At debt's door: the clouds of a sovereign debt crisis loom over Africa

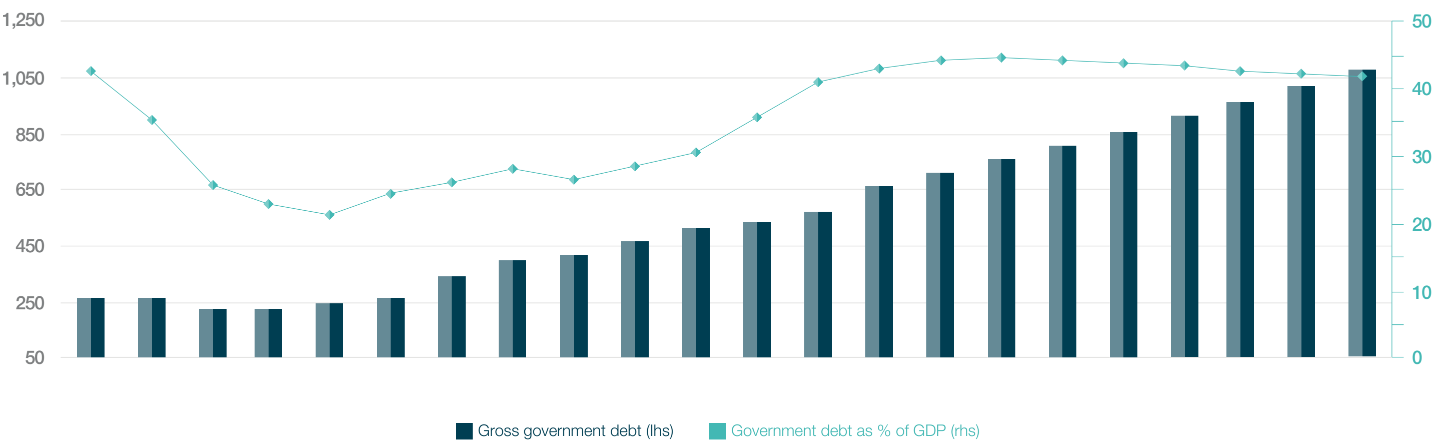
By Jean Devlin

Chad was the last African country to qualify for debt relief under a programme called the Multilateral Debt Relief Initiative. At a stroke, more than USD 1bn was wiped off the country's balance sheet in 2015. Relief from crippling debt service payments has been credited with improving the economic outlook in Chad and 29 other African countries since the late 1990s.

But now? Debt in Africa is back. With the 2008 financial crisis a fading memory, burgeoning interest in emerging and frontier markets and attractive Eurobond rates have encouraged African governments to borrow more and more. Across the continent, rates of public debt have increased by more than 125% in the past ten years.

Source: NKC Research

Fig.1 ▸ Government debt ($bn)



Debt is not always bad. The judicious use of external borrowing to finance major public infrastructure projects, including in power generation and transport, has underpinned strong growth in African countries such as Kenya, whose economies are less resource intensive.

However, steep increases in public debt in recent years have proved problematic in other African markets, particularly those vulnerable to fluctuating commodity prices. In oil-dependent countries such as Nigeria and the members of the Central African Economic and Monetary Community (CEMAC – Gabon, Cameroon, Central African Republic, Chad, Congo (Brazzaville) and Equatorial Guinea), shrinking oil revenues and contracting foreign exchange reserves have seen debt, rather than revenue or tax income, used to plug holes in national budgets.

Infrastructure improvements are strong drivers of economic growth, but big projects have big timelines. In the next two years, these sorts of projects are unlikely to generate sufficient revenues to finance debt repayments. As debt once again piles up, governments that borrow will find themselves between a rock and a hard place: continue to borrow and risk default, or rein in spending and risk the political consequences.

Varying vulnerabilities

Debt levels in Africa still tend to be lower than in the rest of the world. But the sharp rise in external debt, combined with proportionally lower tax collection and other revenues, raises concerns over the return of a pan-African sovereign debt crisis not seen since the 1980s and 1990s. The subsequent years of IMF restructuring programmes in multiple African countries shut down economic growth and the development of indigenous industries, and carried heavy social and political costs.

Barring significant shocks, mass sovereign defaults will not materialise in 2018 or immediately after. Economic and political conditions have changed enormously since the debt crisis of the 1980s and 1990s, with debt levels and debt management policies now as varied as the continent's history and politics. The vulnerability of countries to sovereign default varies widely, depending on how borrowed funds are put to use, the strength of domestic institutions and the extent of reliance on primary commodities, among other factors. The challenge is balancing economic imperatives and political interests.

The responses of African governments to rising debt levels run the risk of creating significant political pressures, especially if they take the form of painful domestic reforms. Austerity in countries already struggling with high costs of living, unemployment and limited access to domestic finance has triggered strikes and demonstrations, notably in Chad and Gabon. Meanwhile, political risks are increasing in countries struggling to boost revenue flows by issuing fines and scrutinising business taxes. These include Tanzania and others announcing reviews of tax arrangements, such as Ghana. Although sovereign defaults remain unlikely, managing high debt levels presents a number of other risks to businesses and foreign investors.

Warning signals

In countries with a more diversified economic base, gains in sectors with strong growth, such as manufacturing and agriculture, will keep sovereign risks at bay over the next year. Kenya, a key example of this, will avoid a debt crisis in 2018. Nevertheless, the doubling of government debt over the past five years raises concerns over the sustainability of borrowing in the longer term. The economic impact of the protracted 2017 presidential election, a regional drought and high inflation exacerbates these concerns and has damaged investor confidence.

A pending repayment of the first portion of a Eurobond worth USD 774.8m in 2018 will be a wake-up call for the government to refocus attention on controlling public borrowing and spending before debt becomes unmanageable. But the outlook is not good. Kenya has a strong appetite for external borrowing and has remained politically intransigent about its downsides, even in the face of warnings by the IMF and ratings agencies.

Prudence versus politics

In certain countries, raising of debt without adequate government planning and oversight has already caused serious problems. In Mozambique, revelations of more than USD 1.4bn of undisclosed debt, a missed Eurobond payment and evidence of high-level corruption in the issuing of loans have undermined confidence in the government's ability to manage its borrowing. The lesson?

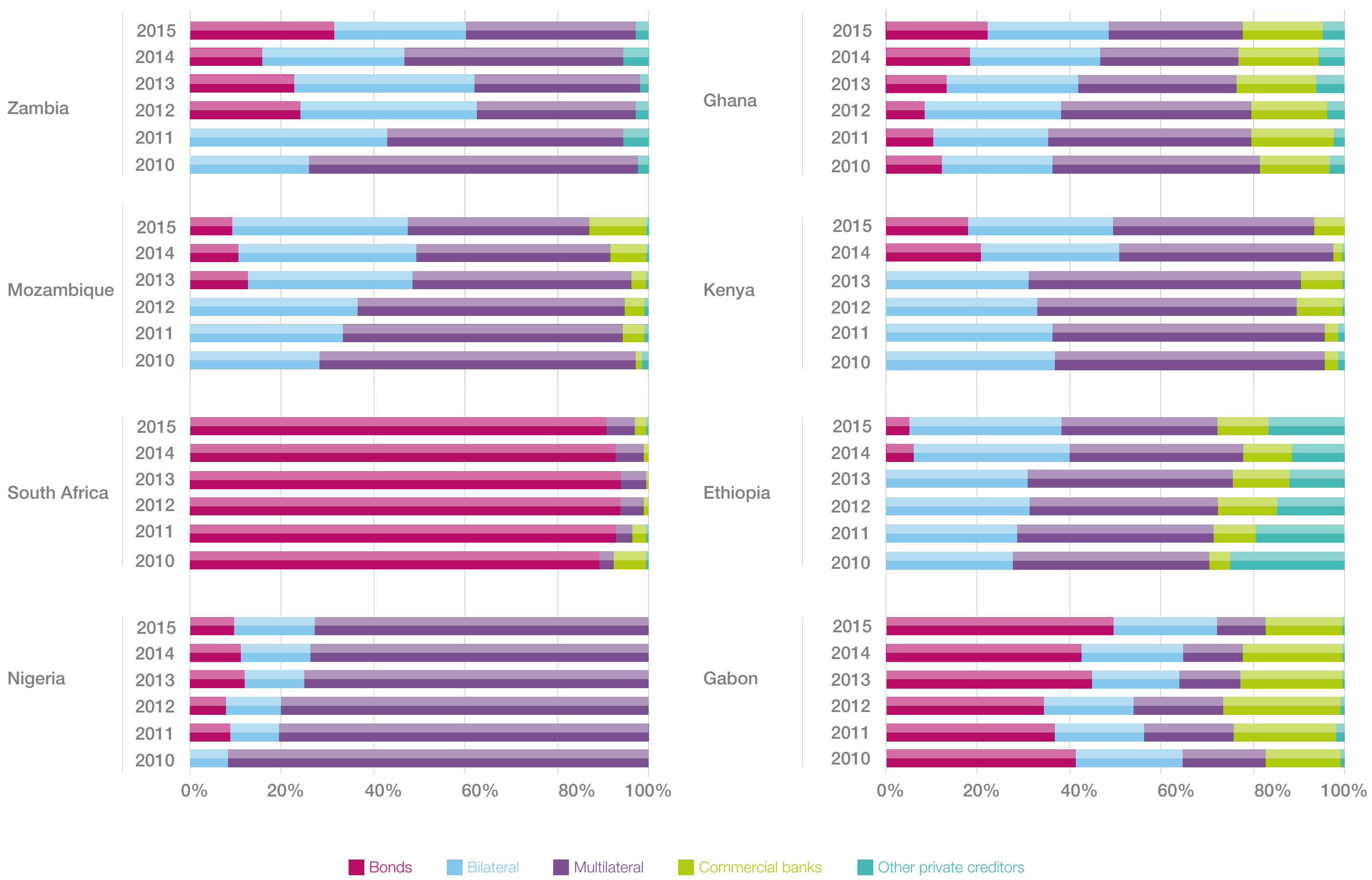
Don't count your revenue flows before they hatch. Mozambique hoped to repay its debts with future cash flows from oil and gas projects that have yet to come online.

Mozambique is not unique. In Ghana, the discovery in 2010 of offshore oil resulted in liberal government spending and borrowing in expectation of quick returns. Ghana then struggled to control spending and to meet its debt obligations, prompting it to turn in 2015 to the IMF. Macroeconomic reforms – and increased investor confidence – followed. And then, in 2017, the revelation of a USD 1.6bn hole in the budget and projections that debt levels will remain around 70% of GDP served as harsh reminders to a new government that only strict management of public finances will undo the damage of excessive borrowing.

Nonetheless, ongoing reforms and government recognition of these issues will drive improvements in 2018. In Ghana in particular, reforms have put the country in a position to clear its maiden 2007 bond. In addition, new revenue streams from liquefied natural gas (LNG) projects and offshore exploration will provide both countries with more room for fiscal manoeuvre.

Source: World Bank, International Debt Statistics 2016

Fig.2 ▶ Borrowing debt



Oiling the wheels

Countries dependent on oil revenues are far more vulnerable to ballooning debt in 2018. In Nigeria, plans to borrow heavily to finance long-term infrastructure projects will not generate sufficient revenues in the coming year to finance debt repayments. Compared with more diversified economies such as Namibia, where government revenues are expected to equal 32.3% of GDP in 2017, in Nigeria revenues will be only 5.4% of GDP. Amid rising inflation and muted oil prices, Nigeria's debt servicing payments – which in 2016 doubled to 66% of total revenues – are likely to rise further, placing extreme strain on an already stretched budget.

Meanwhile, pressures in other vulnerable oil economies have already brought the IMF back to Africa. IMF stabilisation programmes in Cameroon, Gabon and Chad, and ongoing discussions with Congo (Brazzaville) and Equatorial Guinea will aim to firm up these economies over the next three years. Still, attempts to alleviate economic pressures via sharp cuts to salaries, subsidies and development programmes carry enormous political risks. Staunch resistance to reform among government elites – whose political legitimacy and support base are threatened by cutbacks – mean that significant improvements in public financial management under new IMF programmes will fail to materialise. For countries due elections in 2018, such as Cameroon, attempts to preserve political legitimacy are even more likely to trump significant reforms aimed at dealing with debt.

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