulf states, and a growing share of private creditors (the percentage of which rose from 29% to 43% between 2009 and 2019) at the expense of traditional multilateral and Western creditors - such as the bilateral Paris Club members, in particular - due to the increasing recourse to bond debt or to secured loans by leading commodities traders. For example, in 2021, private creditors held 69% of Angola's external public debt, 64% of Ghana's and 42% of Nigeria's (**Chart 4**).

Chart 4 - Share of external debt held by private creditors



Sources : World Bank, Coface

Furthermore, despite the proliferated use of debt issues in local currency over the past few years, the opportunities to tap domestic financial markets have been restricted by their size. The rise in the number of bond issues has therefore gone hand in hand with increased debt denominated in foreign currencies. African nations are consequently prey to greater refinancing and exchange rate risks. Last, the wider panel of creditors poses additional risks. By way of example, the latter may result in the use of collateralised debt instruments (with commodities frequently used as underlying collateral), which, owing to their complexity, are less transparent and make it more difficult for creditors to assess the real debt level.

Arranging debt restructuring agreements is complicated by the diversity of creditors. Although the purpose of the G20 Common Framework for Debt Treatment (CF) was to replace the Debt Service Suspension Initiative (DSSI) by setting a framework to negotiate debt restructuring agreements between all official bilateral creditor G20 members (thus including creditors that were Paris Club non-members), the mechanism did not remove the inherent difficulties posed by multiple creditors and only diminished them. To date, only four African nations (Chad, Ethiopia, Zambia and Ghana) have solicited the CF, and sealing an agreement has been a challenge: Chad and Zambia alone have managed to sign a firm and detailed agreement. Ghana has for the moment only signed an in-principle agreement. It has been an uphill battle to lock in significant debt reduction concessions and still manage equal treatment of creditors.

Among the official bilateral creditors, the ambivalent position of China, which held 62% of the continent's bilateral external debt and 12% of total external debt in 2019, notably through the intermediary of its development banks, constitutes one of the main challenges. While China plays an essential role in debt restructuring owing to its role as a major creditor, restructuring initiatives are handled in a framework decided by others, i.e., using the Paris Club model. Hence, as part of the G20 Common Framework, after accepting an in principle agreement in 2022 to reduce Zambia's debt, of which China holds a third of the external debt, China delayed signing for several months until a final agreement was reached during the G20 Summit for a new Global Financing Pact in Paris in June 2023 to eventually seal a debt restructuring agreement. Moreover, unbidden, China made its own debt restructuring arrangements with countries such as Angola, Congo, Kenya and Ethiopia in response to difficulties faced by a number of countries following years of unbridled financing.

The Common Framework also provides for private creditors to grant comparable terms as those awarded by bilateral creditors in order to ensure that the restructured debt load is balanced fairly between the creditors. This is what they agreed with Zambia. External private creditors are many and varied, and in 2021 held over a third of Africa's external public debt.

All these factors make negotiations cumbersome and slow, and dissuade African governments from applying the framework unless forced to by the urgency of the situation. The situation is all the more problematic in that the unblocking of financing granted by the IMF and other multilateral organisations to developing and emerging countries is conditional on the credible outcome of a restructuring agreement. If difficulties persist in reaching agreements, certain African countries such as Egypt, Kenya, Ethiopia and Tunisia may see their financial situation sink to a perilous state, as many of their very large bonds denominated in foreign currencies will mature in 2024 and 2025, the market conditions of which will no doubt remain harsh.

Economic woes augment social, political and security problems

Spiking inflation and financial woes emanating from more stringent budgetary and monetary policies that are generally demanded by creditors before they agree to grant new loans, and the approval of debt restructuring mechanisms bring their share of social, political and security consequences.

Monetary policy tightening thus causes growth to slow sharply. For example, Egypt's economic growth rate for the budget year of 2021-2022 that was estimated at 6.6% year-on-year, is forecast to slow to 3.5% in 2022-2023, and is expected to rise to only 4.0% in 2023-2024, i.e., below its pre-pandemic rate. Even though it obtained an IMF financing programme in December 2022 the signing of which was the condition precedent for the other multi- and bilateral partners to take back their loans, the measures to unblock the financing tranches have a sizeable impact on the economy. In addition to standard fiscal consolidation, the IMF requires Egypt to switch back to a floating exchange rate, which caused the Egyptian pound to fall. The currency depreciated by around 50% in less than a year. Although the authorities have again supported the pound since March 2023, leading to the *de facto* suspension of fresh payments

> *See page 6*

GHANA'S DEBT CRISIS

Ghana is a striking illustration of the effects of a debt crisis on the real economy in the current context. Although Ghana has long been touted as a model in Africa, it embarked on its biggest debt crisis in the past three decades, revealing major structural weaknesses.

A middle-income country since 2010, Ghana's economy is very poorly diversified. It depends heavily on exports of three raw materials namely oil, gold and cocoa, and is forced to import most intermediate products such as fuel and cereal, as well as equipment and consumer goods. Further weaknesses are low revenues and higher spending driven by the euphoria that went hand in hand with growth in the oil and gas sector. The imbalance in public finances was funded by increased use of domestic and external debt, which was justified by an economic policy based on public investment as the economy's growth driver. However, that debt was not used to diversify Ghana's economy. The pandemic and plummeting oil prices underscored the danger of depending on commodities exports. In addition, public spending rose sharply due to extensive household support measures in response to Covid-19 and in costly project spending in the wake of election promises. These skews in public and external account balances generated additional debt, the cost of which ballooned on back of larger risk premiums.

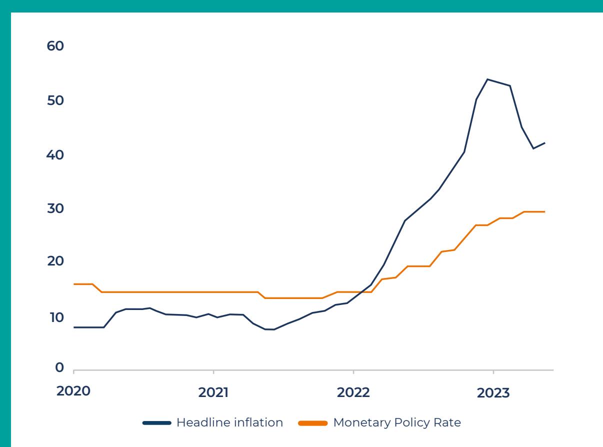
Just when the government was expecting a solid post-pandemic recovery, the war in Ukraine dealt a death blow. Despite robust export activity sustained by high oil and gold prices, the increased cost of food imports (cereals, oil, sugar, etc.) and refined oil product dragged on the commercial surplus and put a brake on lowering the current account deficit. The worsening situation prompted a large number of external bondholders (which held in 2021 almost two-thirds of Ghana's external public debt, representing 37% of its GDP) and domestic creditors (banks, insurance groups and pension funds) to withdraw their funds invested in the Ghanaian economy.

Against a backdrop of global monetary tightening, this combination of factors caused the cedi to collapse – Ghana's currency lost 50% of its value against the dollar in 2022 – and drove up risk premiums, thereby deepening the external debt burden. The country's central bank took action to buoy the currency and drive down inflation, which exceeded 30% over the year, by gradually raising its key lending rate from 14.5% in January 2022 to 29.5% in March 2023 **(Chart 5)** at the expense of increasing interest payments on its domestic debt. Despite not intervening on the markets to shore up the cedi, foreign exchange reserves at the Bank of Ghana sank from USD 9.7 billion at end-2021 to USD 6.6 billion in September 2022 (less than three months of imports) owing to massive import costs, interest payments and capital outflows.

In response, the rating agencies downgraded Ghana's sovereign debt rating in August 2022, chipping further away at investor confidence and undermining the government's access to international markets. Failing to secure sufficient financing to calm the financial markets, Ghana was forced a month earlier to turn to the IMF to restructure its debt and obtain financing. In December 2022, the parties signed a preliminary agreement to secure a USD 3 billion credit facility, which came with several conditions. The agreement was subject to an in principle agreement by official bilateral creditors to restructure the debt they hold. Accra will restructure its domestic debt (a first for this type of negotiation) and implement a budget consolidation program. Pending the restructuring, Ghana temporarily defaulted on a large part of its external debt payments at end-December 2022 and was officially declared in default in January 2023. An initial debt exchange program with domestic holders was carried out in the first quarter of 2023, with a haircut to reduce domestic public debt from 35% to 25% of GDP. A second program was introduced in June 2023 with local banks holding debt denominated in US dollars. External private creditors came together to form a negotiating committee and the government requested restructuring of its debt held by official bilateral creditors under the G20 Common Framework.

An in principle agreement was sealed in May 2023 announcing the start of negotiations between the committee of official bilateral creditors and the Ghanaian government, with the IMF immediately releasing USD 600 million. The remaining amount is to be gradually unblocked over a three-year period, in conjunction with a vast array of reforms. The IMF program and the debt restructuring initiative should enable the government to restore macroeconomic stability and debt viability. The cedi has already appreciated with the first payment. However, the budget austerity imposed by the agreement will curb growth in 2023 (1.5%). Furthermore, growth will remain below its pre-crisis level in 2024 (3%).

Chart 5 - Ghana – Inflation and monetary policy rate (%)



Sources: Ghana Statistical Service, Bank of Ghana, Refinitiv Datastream, Coface

under the agreement, the ensuing spike in inflation after the initial depreciation and monetary tightening employed in an attempt to counter it are curbing growth of Egypt's sizeable economy. Debt restructuring took place in Ghana and Zambia on back of twin monetary and budgetary tightening policies and fresh financing.

Along with inflationary pressures, this economic policy tightening has the potential to unleash social unrest. Numerous examples of social unrest have been seen since 2020 across Liberia, Tunisia, Morocco, Senegal, South Africa and Kenya, among others. Discontent is fuelling political upheaval in the shape of *coups d'État,* as has been the case in Guinea, Mali, Burkina Faso and Sudan. This is providing fertile ground not only for Jihadist action in the Sahel, the Horn of Africa and West Africa, but also for rebellions in countries such as Cameroon, Central Africa, Democratic Republic of Congo and Ethiopia, as well as crime, notably in Nigeria, which is more widely affecting the continent.

This is happening even as Africa's economic growth stood at 3.9% in 2022 and may reach only 3.5% in 2023 (notably due to the sharp slowdown in major economies such as South Africa, Egypt and Ghana), which should be considered against the annual demographic growth rate of 2.6% over the period. The gap therefore leaves little headroom for growth in the continent, which softened between 2019 and 2020.

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