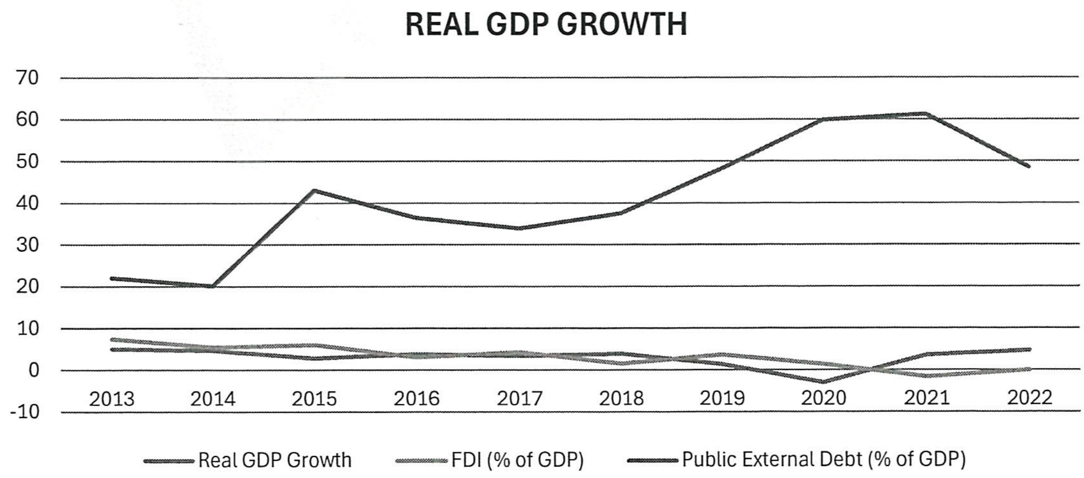
ZAMBIA'S DEBT RESTRUCTURING - A PRE-CURSOR TO CAPITAL MARKET GROWTH

In the aftermath of the economic and financial crisis, there has been on going demand for increased fiscal consolidation across most developing economies. Public debt levels have also generally remained higher than before the pandemic, and in many countries at higher levels relative to GDP seen before only in wartime. In the recent past, we have further noted increased tightening of financial conditions that has led to reduced fiscal support to developing economies which has affected the rate of fiscal consolidation for many.

It must be highlighted that increased public debt has severe implications on the development of private and foreign direct investment flows.[1] This is because higher external debt levels may discourage investment due to uncertainty on sustainability and future tax policy implications.

High public debt may further lead to a strain on already weak and developing capital markets whose market capitalisation is likely to be lower than GDP in most emerging markets which may affect an accelerated growth for capital markets. For instance, a look at some of the key official statistics for Zambia, we noted that an increase in public debt was accompanied by reduced foreign direct investment inflows (See table below).[2]



[1] https://www.bis.org/publ/bppdf/bispap72q.pdf
[2] https://www.boz.zm/statistics.htm

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Though the above relationship cannot conclusively be related to the two variables, the movement in the variables provides a very telling economic challenge – the crowding out effects of public debt.

Zambia's Debt levels have risen over time, culminating in becoming the first African country during the Covid-era to default on its foreign debt. The continent's major copper exporter defaulted in $3bn of Eurobonds issued to Chinese government and private creditors. In addition to this, the nation was grappling with $12bn of External debt.[3]

Among some of the sad consequences of this default was poor credit ratings from international credit rating agencies. For example, in December 2022, Fitch affirmed Zambia's Long Term Local-Currency (LTLC) issuer default rating at 'CCC' leading to the inability to access capital markets and foreign direct investments which constrained already weak fiscal space.[4] And this subsequently impacted the foreign exchange market as uncertainty on restructuring the debt impacts investor confidence in government's ability to fully finance its national budget.[5]

Further, the default had socio-economic consequences. Projects in the water sector, health care services and housing infrastructure could not be delivered in line with commitments thus delaying delivery of clean water and sanitation services and universal access to health for millions of poor people.

The Journey towards successful debt restructuring has seen tremendous milestones. In August 2022, the International Monetary Fund (IMF) approved an Extended Credit Facility (ECF) totalling $1.3bn which aims to restore macro-economic stability, create fiscal space and foster growth. In June 2023, $6.3bn of debt owed to China and other creditors was restructured during the G20 Summit in Paris. Following a series of reviews by the IMF on Zambia's Extended Credit Facility, an agreement was later reached to re-negotiate Eurobonds with bondholders.

The Fiscal stress placed on our National Budgets over the years have restricted growth and Investment in the Capital Markets. Tight monetary conditions and poor credit ratings on the

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[3] https://www.parliament.gov.zm/sites/default/files/images/publication_docs/Ministerial%20Statements%20-%20Debt%20Restructuring.pdf
[4] https://www.fitchratings.com/research/sovereigns/fitch-affirms-zambia-ltfc-idr-at-rd-affirms-ltlc-idr-at-ccc-off-uco-06-12-2022
[5] https://credendo.com/en/knowledge-hub/zambia-seals-debt-restructuring-deal-official-creditors

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international market deters potential investors due to the high risk of loss and low returns.[6] On the local front, less output from GDP reflects a reduction in capital utilized by firms. On the Investor's side, consumption expenditure is tightened to allow for more savings to be channelled towards Investments. This hinders overall Investment activity.

Our Country's Debt-GDP ratio between 2018 and 2023 has shown an upward trend in the first 3 years reaching a high of 103.7% in 2020. Beyond 2021 to date, this ratio has significantly started showing reduction. And as depicted in the graph above, a downward trend in the public debt has prompted a growth in the FDI inflows showing a significant bearing that debt has on the investment flows. A sovereign nation just like a company must create priority to fund its obligations, for creditors to advance investment pledges to its productive sectors and lack of such foreign direct investments could impair the growth trajectory of its domestic capital markets.

We are optimistic of the prospects of Capital Market growth following a successful debt restructure which will instil confidence in the economy and create a favourable investment environment. This will unlock extra funds from cooperating partners, the support coming from cooperating partners in support of Zambia will exceed debt servicing.[7] We anticipate that such inflows to productive sectors would drive participation by both Retail and Institutional Investors within the capital market activities and further boost confidence in our Capital Markets.

Lastly, we must emphasise that the damaging effects of high public debt on capital market development should never be underestimated. The consequences on effective development of the capital market could be far reaching. The Sub-Saharan region has been marred by external debt which has protracted FDI and stifled markets.

[6] https://www.reuters.com/world/africa/zambia-debt-rework-delaying-impede-key-investments-hitting-most-vulnerable-2023-11-24/

[7] https://www.imf.org/en/Countries/ZMB/zambia-qandas#What%20are%20the%20goals%20of%20Zambia%E2%80%99s%20Extended%20Credit%20Facility%20(ECF)%20program?

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It is evident that with strong Fiscal policy there comes an enabled Investment environment that promotes Foreign Direct Investment (FDI) which will trickle down to more activity in Capital Markets.

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