

Scaling the Eurobond Debt Wall

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Warnings of debt distress

April 2017: Warnings from prominent economists (Fundanga, Hantuba)



October 2017: IMF Article IV Consultation

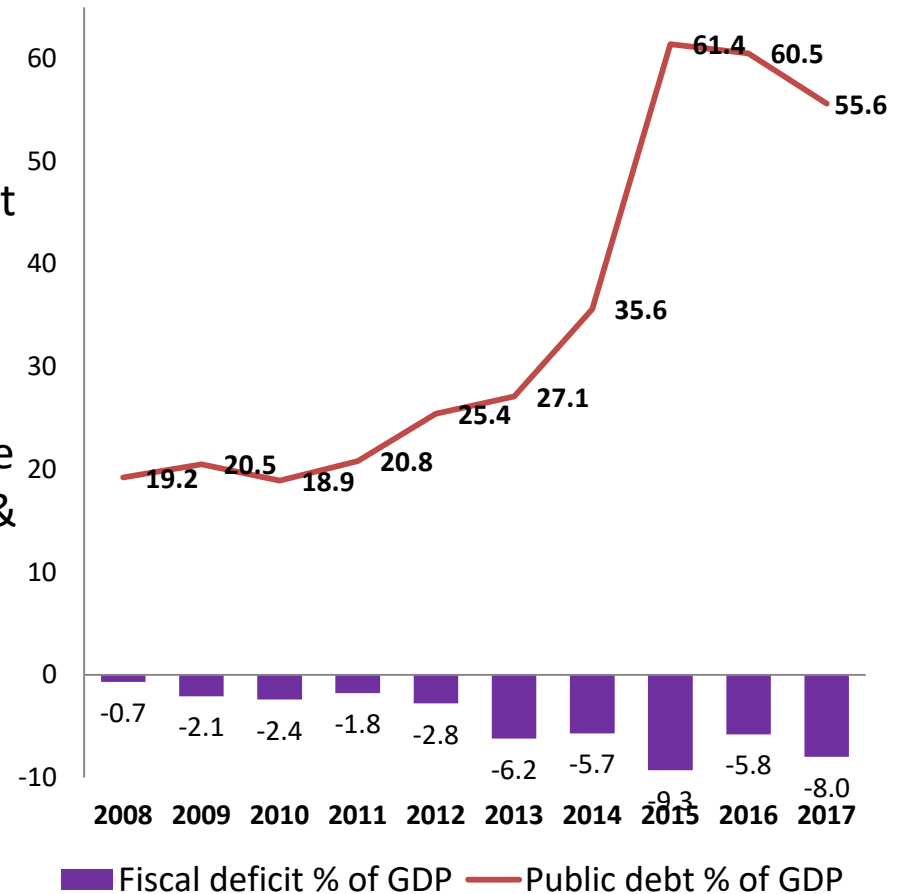


How we got here

- Until recently, Zambia was a poster boy for economic growth in Sub Sahara Africa
- Dwindling concessional resources
- Decline in the international price of copper
- “Hurry to develop”
- Government joined the Eurobond bandwagon in 2012
- Road started getting bumpy soon after that
 - Copper prices continued to decline
 - inadequate electricity supply and operational constraints
 - very large expansion in the fiscal deficit which was mostly driven by a swelling of the wage bill; agriculture, fuel & energy subsidies; flat revenues
 - Economic slowdown, particularly in 2014 & 2015

How we got here

- In last 5 years, Government has been running fiscal deficits averaging 7% of GDP
 - With GDP around US\$24bn, deficit averages US\$1.7bn per annum
- Government has been borrowing extensively to make up this difference
- It added US\$3bn Eurobond debt to the stock of external debt between 2012 & 2015
- Interest payments have soared, with exchange rate fluctuations being the biggest risk, as was witnessed in 2015
- There have been no debt repayment strategies in place



Size & Structure of the Eurobonds

2012

- **Coupon rate:** 5.375%
- **Value:** US\$750m
- **Maturity date:** 20/09/2022
- **Redemption Structure:** Bullet

2014

- **Coupon rate:** 8.5%
- **Value:** US\$1bn
- **Maturity date:** 14/04/2024
- **Redemption Structure:** Bullet

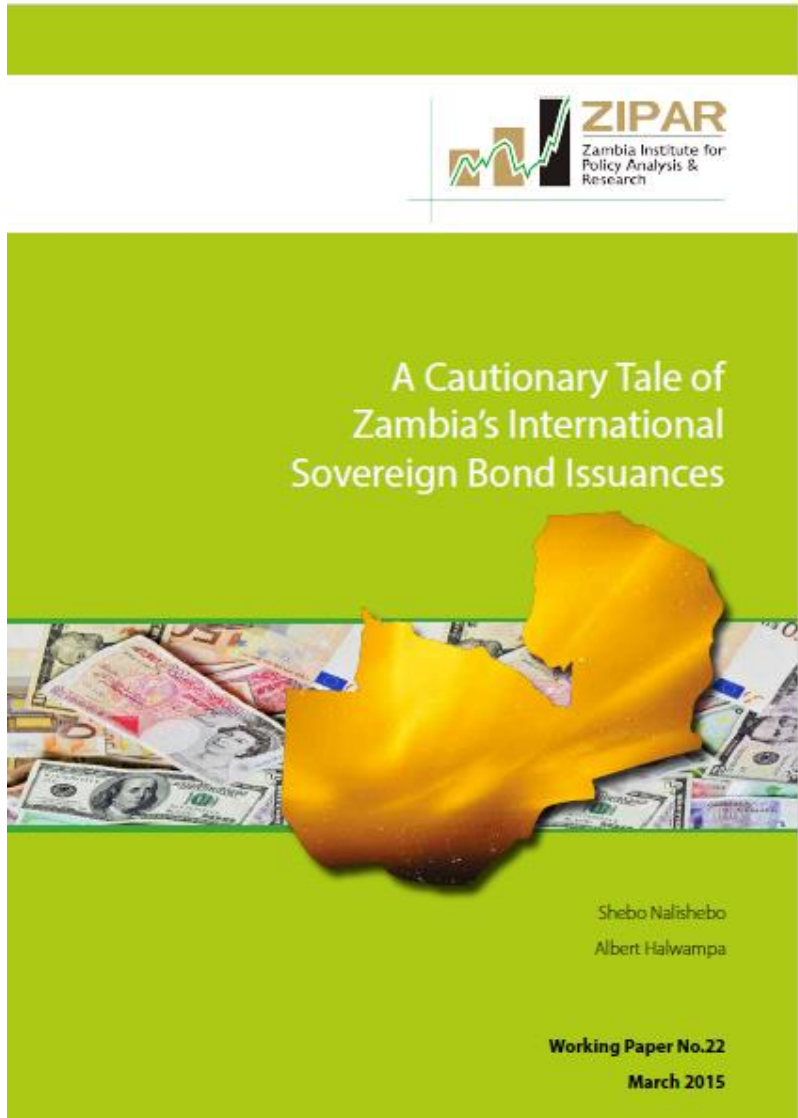
2015

- **Coupon rate:** 8.97%
- **Value:** US\$1.25bn
- **Maturity date:** 30/07/2027
- **Redemption Structure:** 3 instalments

Risks associated with the Eurobonds

- Risk 1: The largest portion of our foreign debt is owed to commercial creditors and accounts for nearly half of the total external debt stock – of this, US\$3.0 billion is Eurobond debt
- Risk 2: Commercial debt, and particularly Eurobonds, carries significantly higher borrowing costs than concessional debt does
- Risk 3: Exchange rate risk still looms ominously on the horizon (2015)
- Risk 4: Spending slippages have led to more borrowing

Reheating 2015 Eurobonds report

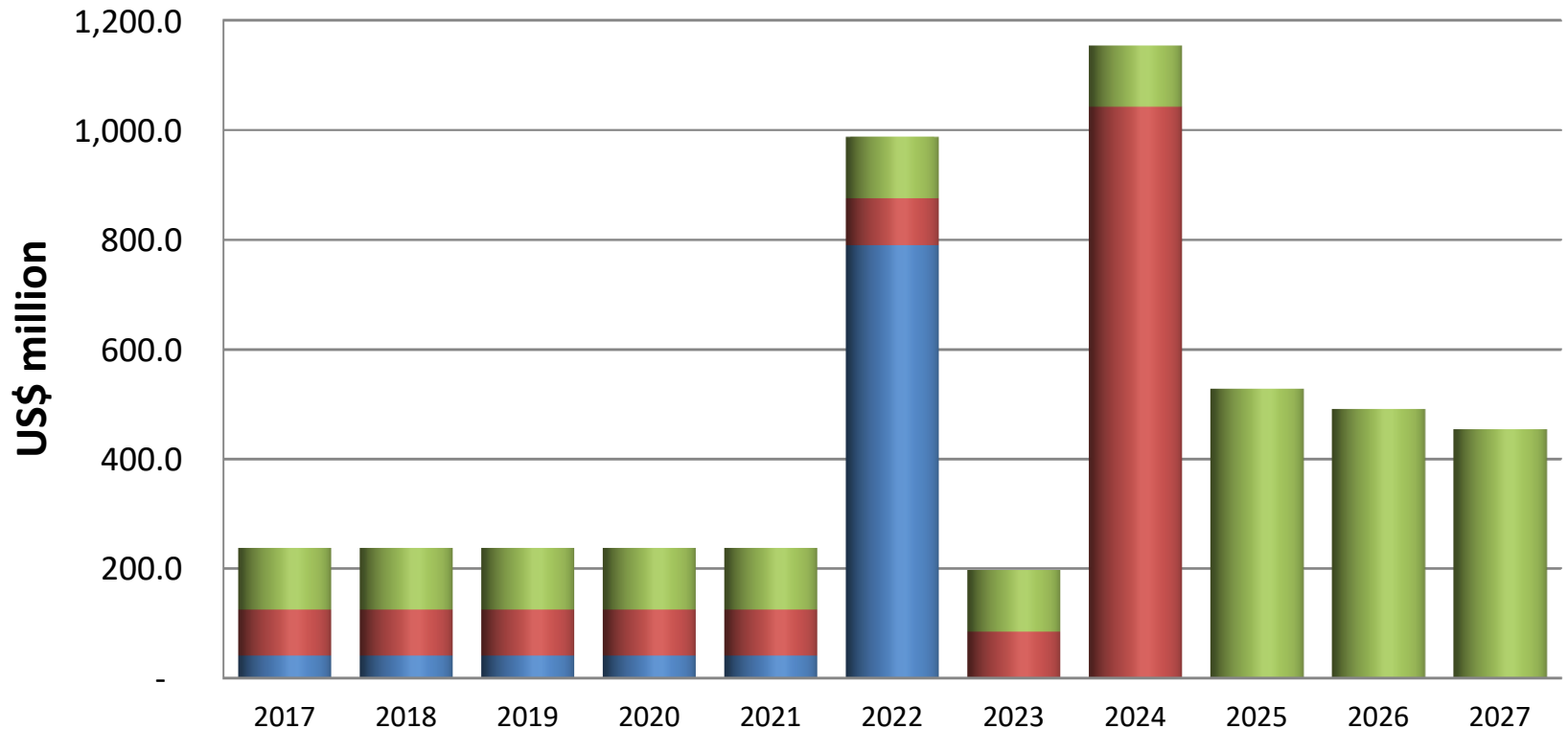


- Address fiscal performance challenges through fiscal consolidation
- Institute measures to address the existing institutional and legal bottlenecks in debt management
- Consider various available financing options

Consider various financing options

- Set up a joint sinking fund for the Eurobonds to insulate against future adverse macroeconomic conditions;
 - Refinance the bonds, by obtaining another bond with lower coupon rates and longer maturities; and
 - Widening creditor sources to reduce the appetite for Eurobonds
- Government announced the setting up of a sinking fund in 2016, but it was never actualised citing budget constraints
 - Plans in MTEF to fund in 2019 & 2020
 - Government planned to refinance the Eurobonds in 2017, timing was considered inappropriate by IMF
 - PPP financing for infrastructure financing

The Eurobond repayment problem



	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
■ Eurobond III	112.1	112.1	112.1	112.1	112.1	112.1	112.1	112.1	528.8	491.4	454.0
■ Eurobond II	85.0	85.0	85.0	85.0	85.0	85.0	85.0	1,042.5			
■ Eurobond I	40.3	40.3	40.3	40.3	40.3	790.3					

Likely liquidity challenges in 2022, 2024

What will be required for sinking fund?

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	TOTAL
Eurobond I	190.3	190.3	190.3	190.3	190.3						951.5
Eurobond II	221.8	221.8	221.8	221.8	221.8	221.8	221.8				1,552.5
Eurobond III	225.9	225.9	225.9	225.9	225.9	225.9	225.9	225.9	225.9	225.9	2,258.9
Total	638.0	638.0	638.0	638.0	638.0	447.7	447.7	225.9	225.9	225.9	4,762.9

US\$638 million (K6.2 billion) p.a. will be required during 2018-2022

Assumption: Annual sinking fund allocation = Annual interest due + (principal/n years)

e.g. Eurobond I = 40.3m + (750m/5)=40.3m+150.0m=190.3m

Where will the money come from?



- Government has previously failed to set up a sinking fund citing budget constraints
- Therefore, putting K6.2 billion for the sinking fund is a tall order
- Government has to consider a cocktail of options

Build reserve fund from copper

- 3-tier mining tax regime: below US\$4,500/mt (4%), US\$4,500- US\$6,000/mt (5%), >=US\$6,000/mt (6%)
- With average 2018 price of US\$5,957/mt, revenue from mineral royalties priced at 5%
- Copper prices on the international market have surged to breach US\$7,000/mt, their highest since 2014 , no one saw this coming
- Increased demand from China; use in electric motor vehicles

Year	Projected Copper price	Mineral royalty rate	Projected copper production (mt)	Projected copper production value (US\$)	Mineral royalty (US\$)	Mineral royalty (ZMW)
2018	5,957 (MTEF)	5%	847,000	5,045,579,000	252,278,950	2,522,789,500
2018	7,050 (Goldman Sachs)	6%	847,000	5,971,350,000	358,281,000	3,582,810,000
				925,771,000	106,002,050	1,060,020,500

Issue bond for small investors

Kenya experience:

- In March 2017, Kenya became the first country to issue a mobile phone-based bond
- which can be bought by phone users without the need for them to have a bank account
- Investors can use mobile phone networks' financial platforms like M-Pesa to send money and receive interest payments on the M-Akiba bonds
- Kenya's first such 3-year infrastructure bond raised its target of 150 million shillings (about US\$1.5 million) within days
- Investors can buy the M-Akiba bonds for as little as 3,000 shillings (about US\$30), earning a tax-free interest of 10%

- To widen creditor sources, Zambia could develop a similar bond market for small investors (retirees, small and medium enterprises, schools, churches, workers, traders and individuals)
- By removing restrictive requirements, Government could tap into the mobile money market [K2.8 billion in 2016]
- Just targeting 25% could potentially raise K700 million in 2018

Rationalise infrastructure spending

- Recognising the pressure that capital outlays put on the Treasury, Government has made a commitment to stick to finishing old projects and not take up new ones
- However, a critical look at the 2018 Estimates of Revenue and Expenditure show that there are some infrastructure projects appearing for the first time in 2018
- For example, under Head 21 (Loans and Investments), Programme 3101 Road “Infrastructure Upgrade” Activity 700 “Other road projects” is allocated K1.8 billion.
- These are unspecified road projects to be financed through loans from various foreign donors
- This budget line could be postponed to save the K1.8 billion and reduce on the rate of foreign debt accumulation

Potential sources for sinking fund

Potential sources	Potential amount 2018	% of 2018 Budget	% of GDP
Build a reserve fund from copper	1,000,000,000	1.4%	0.4%
Issue bond for small investors	700,000,000	1.0%	0.3%
Rationalise infrastructure spending	1,800,000,000	2.5%	0.7%
Total	3,500,000,000	4.9%	1.3%

Refinancing

- Refinancing remains an alternative option that could be used hand-in-hand with the sinking fund
- If the second and third Eurobonds were to be refinanced now for the same amounts and tenor, and assuming the coupon rate will be around the prevailing yield rates on the respective bonds, the total potential savings will be US\$27.875 million, almost equivalent to what has been budgeted for health infrastructure in the 2018 Budget
 - Additionally, refinancing will extend the maturity of the bonds.
- With lessons from Ghana, we reckon now is as good a time as any to consider refinancing some of the bonds

The Ghana experience

2007: Ghana issues \$750m ten-year Eurobond at 8.5% coupon rate

2013: Cabinet & Parliament approves buyback & refinancing strategies as part of the 2014 Budget; Issues \$750m ten-year Eurobond at 7.875%; invites bondholders of existing 2007 bond to exchange their holding for up to \$250m of the new notes due in 2023; translates into annual saving of about \$1.375m

2014: Sinking Fund set up from oil reserve savings for the management of external debt redemptions

2015: Ghana signs 3 year IMF Extended Credit Facility; Ghana issues \$1bn 15-year Eurobond at 10.75% coupon rate, with a \$400m World Bank partial guarantee to refinance 2007 Eurobond

2017: IMF credit facility extended by one more year; Used \$200m Sinking Fund, from oil reserve savings to pay for 2007 Eurobond, avoids default;

Appointing a fund manager

- Government should appoint an independent fund manager:
 - To ensure transparency, accountability and minimise the risk of fungibility, and
 - avoid the Mozambique experience in which “Tuna” bonds were diverted to military equipment
- Government should disburse the initial funds to a fund manager/agent, as is the case in Gabon and Cameroon,
- Fund Manager will in turn purchase financial assets to build up and manage the ensuing portfolio till maturity

Conclusion

- To scale the Eurobond Debt Wall, Government should consider various financing options (sinking fund, refinancing)
- Sinking fund in 2018, and not 2019 as currently planned;
- This would be initially funded through a combination of extra proceeds from mineral royalties, domestic borrowing and rationalising infrastructure investments
- Considering that not all funds can effectively be raised by using the sinking fund, Government has to consider refinancing and/or “buy-back” options
- Government should seriously consider appointing an agent to administer the Sinking Fund & refinancing
- The fund manager will in turn purchase financial assets to build up and manage the ensuing portfolio till maturity, ensure transparency and accountability and avoid misapplication of funds
- The liquidity issue is real, the solutions should be practical; lip service will lead us to a default
- The time to act is now!