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The Debt Sustainability:
After HIPC Initiative and the Global Crisis

by

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DEBT SUSTAINABILITY AFTER HIPC INITIATIVE AND THE GLOBAL CRISIS: RESULTS AND PROSPECTS IN EASTERN AND SOUTHERN AFRICA

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Discussion Outline

- Introduction
- Recent trends in public debt in the MEFMI countries
- Key drivers of debt trends
- Prospects for debt sustainability in the region
- Policy actions for long term debt sustainability

Introduction

- The HIPC and MDRI debt relief reduced the public external debt burdens of most highly indebted poor countries from the late 1990s to the mid 2000s;

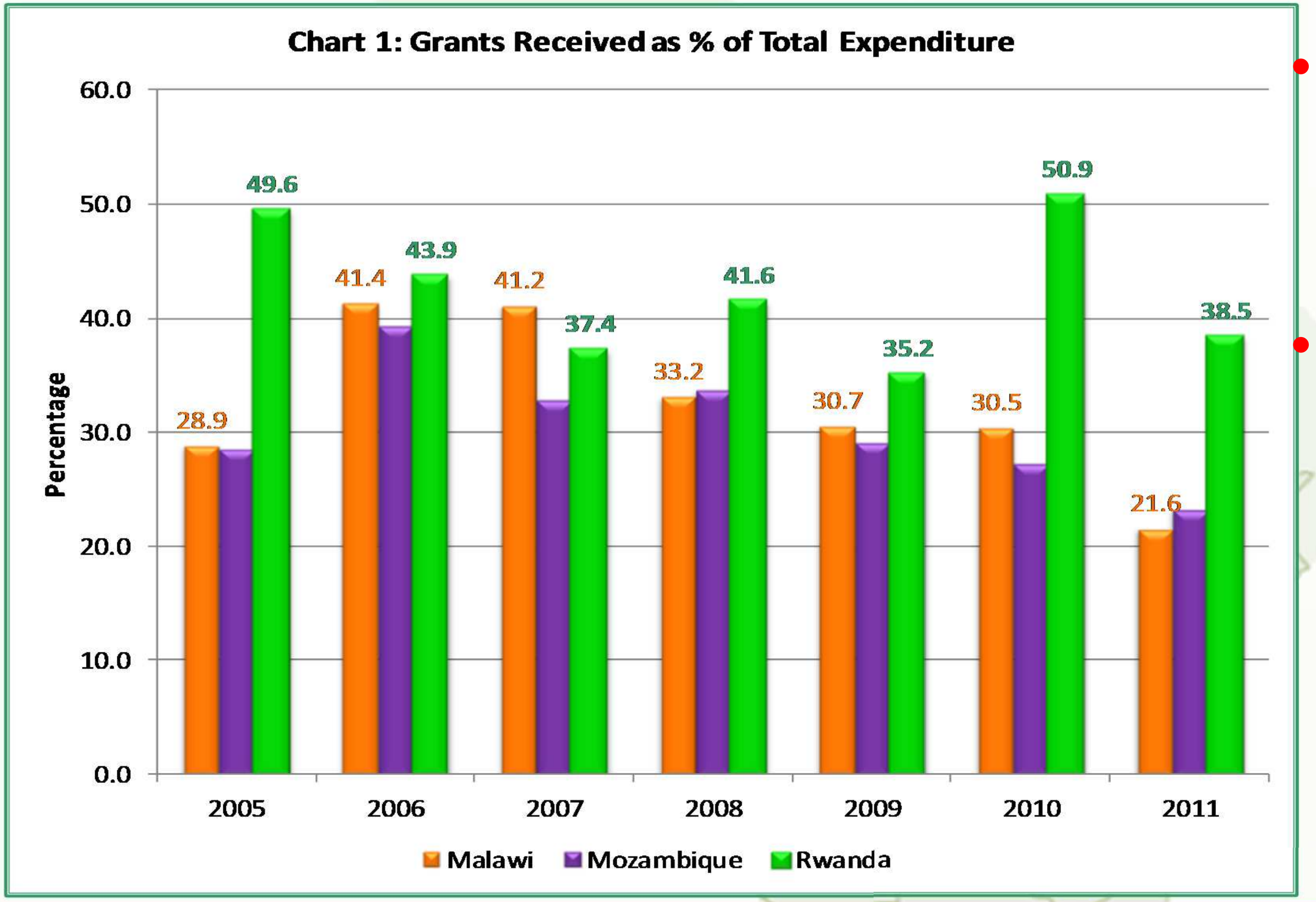
- However, maintaining debt sustainability remains a challenge for post HIPCs less than a decade after benefitting from debt relief;
  - How do governments meet development needs without accumulating debt to unsustainable levels?
  - There are large infrastructure gaps, poverty levels still high, health & education indicators below required standards.

Introduction (ii)

- Local resources are far less than the financing requirements, implying:
  - Continued reliance by most post HIPCs on grants – Not adequate but also declining after the global crisis
  - Continued borrowing from both domestic and external sources

- Traditional sources of credit are shrinking and new options with harder terms emerging – Sovereign bonds, domestic debt, new bilaterals, commercial lenders, etc

Evidence of Reliance on Grants



Source: IMF article IV documents

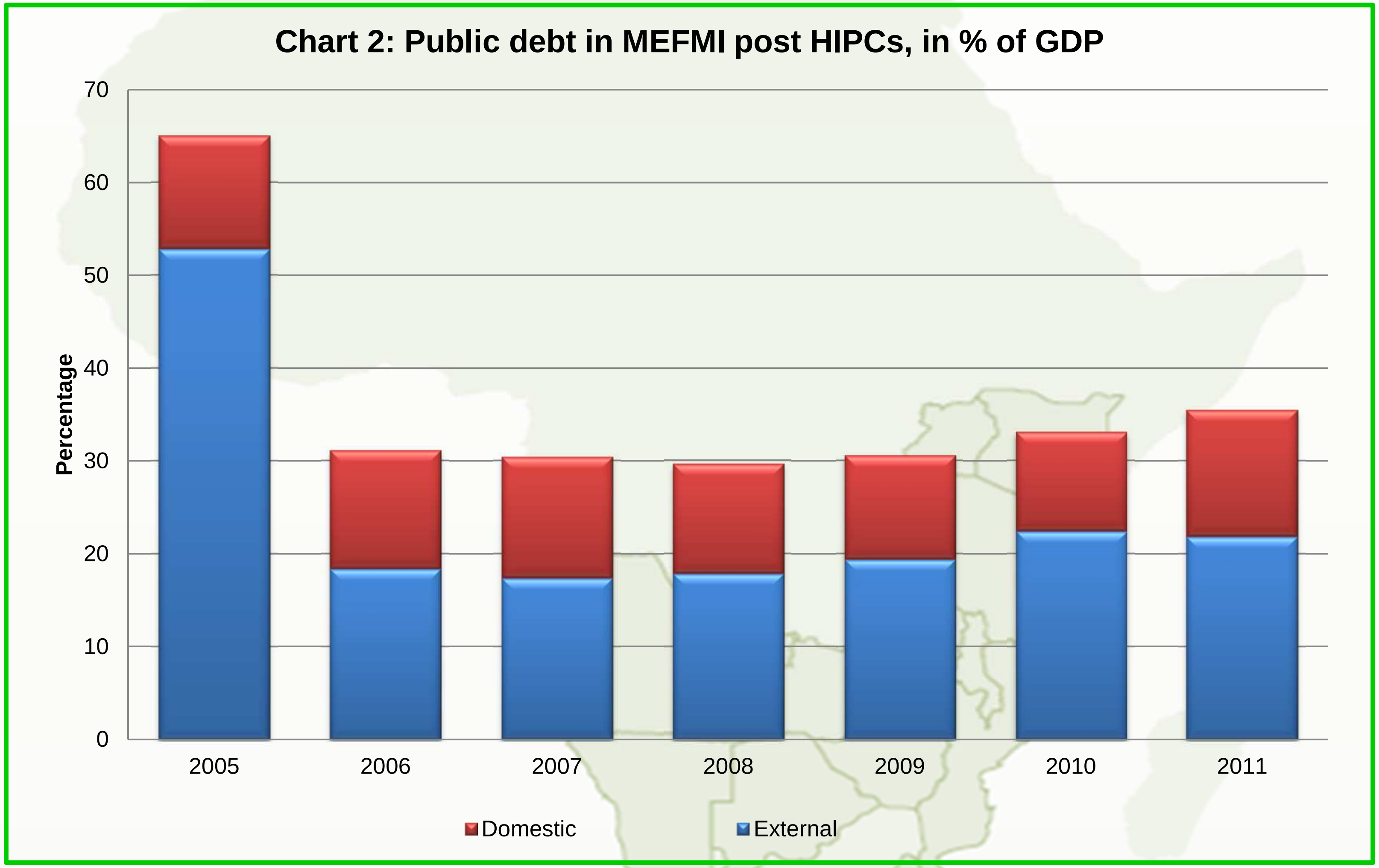
- The heavy reliance on grants is unsustainable
- Countries will resort to much heavier borrowing as grants dwindle.

But what are the trends in post HIPC debt build up?

Trends of Debt in MEFMI Region

- Debt relief reduced external debt in MEFMI HIPCs from an average of 53% of GDP in 2005 to 18% of GDP in 2006.
- Consequently, total public debt was reduced from an average of 65% in 2005 to 31% of GDP in 2006
- However, there has been a marked increase in total public debt since then, with total public debt estimated at 36% of GDP as at end-2011 in the MEFMI post HIPCs.
- Both external and domestic debt have increased during this period:
  - External debt has increased to 22% of GDP in 2011 from 18% of GDP in 2006.
  - Domestic debt increased from an average of 12% of GDP in 2005 to 14% of GDP by 2011. Nevertheless, the increase has been significant in some countries e.g. Malawi, Tanzania and Uganda as illustrated in chart 6.

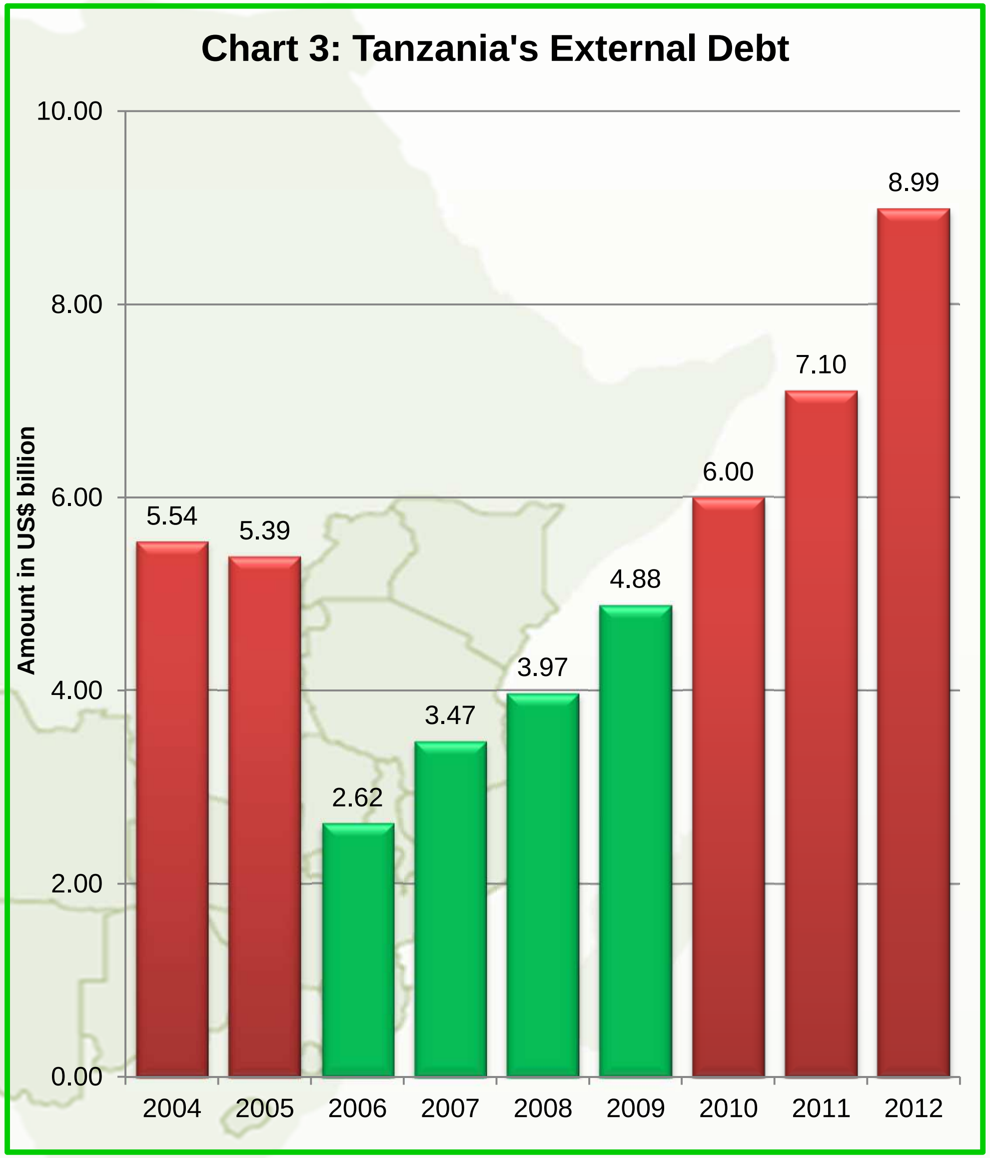
Public Debt in MEFMI Post HIPCs



Source: IMF Article IV & DSA documents

External Debt Trends

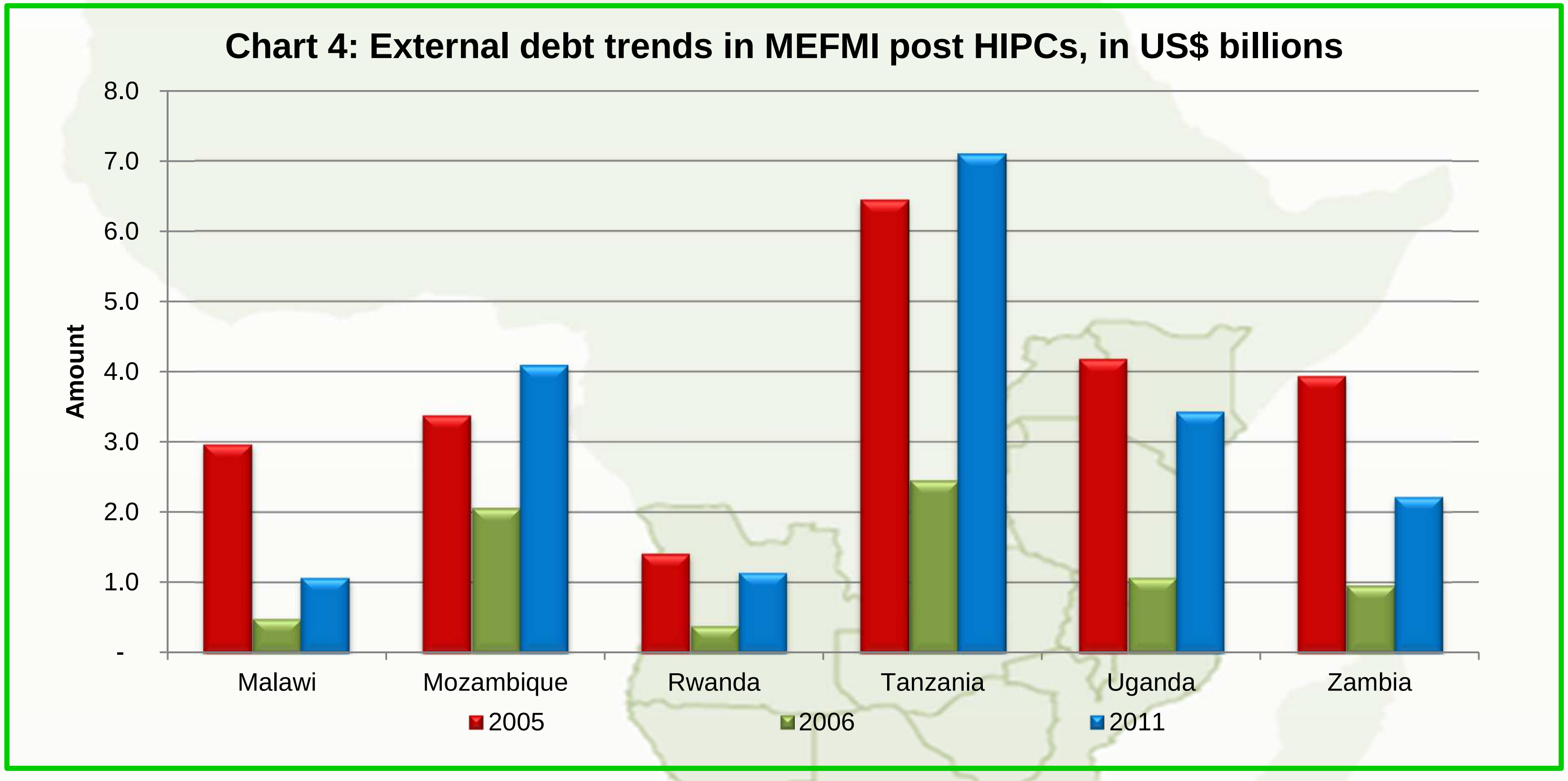
- All the post HIPCs have registered increases in external debt in nominal terms and as a ratio of GDP;
- The increase has been pronounced in countries such as Tanzania, Mozambique and Uganda.
  - o Tanzania's public external debt reached an all-time high of US$8.9 billion (29.4 percent of GDP) in 2012from US$2.6 in 2006 (17.3 percent of GDP)
  - o External debt US$5.4 billion (40.1 percent of GDP before debt relief in 2005 (see figure below)



Source: Tanzanian Authorities

External Debt Trends in other post HIPCs

- Similar trends are observed in other countries: Malawi, Mozambique, Rwanda and Uganda:

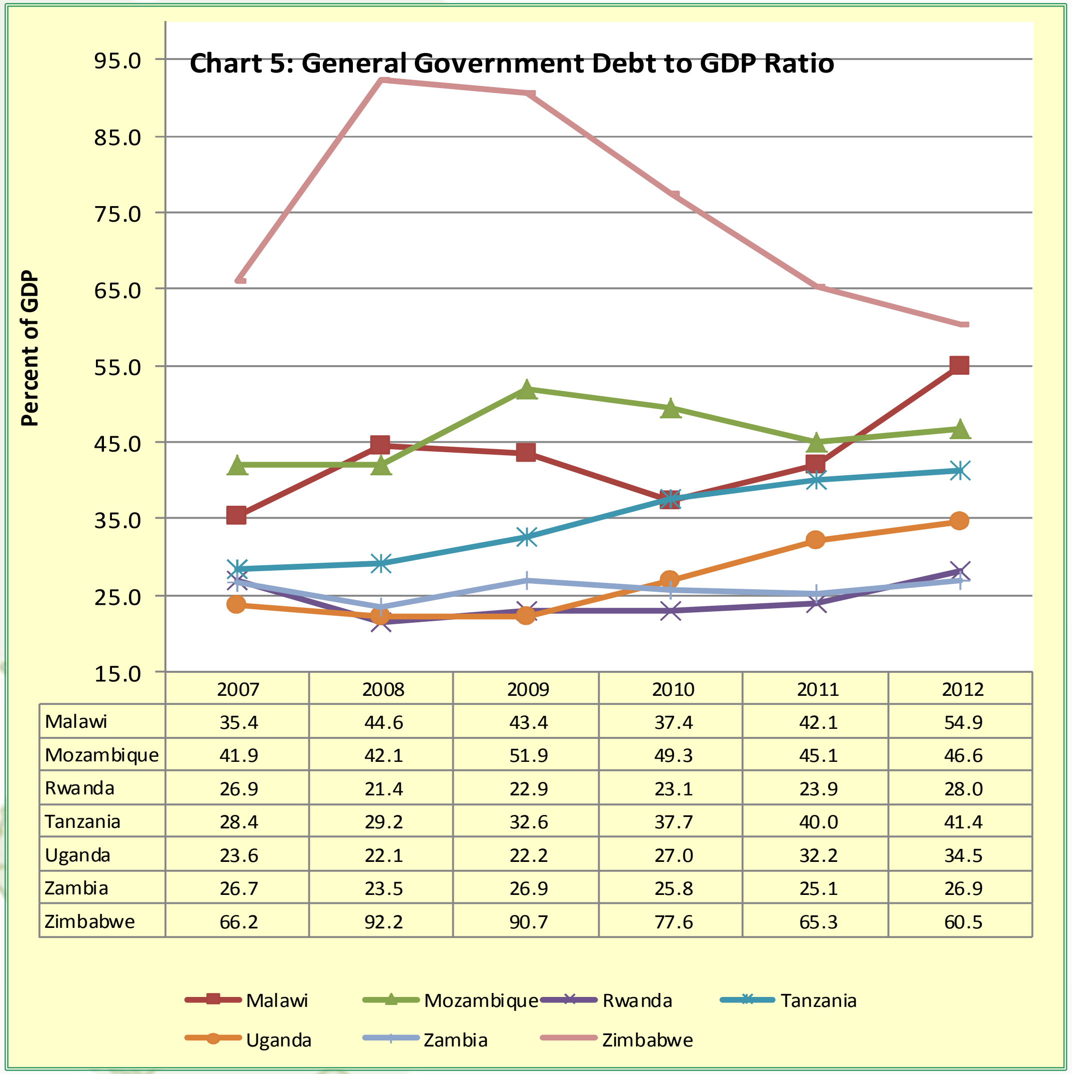


Source: World Bank Global Development Finance & country debt reports

- In Mozambique and Tanzania the level of debt is already higher than the pre-HIPC levels

Source of Consolation

- The GDP growth of most post HIPCs in Eastern and Southern Africa has been very good.
- Therefore, the debt to GDP ratios remain within sustainability thresholds.
- Increases are evident but they are not too dramatic, except for a few cases.

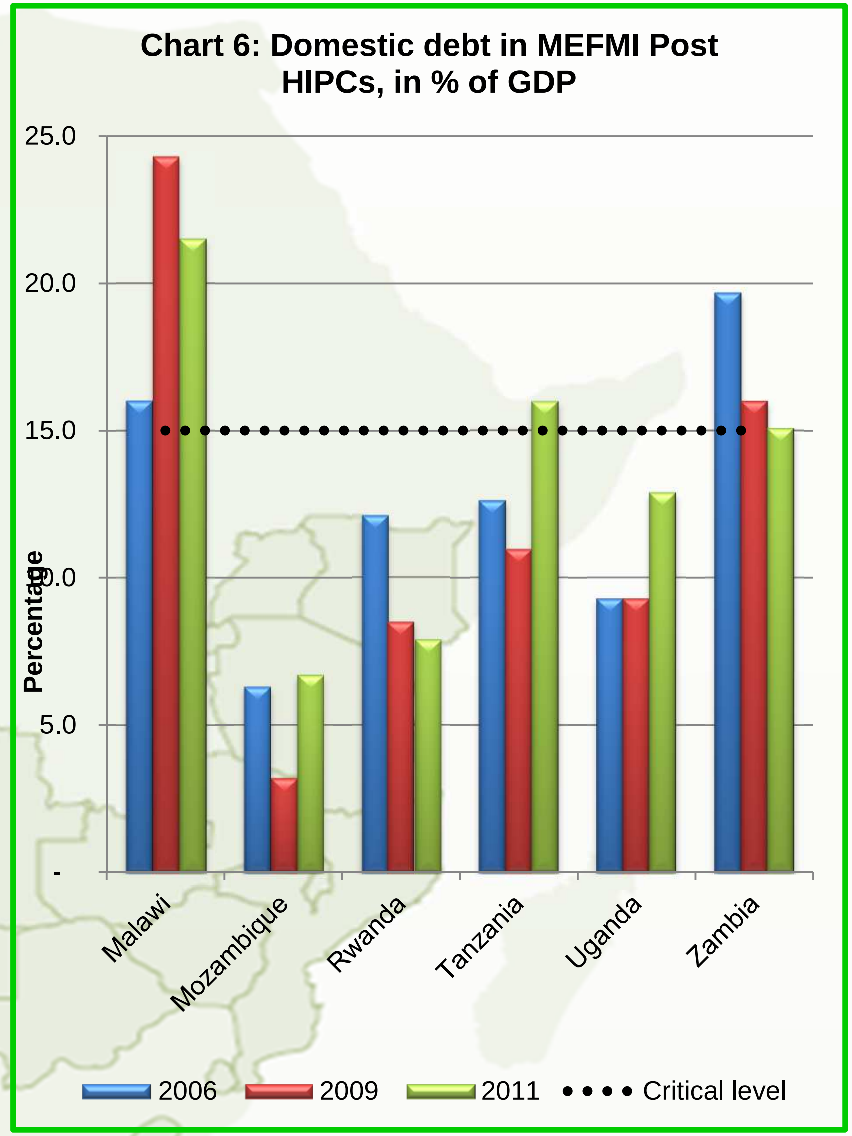


	2007	2008	2009	2010	2011	2012
Malawi	35.4	44.6	43.4	37.4	42.1	54.9
Mozambique	41.9	42.1	51.9	49.3	45.1	46.6
Rwanda	26.9	21.4	22.9	23.1	23.9	28.0
Tanzania	28.4	29.2	32.6	37.7	40.0	41.4
Uganda	23.6	22.1	22.2	27.0	32.2	34.5
Zambia	26.7	23.5	26.9	25.8	25.1	26.9
Zimbabwe	66.2	92.2	90.7	77.6	65.3	60.5

Source: IMF WEO database

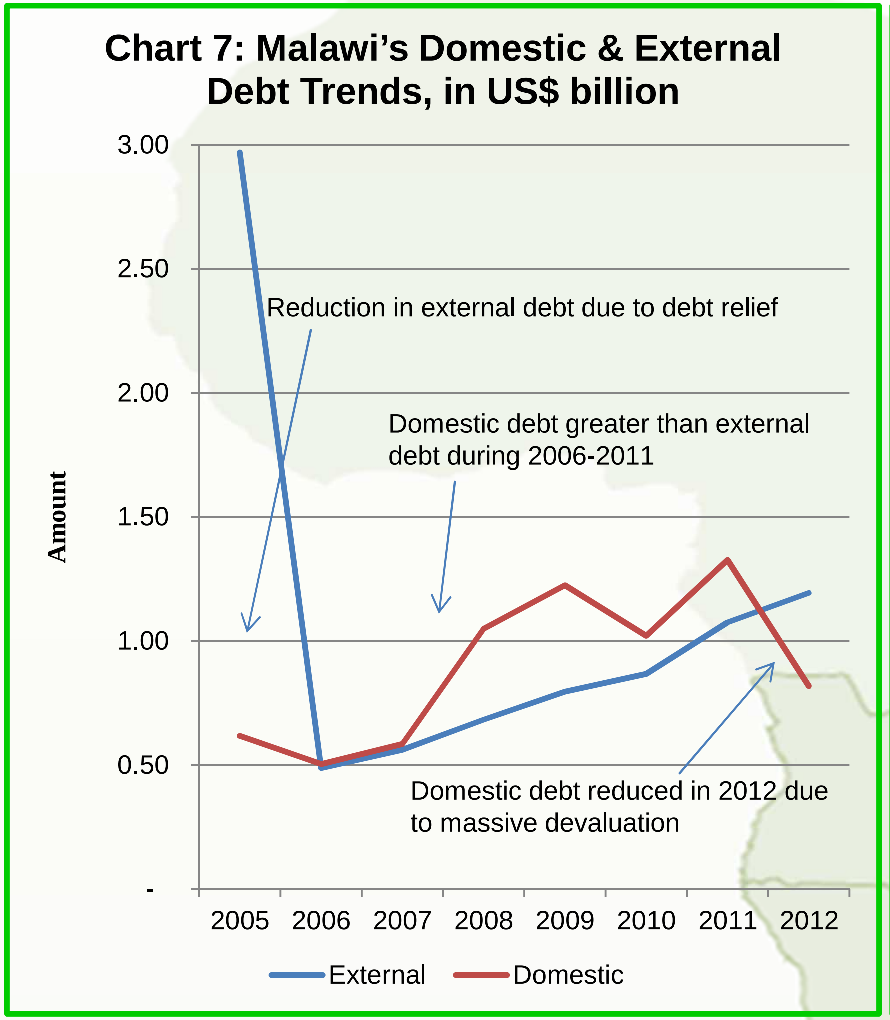
Domestic Debt is also rising

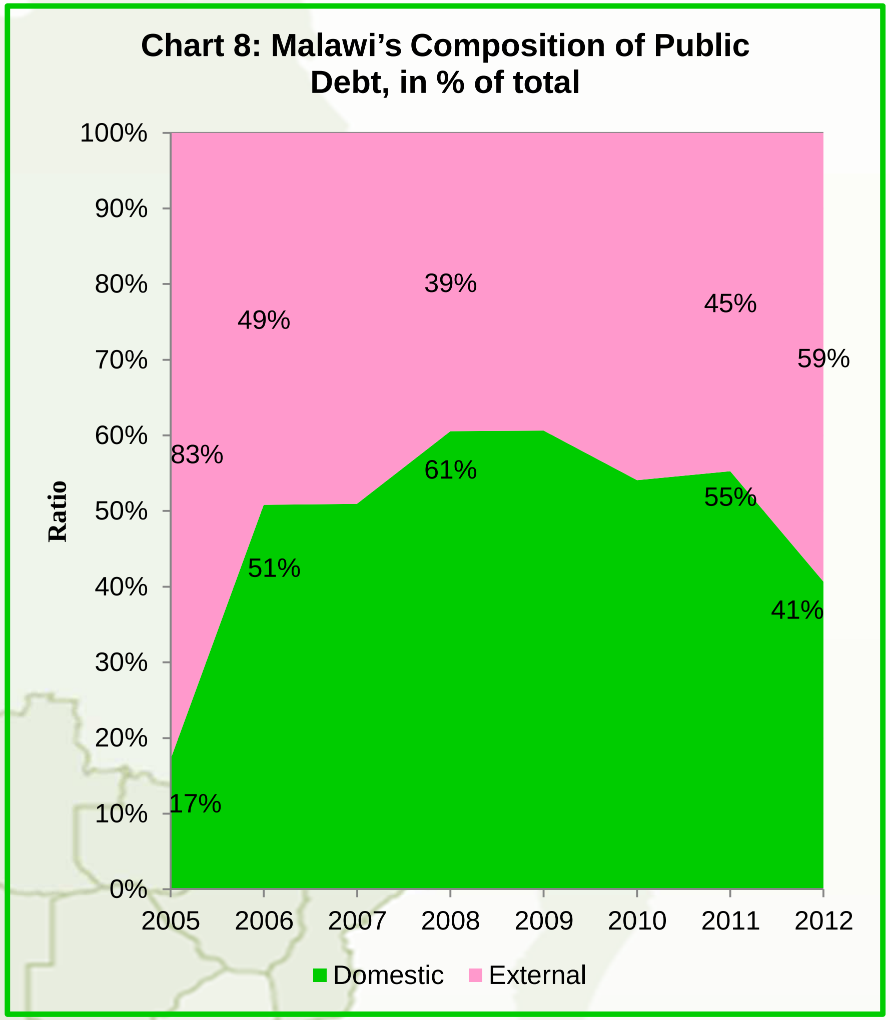
- Domestic debt has also been increasing in absolute amounts, as a proportion of total public debt and as a ratio of GDP.
- In some cases, domestic debt is already in the critical range of 15-20 percent of GDP e.g. Malawi, Tanzania and Zambia while Uganda is closer to this range.
- A key feature of domestic debt in the MEFMI region is its short term maturity structure, which entails rollover risks.



Source: Country debt reports and IMF DSA & Article IV documents

The Rising Domestic Debt – Case of Malawi





Source: Malawi Debt Reports

Key Drivers of Debt Accumulation in MEFMI Post HIPCS

- ❖ Budget deficits
- ❖ Other factors

The Key drivers

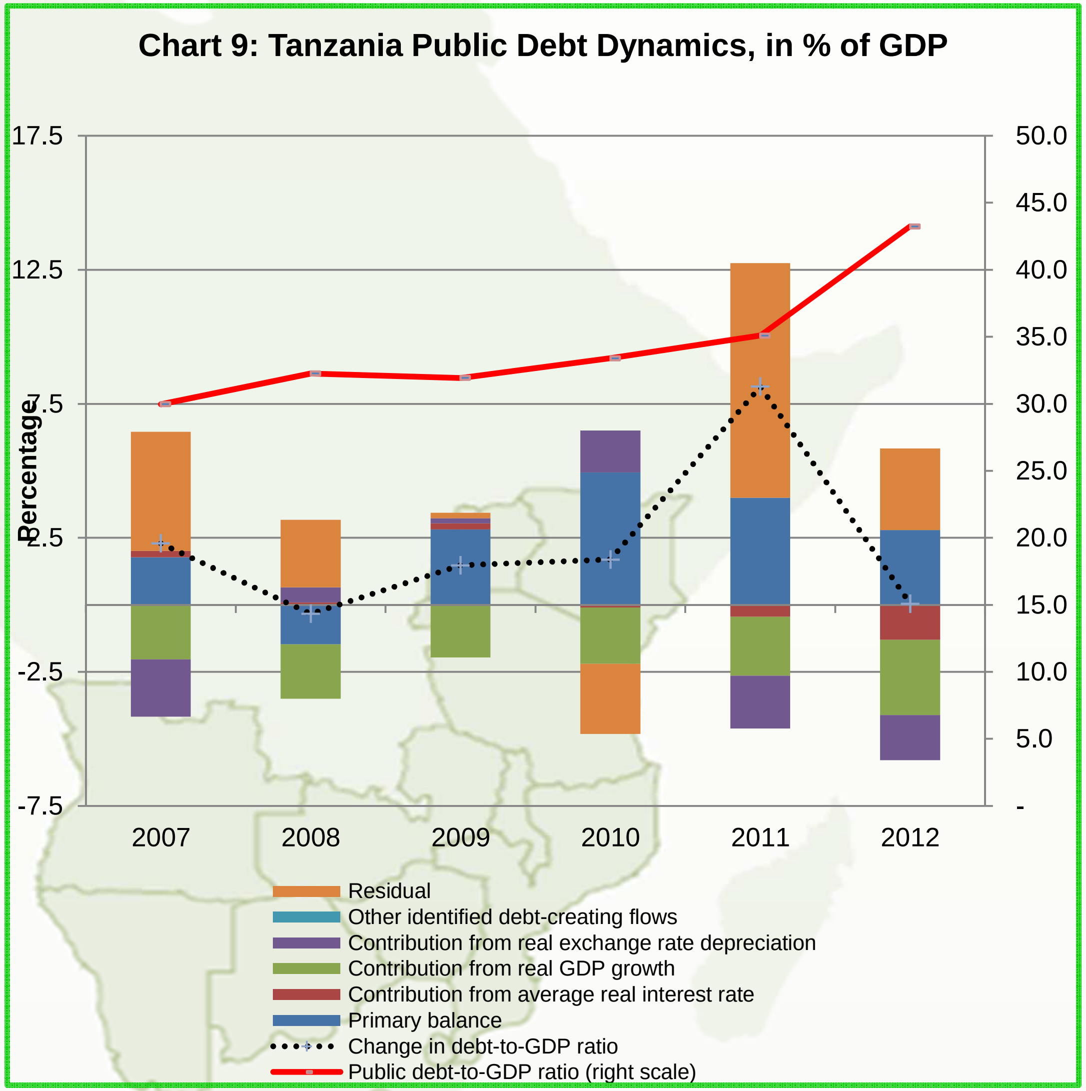
Key Drivers of Debt Accumulation

- External debt relief under MDRI was the main factor driving the reduction in public debt in MEFMI region in 2005 and 2006.

- After 2006, there was:
  - Increased fiscal space that allowed increased borrowing.
  - The need to invest in development activities that address MDG targets, implying the need to borrow.
  - Other dynamics such as high domestic interest rates and contingent liabilities.
- But new lenders have also emerged with less stringent conditionalities.

Factors Driving Debt Increase in Tanzania

- Each bar represents the contribution of each factor to the annual change in the debt-to-GDP ratio (represented by the dotted black line).
- A positive value means that a given factor contributed to an increase in the debt-to-GDP ratio while a negative value means that a given factor contributed to a decrease in the ratio.



Source: IMF and Country DSA Reports

Role of New Sources of Financing

- New bilaterals have emerged, providing alternative sources of foreign loans to low income countries. These include China, India etc.
- The new lenders are attractive because they provide relatively larger amounts of financing without policy and other related conditionalities.

•The bonds issued are large and are likely to drastically increase external debt. This may compromise the gains on debt sustainability.

- Access to International capital markets enabled by the debt relief and improved credit ratings have created more opportunities as former HIPCs are now issuing sovereign bonds e.g. Ghana, Zambia, and Rwanda.
- Zambia was the first MEFMI post-HIPC to issue a sovereign bond in the global capital market in September 2012, raising US$750m followed by Rwanda in April 2013 (US$400m);
- Other countries like Tanzania and Kenya are expected to follow.

The Status of Debt Sustainability

Given the rapidly rising public debt does it remain sustainable?

Debt Sustainability in the MEFMI Region

- Recent debt sustainability analyses indicate that most countries in MEFMI region have low risks of debt distress e.g. Uganda, Tanzania and Zambia.

Table 1: Projected Present value of external debt to GDP ratio

Country	Threshold	2013	2014	2015	2016	2017	
Malawi	**40**	21.0	21.0	21.0	20.0	19.0	Moderate Risk of debt distress
Mozambique	**40**	32	35	37	38	39	
Rwanda	**40**	14	15	15	14	12	
Zambia	**40**	12	12	11	10	10	Low Risk of debt distress
Tanzania	**50**	32	32	31	31	30	
Uganda	**50**	13	14	16	18	20	

Source: IMF and Country DSA Reports

Debt Sustainability in the MEFMI Region

- However, a few other cases have moderate risk of debt distress (Malawi, Mozambique, and Rwanda). The relevant thresholds are breached in case of shocks to the economy.

Table 2: Projected PV of external debt to exports ratio in case of shock

Country	Threshold	2013	2014	2015	2016	2017
Malawi	**150**	110.0	185.0	179.0	172.0	166.0
Mozambique	**150**	97	133	200	199	194
Rwanda	**150**	144	202	206	187	167

Source: IMF and Country DSA Reports

- Only Zimbabwe is in debt distress in the MEFMI region but it has never received debt relief. It is still pursuing available debt relief options.

Risks to Debt Sustainability

- The DSA results for the region show that public debt ratios are highly sensitive to:
  - Shocks in GDP growth and higher primary deficits;
  - Exchange rate shocks especially resulting from currency depreciation;
  - Less favourable terms on new public sector loans; and
  - Some countries such as Rwanda, Malawi and Mozambique have sensitivity to exports shocks.
- Rwanda, Malawi and Mozambique are also vulnerable to shocks to real GDP growth.
- These results highlight the fact that maintaining ***high growth*** rates among the former HIPCs and ***macroeconomic stability*** are important in ensuring continued public debt sustainability.

What Needs to be Watched

- One of the key risks to debt sustainability is borrowing on less favourable terms. Yet a number of countries are having declining ratios of multilateral and bilateral debt but increasing levels of commercial debt.
- See cases of Kenya and Tanzania:

Table 4: Kenya External Debt

	US$ Billion		Share of Total Debt (%)	
	2011	**2012**	**2011**	**2012**
Multilateral	6.12	5.58	65.7	61.3
Bilateral	2.96	2.65	31.7	29.2
Commercial Banks	0.24	0.86	2.5	9.5
Total	**9.32**	**9.09**	**100**	**100**

Table 5: Tanzania External Debt

	US$ Billion		Share of Total Debt (%)	
	2008	**2012**	**2008**	**2012**
Multilateral	3.8	5.8	79.2	65.2
Bilateral	0.9	1.0	18.8	11.2
Commercial Banks	0.10	2.1	2.0	23.6
Total	**4.8**	**8.9**	**100**	**100**

How should countries and development partners address the risks to sustainability?

Policies for Long Term Debt Sustainability

- Maintaining debt sustainability in low income countries requires policy actions at country and international level.
- At the global level, there is need to consider the following:
  - Countercyclical aid is critical for developing countries. Development partners should ensure smooth aid flows even in times of crisis rather than cut it. Aid dependent low income countries are particularly vulnerable to reduced aid flows, based on the fiscal outcomes during the recent global financial crisis.
  - Therefore, donors should meet their aid commitments made through several initiatives, including the Paris Declaration.

Global Actions for Debt Sustainability

- Development partners should support exports growth in developing countries through:
  - Improved market access for products from LICs: This is an old story, but still relevant today as trade barriers still exist, thus inhibiting exports;
  - Aid for trade initiatives need to be encouraged.
- Development partners should continue supporting capacity building in low income countries to ensure sustenance of analytical and surveillance capacity. The support for capacity building should go beyond the traditional debt management spheres into areas that cause contingent liabilities such as the Public Private Partnerships and project management skills.

Country Level Actions

- At country level, there is need for the authorities to:
  - o Promote growth oriented policies, including exports sector;
  - o Moderate commercial borrowing and explore alternative means of financing, including Public Private Partnerships, deepening domestic markets and maximizing borrowing from concessional and semi-concessional sources;
  - o Maintain sound fiscal policies to avoid rapid accumulation of public debt;
  - o Implement sound exchange rate policies timeously as large exchange rate adjustments would lead to significant worsening of public debt ratios. There have been a few slip ups in the region in the last decade.
  - o Put in place mechanisms to closely monitor contingent liabilities and other debt creating flows.

Conclusion

- Debt relief under the HIPC and MDRI Initiatives was a major milestone for heavily indebted low income countries.
- While the current analysis indicates that there is low to moderate risk of debt distress, public debt has started increasing at a pace that has to be keenly watched.
- The fact that the traditional sources of borrowing for low income countries (LICs) have been adversely affected by the global crisis makes it worse as LICs have to resort to more expensive sources of loans.

Thank You!