AFRODAD

Southern Africa

Regional Debt Profile 2017

1. Introduction

The Southern Africa sub-region is made up of the following member states: Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia and Zimbabwe. AFRODAD sub-regions follow United Nations Economic Commission for Africa (UNECA) categorizations. Although most of sub-region member countries belong to the Southern African Development Community (SADC), countries like Tanzania are excluded in this profile. SADC was established as a development coordinating conference (SADCC) in 1980 and it was transformed into the SADC in 1992 in Windhoek, Namibia where the SADC Treaty was adopted, redefining the basis of cooperation among member states from a loose association into a legally binding arrangement. It is an inter-governmental organization whose goal is "to promote sustainable and equitable economic growth and socio-economic development through efficient productive systems, deeper co-operation and integration, good governance and durable peace and security among fifteen member states".

2. Southern Africa Regional Economic Outlook

Africa registered impressive economic growth between 2001 – 2014 averaging 5% according to the Africa Economic Outlook 2016. Since 2015 the growth has been adversely affected by weaknesses in the global economy and price falls of key commodities. In 2016 Africa's economic growth continued to deteriorate, registering a growth of 2.2%, down from 3.4% recorded in 2015. The growth was lowest in West Africa and Central Africa but highest in East Africa followed by North Africa with Southern Africa recording the third-best performance as shown in Table 1 below. In Southern Africa growth slowed down in 2016 to 1.1% from 1.9% in 2015, mainly due to weak international commodity prices, drought, and power shortages. Most of the Southern Africa countries are still dependent on primary commodities and have not made significant progress in diversifying their economies. Countries such as Zambia are highly dependent on copper, tobacco in Malawi, oil in Angola, and mining in Mozambique. The prices of commodities have been low in the recent past and have had a negative effect on economic growth. Mozambique is one of the African countries with the fastest growing economies in the world with growth of 6%-10%. South Africa, the region's economic engine continues to register low growth affecting the whole region. However the extractive sector, energy sector and agriculture sector continue to drive growth in the region.

Table 1: Macroeconomic developments in Africa, Real GDP growth (%)

	2008-12	2013	2014	2015	2016(e)
North Africa	4.4	1.7	1.5	3.3	3.0
Central Africa	4.9	4.0	6.0	3.6	0.8
East Africa	5.6	7.2	5.9	6.5	5.3
Southern Africa	3.1	3.7	2.8	1.9	1.1
West Africa	6.2	5.7	6.1	3.3	0.4

The continuous fall in commodity prices resulted in reduced export earnings and consequently current account deficits. The commodities fall in prices also resulted in loss of fiscal space resulting from low revenues. Inflationary pressures increased in countries where currencies depreciated in the wake of lower commodity prices. Harsh climate conditions continue to affect agricultural productivity in countries such as Botswana, Zambia and Zimbabwe. Water and electricity shocks in South Africa, Botswana and Zimbabwe affected productivity in the manufacturing sector. This resulted in lower diamond production in Botswana associated with low global demand.

3. Regional Public Debt Trends

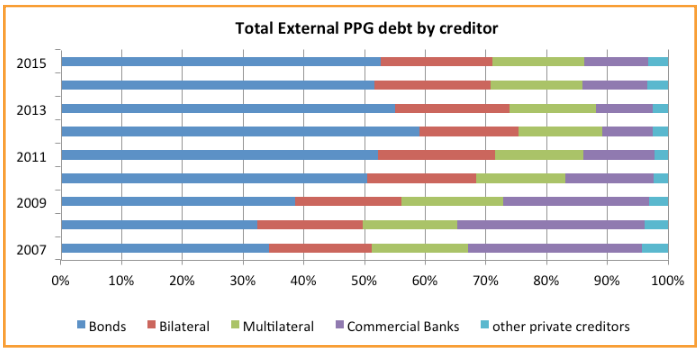
Most of the Southern Africa sub-region countries of Angola, Lesotho, Malawi, Mozambique, Swaziland, Zambia and Zimbabwe experienced external debt crises during the 1990s. Countries had unsustainable high debt stocks and were experiencing difficulties servicing the debts. In 1996, the IMF and World Bank launched the Heavily Indebted Poor Countries (HIPC) Initiative aiming to ensure that countries do not have debt burdens they cannot manage. In 2005, to help accelerate progress toward the United Nations Millennium Development Goals (MDGs), the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative (MDRI). The MDRI allowed for 100 % relief on eligible debts by three multilateral institutions—the IMF, the World Bank, and the African Development Fund (AfDB)—for countries completing the HIPC Initiative process. By 2016, four countries had benefited from debt relief under the HIPC initiative and MDRI. These are Angola, Malawi, Mozambique and Zambia.

Table 2: External Debt Stock in the Southern African Region (public and publicly guaranteed), 2007-2015 in US$ Millions

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Angola	9231	12690	13635	15466	17525	19203	23349	27826	27304
Botswana	391	389	1387	1349	1890	1924	1804	1827	1687
Lesotho	642	660	681	700	719	747	757	758	765
Malawi	759	769	846	729	929	1025	1244	1364	1454
Mauritius	627	597	740	1007	1171	1368	1735	1812	1718
Mozambique	2344	2726	3165	3170	4032	4793	6826	7930	8903
South Africa	19471	19280	22315	36274	41551	56502	54586	56642	57598
Swaziland	380	363	402	397	373	335	311	283	273
Zambia	1107	1157	1200	1290	1884	3101	3266	4659	6375
Zimbabwe	3693	3654	3735	3664	3820	3884	3951	3708	3567
	2007	2008	2009	2010	2011	2012	2013	2014	2015
TOTALS	**38646**	**42285**	**48105**	**64046**	**73893**	**92881**	**97829**	**106810**	**109646**

**Namibia external debt statistics not available* *Compilation based on World Bank data 2017*

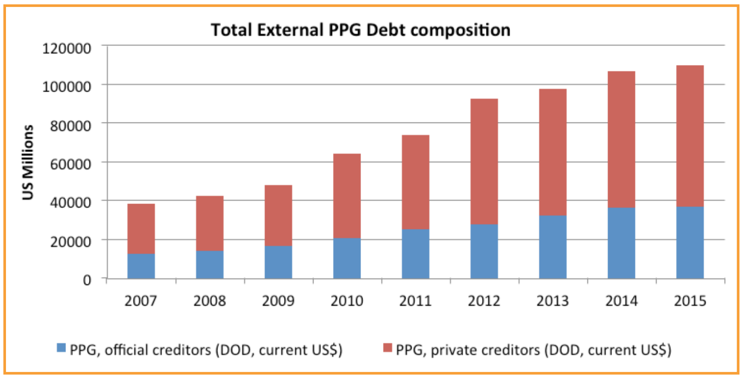
Figure 1: External Debt Stock in the Southern African Region (public and publicly guaranteed), 2007-2015 in US$ Millions



Compilation based on World Bank data 2017

Public debt levels in the region increased over the past years both in nominal terms and as proportion of GDP. Public and publicly guaranteed debt increased by more than 100% from $48.105 billion in 2009 to $109.646 billion in 2015.Angola, Mozambique, South Africa, Zambia and Zimbabwe have huge total debt stocks, rising since 2006/7, compared to other member countries of the region. Large percentage of South Africa's debt stock is made up of more domestic debt than external debt. Majority of Southern African countries received debt relief under the HIPC and MDRI initiatives, which saw their debt stocks reduced substantially around 2006 and 2007, but as end 2015 and 2016 some countries such as Mozambique and Tanzania`s total external debt stocks had reached and surpassed pre-HIPC levels .

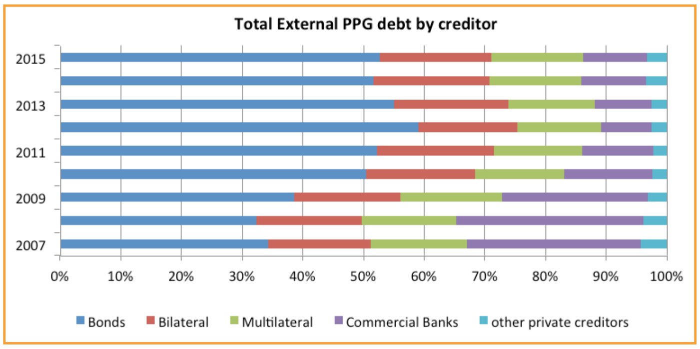
Figure 2: External Debt Stock composition in the Southern African Region (public and publicly guaranteed), 2007-2015 in US$ Millions



Compilation based on World Bank data 2017

Figure 2 above shows that PPG external credit in Southern Africa has largely been in the form of private creditors rather than official creditors. Most of the external debt acquired by Southern African countries between 2007-2015 has been through bonds and commercial banks. Private credit, however poses greater debt sustainability risks than official creditors as debt restructuring is more complex due to the different bondholders who might have diverging interests and jurisdictions.

Figure 3: Share of public and publicly guaranteed external debt, 2007-2015 in percentage



Compilation based on World Bank data 2017

Figure 3 shows that external debt has mainly been from bonds. The share of commercial bank loans has been reducing since 2007 where it constituted about 28.6% to 10.5% of external debt in 2015. There has been a considerable increase in the use of bonds since 2007 to 2015 where bonds made up 34.2% of total PPG earlier and over 50% at the end of 2015. The increased bond issuance for Southern African countries has been largely driven by South Africa, Zambia and Mozambique. Although multilateral credit has been widely viewed as effective and having a large impact on the economy there has been a limited use of it in Southern Africa. Countries have been favouring commercial borrowing to raise large sums of money without heavy handed policy prescriptions. Servicing international sovereign bonds carries interest rate and foreign exchange risks as well as complex debt restructuring processes. If international interest rates raise debt rollover may not be feasible in the future and investor interest may shift to other instruments and markets. International sovereign bonds may be more difficult to restructure than bank loans since they are open to investors and investment banks there is a much larger number of creditors involved that must coordinate in the event of default and the introduction of collective action clauses may be required.

3.1 Drivers of Public Debt

Analysis of the drivers of external debt stock increases in Southern Africa shows that persistent larger budget deficits, external shocks, infrastructure development and availability of new borrowing opportunities with less pre-condition are some of the major drivers in public debt accumulation.

The recent slump in commodity prices revealed vulnerability of countries to adverse shocks. Countries financed fiscal deficits through borrowing, either from external or domestic sources. Southern Africa countries have not made significant progress in diversifying their economies, which are still heavily dependent on primary commodities. The prices of commodities have been low in the recent past and this has led to higher deficits which might constrain debt servicing in future.

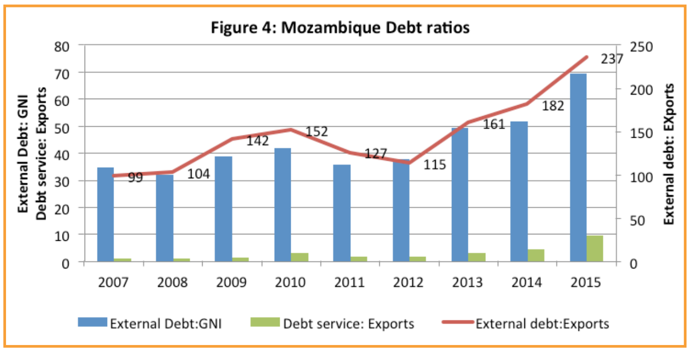
3.2 Selected countries with rising debt indicators

In selecting countries for further debt analysis debt ratios which indicate potential debt related risks were used. Debt ratios are considered in conjunction with key economic and financial variables such as expected growth and interest rates, which determine their trend in medium-term scenarios. For the purposes of this debt profile we shall consider 3 debt ratios, i.e. debt-to-exports, debt service-to-exports and debt-to-Gross National Income (GNI) ratio.

For individual country analysis, the analysis was based on countries whose debt ratios are signaling that debt service difficulties are likely to occur. These are countries whose external debt: to exports is above 150% or external debt to GNI is above 50%.In most cases countries with high external debt to exports ratio and high external debt to GNI ratios have a rising debt service ratio which can be regarded as a sign of an imminent debt crisis.

Zimbabwe and Mozambique have already surpassed the external debt ratio thresholds above.

3.2.1 Mozambique



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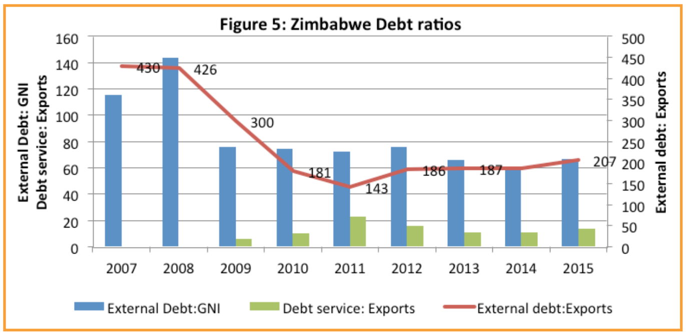
Mozambique like Malawi and Angola also received debt relief under HIPC and MDRI initiatives. Despite debt relief granted to Mozambique in 1999, external debt stock has been on the rise. Mozambique is one of the previously HIPC countries where debt has been growing rapidly since 2011.The period starting from 2011 is characterized by a drastic increase in the eternal debt of Mozambique. As shown in Figure 4 above, the external debt to exports ratio has been rising sharply since 2012 reaching a high of 236.7% in 2015. PPG external debt increased by 86% between 2012 and 2015, where it was $4.793 billion in 2012 and 8.903 at the end of 2015.This is way above pre-HIPC levels when its PPG external debt was $5.983 billion in 1998. The increase in external debt between 2013 and 2015 is associated with the issuance of sovereign bonds. Mozambique borrowed USD 1.4 billion over the period 2013 to 2015 in an undisclosed commercial debt. The level of debt took an explosive path with the contraction of the commercial loans between 2013 and 2015 making Mozambique one of the countries in Africa with the highest debt ratios. The onerous terms of the loans and the pace of currency depreciation has created severe liquidity constraints compromising

Mozambique's capacity to meet debt service obligations. This has been exacerbated by weaker commodity prices and lower demand amongst trading partners that the country has been facing. Given that there has been a rapid increase in the country`s liabilities yet due diligence mechanisms to govern them remain lagging, Mozambique`s debt sustainability now rests on the ability to restructure the debt.

3.2.2 Zimbabwe



Compilation based on World Bank data 2017

Zimbabwe has been in default since the last decade on most of the external debt. The external debt dates back primarily to the early 2000s when the country accumulated payment arrears as a result of both external and internal factors, which negatively impacted economic performance and viability and also foreign currency availability.The bulk of the outstanding external debt including arrears, is owed mainly to bilateral and multilateral creditors. At the end of 2014, Zimbabwe`s external debt stock (including arrears) was US$10.8 billion, with over 70% being arrears. Due to the arrears, the country has not been able to access new sources of finance regardless of the urgent need for such funds for infrastructure development. Although the debt to exports ratio has been falling since 2007 from 430.2% to 207.4% in 2015 as shown in Figure 5, Zimbabwe's debt situation remains an impediment to both external sustainability and economic development. The Government however, developed a debt clearing strategy and to date Zimbabwe has managed to pay back arrears to the IMF-administered Poverty Reduction and Growth Trust(PRGT) which were cleared in October 2016, allowing the country`s PRGT eligibility to be restored and the declaration of non-cooperation to be lifted. Subsequently Zimbabwe has been holding discussions on over financing and modalities to clear the arrears to the World Bank and the African Development Bank.

4. Domestic Debt Levels Rising

Domestic debt has also been increasing in some of the Southern Africa countries in absolute amounts and as a proportion of total public debt and as a ratio of GDP. Borrowing from the domestic market has become a viable option for most countries due to chronic annual budget deficits, drying up concessional lending, reduction in official development assistance (ODA) inflows, and impact of the global financial crisis of 2008 and 2009. Foreign aid is linked to project financing and hence cannot finance governments with recurrent budget deficits therefore resort to domestic savings through issuance of domestic debt.

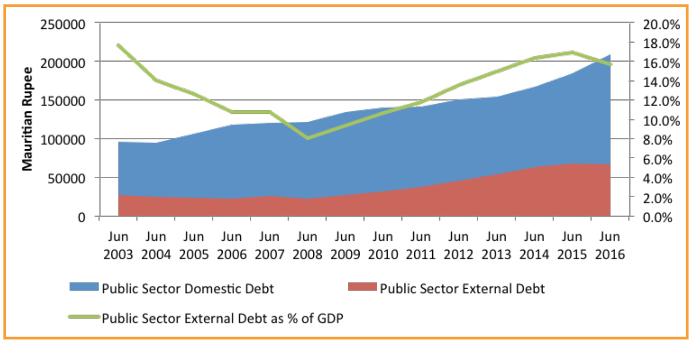
There are currently no internationally agreed thresholds for assessing domestic debt sustainability. However, the IMF describes the domestic debt burden as significant when the nominal domestic debt stock to GDP ratio is above 15% - 20%. It has already reached the critical threshold in countries such as Malawi, Mozambique and Zambia. Although the rate of accumulation of domestic debt for most Southern African countries has been increasing since 2015, the majority of the sub-region members rely on external sources of finance to support their development, but South Africa, Namibia and Mauritius use their domestic debt markets more and this is reflected by the dominance of domestic debt in their total public debt portfolios.

South Africa`s domestic debt/GDP ratio grew from 22.3% in 2008 to about 43% in 2014(MEFMI 2016). The country's national budget was generally balanced up to 2008, thus putting minimum pressure on total debt accumulation. However, budget deficits have been recorded since 2009, due to the 2008/09 global financial and economic crisis. Consequently, the Total Debt/GDP ratio which had declined from 41.3% as of March 2004 to 25.3% as of March 2008 rose to reach 37.6% as of end March 2012, mainly driven by domestic debt. The dominance of South Africa`s domestic debt has continued to grow over the years. In 2015 domestic debt was ZAR1.814billion whilst external debt was ZAR168.6 million, with domestic debt constituted about 91% of total public debt.

Namibia`s largest annual increase in the central government stock of debt was experienced between 2010 and 2011 when the total outstanding debt increased by 98.8% from N$12 968.7million as of end 2010 to N$25 787.6million as of end 2011. In a bid to address the country's high unemployment rate and also support strategic economic sectors in the face of the 2008 global and regional economic slowdown, the government of Namibia unveiled the Targeted Intervention Programme for Employment and Economic Growth (TIPEEG) in 2011. Given the huge funding requirements of this programme, the government turned to both domestic and international capital markets to source funding, resulting in a corresponding huge upsurge in the country's debt. Domestic debt as a percentage of GDP stood at 16% and 12% in 2012 and 2013 respectively whilst for external debt the ratio was 9% and 10% respectively for the same period reflecting the dominance of the country`s reliance on domestic debt.

Mauritius, Figure 3 below shows a decomposition of Mauritius total public debt into domestic and external debt. Domestic debt is generally more dominant than external debt. External debt represented less than a quarter of total public debt and 15.6% of GDP as at June 2016. The dominance of domestic debt over external debt is in line with the country's 2008 debt management strategy which emphasizes the foreign currency risk associated with external debt. The strategy thus recommends limiting the size of the public sector external debt stock to a level that will result in an annual debt service of the external debt portfolio not exceeding 10% of export earnings. In this respect, the debt service ratio as at end of June 2016 stood at 3.6%. It has, in fact, remained within the range 3% to 8% over the period 2003 and 2016.

Figure 6: Domestic and External Public Debt, June 2003 to June 2016



Source: Compilation based on Mauritius Ministry of Finance and Economic Development data

5. Sovereign Bond Issuance in Southern Africa

Capital market conditions are increasingly encouraging governments in Sub-Saharan Africa to turn to international markets to raise development funds. Before 2006, only South Africa had issued a foreign-currency denominated sovereign bond in Sub-Saharan Africa. From 2006 to 2014, thirteen African countries have issued a total of US$15 Billion in international sovereign bonds, with five countries from Southern Africa (Judith E. Tyson 2015).

Although the Southern Africa region economic growth has been declining since 2014 there are huge infrastructure investment needs in the region. Tapping the international debt market offers an opportunity to finance development needs such as in infrastructure, education and health. However, it also increases external debt, and bullet repayments will require strict fiscal management. A number of countries issued large Eurobonds and these are drastically increasing external debt, which may compromise the gains on debt sustainability..

Between 2009 and 2015, Southern African member countries (excluding South Africa) raised $5,350 billion from the international capital market.

Figure 7: Southern African Countries Cumulative Sovereign Bond Issuance 2011 – 2015 USD Millions (excluding South Africa)

Country	2011	2012	2013	2014	2015	TOTAL
Zambia	-	750	-	1.000	1.250	3,000
Mozambique	-	-	850	-	-	850
Angola	-	1.0	-	-	-	1,0
Namibia	500	-	-	-	-	500
Total	**500**	**1,750**	**850**	**1,000**	**1,250**	**5,350**

Source: *Bloomerg, Dealogic, Financial Times (Judith E. Tyson 2015)*

Apart from South Africa, which has Eurobonds in several currencies, all Eurobonds by Southern African countries have been issued in USD with maturities mostly around 10 years and most are listed at the London Stock Exchange. International debt issues incur repayment costs which might rise if the currency depreciates. International bonds with a bullet repayment structure can lead to phases of soaring debt servicing obligations and demand competent public debt management.

Sovereign bond issues are contributing to economic development. The use of funds varies in relation to potential contribution to development goals. Some countries have used funds positively, such as for infrastructure. However some countries appear to have used funds for purposes with little or no developmental impact such as "pork barrel", which is political spending on public sector salaries and military hardware. In Southern Africa bond proceeds were used for infrastructure investments by Namibia, Zambia and Angola while in Mozambique part of the funds were used for public sector salary increments, financing of state-owned enterprises and purchases of military equipment.

6. Regional Outlook for Debt Sustainability

According to the World Bank/IMF debt sustainability analysis for low income countries conducted in 2015/16 most of the Southern African countries were found to be in moderate risk debt distress category with only Zimbabwe being in debt distress. AFRODAD`s analysis classified Zimbabwe and Mozambique as high risk debt distress countries. Although Mozambique was rated as a moderate risk debt distress country by the IMF and World Bank in 2016, it has recently been defaulting and missing loan repayments. Overall the sub-regional public debt is still sustainable despite the rapid debt accumulation. This is mainly due to the rising GDP growth rates in member countries. However, the recent increase in commercial borrowing implies a new set of risks as this type of financing is associated with high interest rates and shorter grace and maturity periods, thus raising concern about debt sustainability. Falling commodity prices, a rising dollar and the prospect of higher interest payments mean these debts may be harder to repay than ever.

7. Recommendations

Developing and maintaining strong institutions to control spending manage debt: Given that there is a growing heavy reliance on bond issuance as a source of financing in Southern Africa, Governments need to constantly review their capacity for issuing international sovereign bonds as financing from the private sector is erratic and can affect sustainability. Governments need to carefully consider other alternative options of finance in order to come up with cost-effective finance to fund public projects.

Debt leveling: There has been a significant rise in domestic debt in most of the Southern African countries and domestic debt now constitutes a large share of total debt in some countries. Domestic debt is much more expensive than external debt as it consumes a large percentage of government revenue given that domestic interest rates are higher than foreign ones. This has significant negative implications for private investment, fiscal sustainability, economic growth and poverty reduction. Governments need to formulate and implement prudent domestic debt management strategies to mitigate the effects of the rising debt on the economy.

Enacting Responsible Lending and Borrowing in the Financial System: Mozambique highlights the need for improved monitoring, disclosure and management of debt and fiscal risks. The Government needs to enact responsible borrowing in the financial system. This prevents future debt crises and increase transparency and accountability, allowing citizens to be involved in economic decisions that impact their lives. Loans should be used for the specific intended purposes with no diversions into non-productive purposes.

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