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Covid-19 aggravates Sub-Saharan African debt problems

Atradius Regional Economic Outlook

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Executive summary

Due to the Covid-19 pandemic many countries in Sub-Saharan Africa faced severe downturns this year, resulting in an unprecedented regional economic contraction. Although a health crisis has been averted, it is the domestic and international measures implemented to contain the pandemic that have had a large impact on economies and societies. For some of them, the economic progress made in the past decade has been lost. Many countries, particularly those that are highly indebted, lack the room to support their economies through fiscal stimulus packages similar to those in many developed economies. Therefore, a recovery is likely to be slow for these African countries. The pace and shape of the recovery will depend on how their economies were faring before the crisis and on the structure of their economy.

Key points

- A health crisis has been averted, but at a large economic cost. The region is facing a severe recession this year. Most affected countries are those dependent on tourism, oil exports and volatile financial flows. Countries that have elevated debt levels are especially vulnerable.

- The Covid-19 pandemic is aggravating the debt problems for some countries. The elevated debt levels and the widening fiscal deficits limit the room for governments to support their economies and implement the large fiscal stimulus packages seen in advanced economies.

- Substantial financial support from multilateral financial institutions like the IMF and the World Bank will help African countries to mitigate the negative impact on their economies and societies.

- Economic recovery will be slow due to existing vulnerabilities and the limited room to support the economies. The rebound is also surrounded by an unusual high level of uncertainty.

Severe economic downturns expected

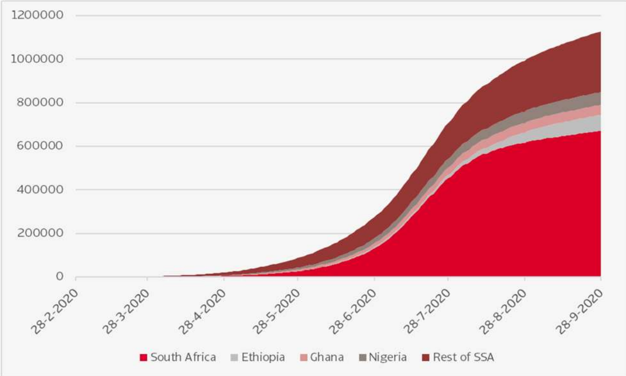
Health crisis averted

Africa was one of the latest continents to experience reports of Covid-19, and many feared the worst. Home to some of the least developed countries and the world's weakest healthcare systems, there were significant concerns that African states would not be able to contain the virus. However, Africa seems to have weathered this storm relatively well thus far.

When the global pandemic took off and the first infections were reported, African governments acted decisively. Across the continent, restrictive measures were taken to contain the spread of the virus. Borders were closed, and partial lockdowns were implemented. However, the lockdowns had a severe negative impact on countries in which many people work in the informal sector and are living on hand-to-mouths. Social distancing and self-quarantine proved challenging on a continent where many live in crowded slums, and 85% of the inhabitants live on under USD 5.50 per day. Therefore, many African countries eased the lockdown restrictions prior to reaching the peak of infections. Despite the poor quality of the healthcare system, the number of infections and fatalities is relatively low compared to other regions of the world. The reason for this could be the relatively young population in Africa, with almost 60% of the population under the age of 25 (Covid-19 seems to have a higher mortality rate for older age groups). Other reasons for the relatively low rate of infections and mortality in Africa could be the low rate of travel, outdoor living and experience in controlling epidemic outbreaks like Ebola. That said, confirmed infections and reported deaths are most likely underreported, as the testing capacity is limited in Africa.

Currently, more than 1.1 million confirmed Covid-19 infections are reported in Sub-Saharan Africa (SSA), and infections have spread through almost all countries. However, this spread is quite uneven throughout the region. Just five countries account for more than 75% of all confirmed infections. Of these five, South Africa has by far the most confirmed infections, followed by Ethiopia, Nigeria, Ghana, and Kenya. At the end of March 2020, South Africa introduced one of the strictest lockdowns in the world. However, in order to soften the negative impact on the economy, lockdown restrictions were gradually eased in June. This has resulted in a sharp increase in Covid-19 cases, as the virus spread rapidly in the impoverished and densely populated areas.

1.1 Total Covid-19 confirmed cases



Source: Macrobond

The World Health Organization (WHO) said that the Covid-19 outbreak might have passed the peak, as the number of new daily confirmed cases has declined over the past two months. However, some countries still report a rise in infections, and as many countries are reopening their economies, a surge in infections is likely, as witnessed in other regions of the world.

More challenges next to Covid-19

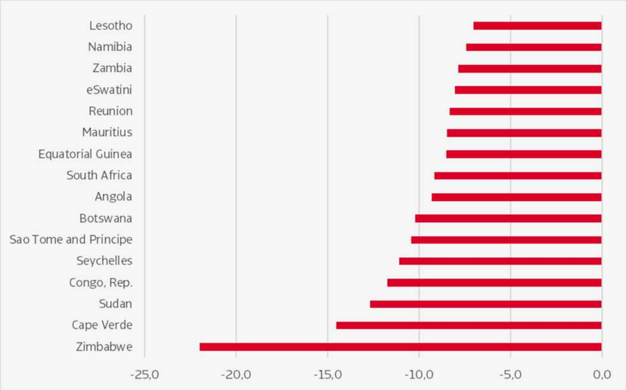
Although a health crisis has been averted, the pandemic has had a severe impact on economies. Covid-19 also arrived at a time when the region already faced several challenges. In many countries, especially in the Sahel region, the security situation has deteriorated due to the increase in terrorist attacks and armed conflicts. In addition, SSA countries have experienced several natural catastrophes. Extreme weather related shocks like drought, floods and cyclones in Southern Africa suppressed agricultural production and food security. Furthermore, the severe locust outbreak in East Africa is hurting the agricultural production in countries like Ethiopia and Kenya.

All but five in recession

SSA economies are hit hard by the Covid-19 pandemic, with an economic contraction of 4.6% in 2020 due to the disruption in trade, the drop in commodity demand, fallen commodity prices and worldwide travel restrictions. However, the regional decline masks large variations across groupings of countries and regions.

Most SSA countries, aside from a specific five[1], have entered into or extended their recessions this year. Most affected countries are those dependent on tourism and the exports of commodities, especially oil. In addition, many faced a drop in financial inflows, aggravating vulnerabilities.

1.2 Largest contractions in 2020

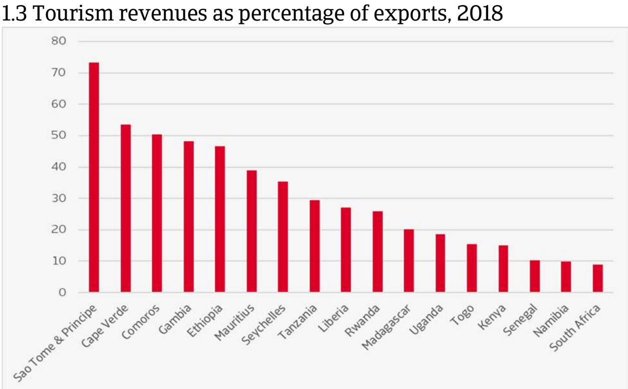


Source: Oxford Economics, Macrobond

Collapse in tourism

The Covid-19 pandemic caused a collapse in worldwide tourism, and SSA is no exception. The tourism sector in the region grew quickly in previous years, particularly due to key travel destinations such as Kenya, Mauritius, and Tanzania. The pandemic brought the tourism sector to a standstill, affecting the economic activities affiliated around hospitality, entertainment, and transport/logistics. Although many African destinations have relatively minor Covid-19 outbreaks, international travel is severely disrupted due to the travel restrictions and the general avoidance of air travel. Countries where the contribution of tourism to the economy is large are seriously affected. In small island economies where the tourism sector accounts for more than 20% GDP, such as Cabo Verde, Seychelles and Mauritius, large contractions are expected this year. Most vulnerable are those countries that are highly dependent on tourism for generating export proceeds. Countries where tourism accounts for more than 25% of export revenues, such as Tanzania, Mauritius and Cabo Verde are particularly vulnerable.

1.3 Tourism revenues as percentage of exports, 2018



Source: World Bank

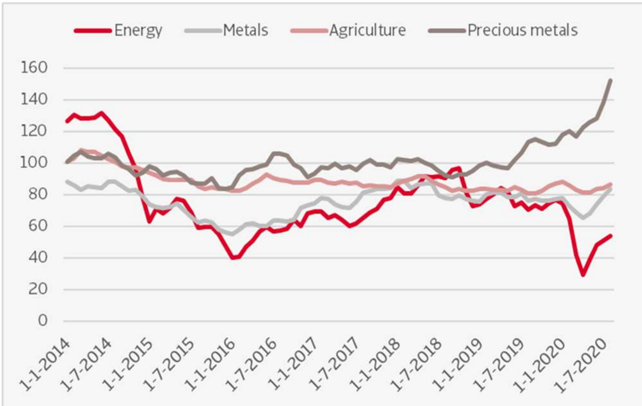
The collapse in the tourism sector will result in major job losses and business closures, with a recovery in tourism likely to be slow and gradual. This is dependent on the duration of the pandemic, which is highly uncertain. In addition, restraint among international travelers to travel and capacity constraints due to the continued social distancing requirements will probably hold off a strong recovery. Business travel is also affected by the strong increase of online meetings, events and conferences, which, in combination with cost-reductions, might further dampen a recovery.

Decrease in commodities demand affects trade

SSA trades with the rest of the world, mainly exporting oil, metals and agricultural goods. However, the countries still play a small role in the global value chain. They mostly produce primary commodities, which are then further processed in other markets. A few countries, such as Zambia, are part of the value chain in electronics due to the delivery of commodities like copper. Limited manufacturing takes place in South Africa, Ethiopia, Kenya and Tanzania.

At the start of the Covid-19 outbreak, demand for commodities already declined, and commodity prices fell sharply. With commodities being SSA's main export product, the drop in external demand is affecting countries across the region. The severity depends on which commodity the country is exporting.

1.4 Commodity price indices, January 2014-August 2020
Index (2010=100)



Source: World Bank

The countries most affected are those that export oil and metals. Confronted by a reduction in demand and lower prices, these countries have entered deep recessions. Metal exporters such as South Africa, Botswana and Zambia have seen a sharp decline in export revenues. However, the shock is hardest felt in the oil exporting countries such as the Republic of Congo and Angola, where oil accounts for more than 90% of the exporting revenues.

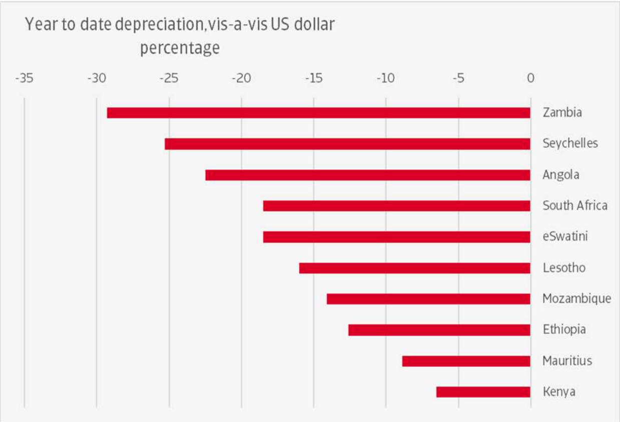
[1] Ethiopia, Rwanda, Mali, Burundi, Guinea

Countries that are not resource-intensive are expected to suffer the least, as they benefit from a more diversified economic structure. Many of them posted high economic growth rates before the Covid-19 outbreak due to high public investments. Nevertheless, some will experience a small economic contraction this year. For instance, Kenya's GDP is expected to contract by 0.7%, due to a collapse of the tourism industry and lower activity in the export-orientated sector. The containment measures also hampered the services sector. In Ethiopia and Rwanda, the slowdown will be substantial, but growth rates will remain slightly positive. For some countries in this group, the impact of Covid-19 is compounded by the locust invasion.

Foreign financing flows dip

The outbreak of Covid-19 triggered sharp currency depreciation in SSA, especially among tourism-dependent economies and resource-intensive countries. The deterioration in tourism and commodity revenues resulted in large external imbalances, putting pressure on the currencies. For the oil exporting countries in the CFA-zone (CEMAC and WAEMU), exchange rate movements followed the developments of its reference currency, the euro, and have been muted. South Africa, which is more integrated into the global financial markets, saw its currency depreciating sharply due to the large outflow of capital.

1.5 Largest currency depreciations in SSA



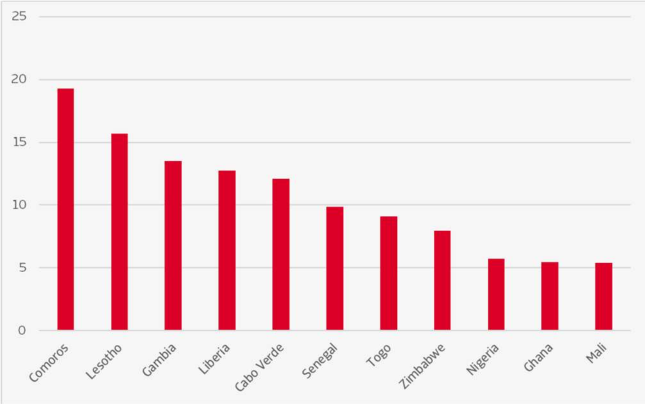
Source: Macrobond

Financial flows to SSA countries are expected to decrease because of the pandemic. They consist of remittances, foreign direct investments (FDI), official development aid (ODA) and portfolio investments.

For many countries in the region, remittances are the most important source of foreign financing. Historically, remittances are a stable source of financial inflows and used to increase in case of a shock to the sender's economy of origin. In case of a natural disaster, recession or political crisis, migrants support their families with remittances. However, the unpreceded shock to the global economy could make remittances an uncertain source of financing. Job losses and recessions in the EU and US, will depress remittances. The impact on SSA countries will vary, depending on how important these remittances are for their economies (as contributors to consumption, investment and the balance of payments). The loss in remittances will compound the recession in many SSA countries and put pressure on external balances.

In absolute terms, Nigeria is by far the largest receiver of remittances due to its large population and strong international connections. In 2019, it accounted for half of the inflows in SSA, followed by Ghana, Kenya and Senegal. Countries where remittances account for a large share of GDP are the most vulnerable, especially if these are low-income countries.

1.6 Remittances as percentage of GDP, 2019

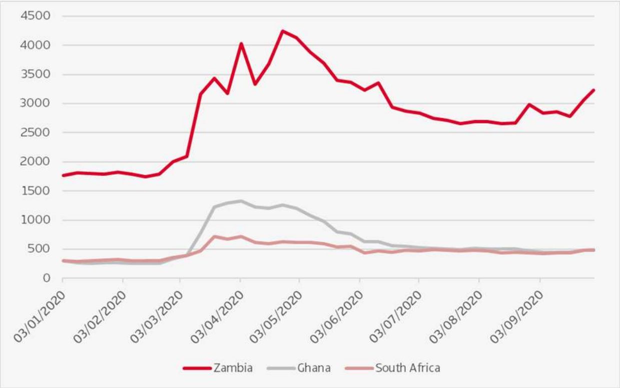


Source: World Bank

FDI is expected to be lower due to the pandemic. Unable to travel, investors postpone investments or divest. Investments in the oil and mining sector will probably be lower due to decreased commodity prices. Since 2000, Chinese investments and Chinese loans to African governments have increased sharply. Most of Chinese FDI went to sectors such as energy, mining, construction and transport. However, due to the economic slowdown in China it is expected that Chinese FDI and loans will decrease this year. At the same time it is uncertain what the Covid-19 impact will be on official development aid (ODA). Because advanced economies are combatting Covid-19 crises at home, ODA could be constrained.

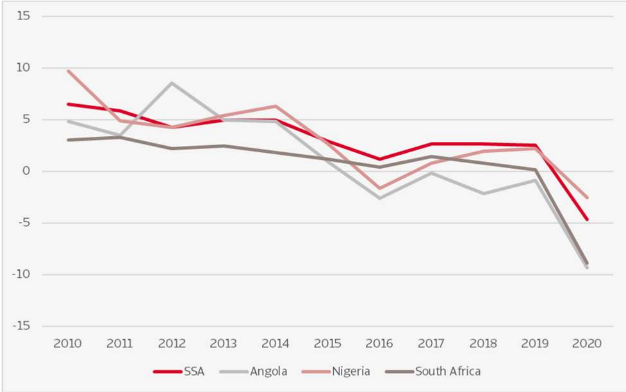
The rising volatility in the international financial markets has hit portfolio flows into SSA. In the beginning of the pandemic, global financing conditions deteriorated sharply, triggering capital outflows from emerging and frontier markets. For SSA countries, which have been increasingly active on the international financial markets, this resulted in a temporary shut out and a sharp widening of bond spreads. According to the IMF, capital outflows amounted to USD 5 billion for the region with the largest outflows in relation to GDP recorded in South Africa, Ghana and Cote d'Ivoire.

1.7 Sovereign bond spreads, basis points



Source: Bloomberg

1.8 GDP growth SSA and largest economies, y/y change



Source: Oxford economics

Due to increasing volatility, bond yields widened significantly, making it quite expensive to borrow and refinance debt. For instance, just before the Covid-19 outbreak, Ghana was able to successfully issue Eurobonds against relatively low interest rates. However, in March 2020 the bond yield spread jumped above 1,000 basis points. While the spreads have been narrowing for some countries in recent weeks, yet they remain high, making financing conditions difficult. In general, SSA governments are temporarily unable to access the international financial markets for funding and unable to refinance maturing debt against favourable interest rates.

Regional growth differences

The more diversified economies are faring better, as they are more resilient. These are mainly in Eastern Africa, such as Rwanda, Ethiopia and Uganda. Countries in this region also entered the current crisis in a rather good state, as they showed high economic growth rates in previous years. Despite the locust invasion, a few of them are still recording positive growth rates.

Countries in Central Africa, where most of the oil exporters are located, are hurt by the lower demand for oil and the associated price decline. The lower oil price is also hurting countries in Western Africa. Here, the recession in the largest economy, Nigeria, is affecting other countries in the region. In addition, this part of SSA is also affected by the lower metal prices and declining mining activities. The most affected region is Southern Africa as the severe contraction in South Africa has a spillover effect on neighboring countries.

Three largest economies take a dive

Overall, the deep recessions in the largest economies in SSA, Nigeria, South Africa, and Angola account for a large share of the regional growth decline. All three struggle with structural weaknesses that constrained economic growth for several years. Since the oil price decline in 2014, the oil producing countries Nigeria and Angola performed poorly and have been moving slowly to implement reforms to diversify their economies. South Africa has also been reluctant to implement much-needed reforms to improve the situation at its public utilities.

The largest economy, **Nigeria,** is expected to experience an economic contraction of 2.5% this year, due to the low oil price, declining oil production and the impact of the lockdowns in economic hubs on domestic activity. The squeeze in revenues results in a tightening of the foreign exchange liquidity. To soften the pressure on the availability of foreign exchange, the central bank allowed the official exchange rate to devaluate. Due to the devaluation and supply constraints of goods, inflation is high at 14.2%. With the oil price expected to stay relatively low next year, the economy will only gradually recover, expected to grow 1.8% in 2021.

The most industrialised economy of SSA, **South Africa**, has been hit particularly hard. It implemented one of the strictest lockdowns in the world, which resulted in a deterioration of domestic activity. The retail and mining sectors, two main pillars of the economy, were substantially affected. Adding a combination of low commodity prices, a reduction in tourism arrivals, a decrease in external demand due to the economic slowdowns in its main trading partners, and capital outflows, the economy is expected to contract by 8.9% this year. A recovery of 5.3% is expected in 2021.

The third largest economy of the region, **Angola**, is hit by the low oil price and declining oil production. The sharp decline in exports and investments will lead to a recession of 9.3% in 2020. The economic growth is expected to recover to only 1.8% as the oil prices remain relatively low.

Real GDP growth forecasts (% y-o-y)

	2019	2020f	2021f
Angola	-0.9	-9.3	1.8
Ghana	6.5	-1.5	6.3
Kenya	5.4	-0.7	5.1
Nigeria	2.2	-2.5	1.8
South Africa	0.2	-8.9	5.3
SSA	2.6	-4.6	4.0

Sources: Oxford Economics, Atradius

High debt levels limit room to support

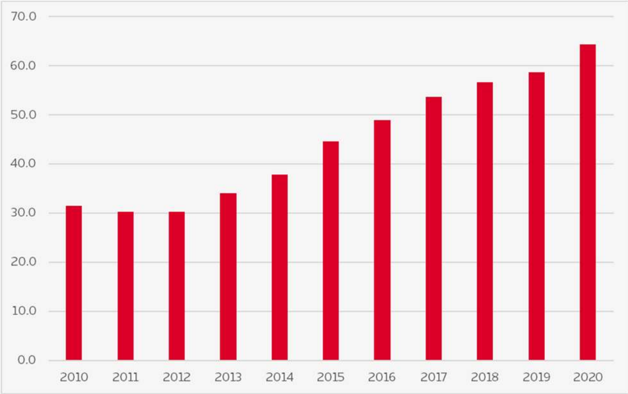
To mitigate the Covid-19 impact on the economies and societies, authorities across SSA have resorted to expansionary policies. Depending on room to manoeuvre, central banks cut interest rates. In some countries, a very accommodating monetary policy was followed. South Africa cut the interest rate aggressively since the beginning of this year by 275 basis points. It also announced quantitative easing measures to encourage lending and investments. Other countries with large interest rate cuts were Namibia (250bp), Uganda (200bp) and Ghana (150bp). Almost all countries in the region implemented measures to increase liquidity in the banking system and relaxed macro-prudential norms. A few have even resorted to the unorthodox measure of monetary financing (e.g. Ghana).

In addition to expansionary monetary policies, most countries turned to fiscal policy to support their economies. Governments increased healthcare spending and introduced measures to contain the virus. They also provided financial support to households, especially the most vulnerable, and to businesses. Cash transfers, unemployment benefits, tax cuts and deferrals were provided. Although all countries support their economies, the size of the stimulus packages varies highly across the region. The largest fiscal stimulus packages were announced in South Africa (10% of GDP) and Senegal (7% of GDP). However, these kinds of sizeable stimulus packages are exceptional in the region. Unlike in most advanced economies, fiscal space and financing options are rather limited for SSA countries to support their economies. Simultaneous to the rise in spending, government revenues declined due to collapsing commodity revenues, the recessions and fallen custom duties. The resulting high fiscal deficits limit the fiscal space to provide extra support to the economy. At the same time, countries were unable to finance their deficits through bond issues due to deteriorating financing conditions. Elevated public debt levels in the region are additionally narrowing the fiscal space. In the past decade, public debt has increased sharply in many countries.

Concerns about debt sustainability

Due to the higher fiscal deficits, public debt will rise further this year, raising concerns about debt sustainability. Even before the Covid-19 crisis, the elevated debt levels of some countries were worrisome. Furthermore, the changing debt structure is making the situation riskier. Compared to previous years the composition of debt in SSA has changed dramatically, towards more commercial and foreign currency denominated debt. Previously, SSA countries mainly relied on multilateral financial institutions like the IMF and the World Bank and traditional official bilateral creditors for their financing. Nowadays, commercial debt accounts for a large share in total public debt. This commercial debt consists of Eurobonds and other private creditors, mostly denominated in foreign currency. This is making the debt riskier than before due to the higher refinancing risk and exchange rate risk.

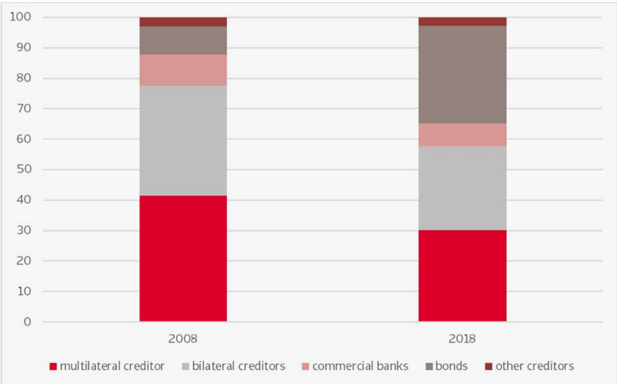
1.9 Median gross government debt percentage GDP



Source: Oxford Economics

In addition to the increase of commercial debt, other bilateral creditors outside the Paris Club have replaced traditional Western creditors. The introduction of these new creditors could bring along opacity in the recording of debt, threatening debt transparency. One of these new creditors is China, which provided large loans to many African governments. A few SSA countries like Angola, Zambia, Kenya and Ethiopia received sizable loans from Beijing. Uncertainty regarding how much is lend or the conditions attached to the loans (oil as a collateral) is creating transparency problems and threatening debt sustainability in these countries. Some of them like Zambia already struggle to repay their debt obligations.

1.10 Composition of public external debt by creditor



Source: World Bank

The changing debt composition has pushed up debt servicing obligations. In combination with declining government revenues these higher debt servicing costs challenge governments to keep honouring their debt obligations. They face the difficult trade-off in this crisis to honour the debt, or to spend more to support the economy and to contain the virus. Therefore, support was needed. Multilateral financial institutions such as the IMF and the World Bank grant a debt service moratorium and provide financial assistance to cushion the Covid-19 impact on the economies and to finance the widening fiscal deficits.

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Multilaterals to the rescue

International financial institutions responded quickly to the need for financial assistance. At the end of March, the IMF provided immediate debt relief to the poorest and most vulnerable countries affected by the pandemic through modifying its facility Catastrophe Containment and Relief Trust (CCRT). Through the CCRT, it approved debt relief to 22 African countries for a six-month period ending in October 2020. The CCRT can be extended up to two years. The IMF is also providing financial support through the emergency lending facilities, such as Rapid Financing Instrument (RFI) and Rapid Credit Facility (RCF). As of September, around 30 countries were receiving financial support through one of these facilities. In addition, the IMF has augmented access under existing program arrangements. The World Bank and the African Development Bank also provide loans and technical assistance.

In April 2020, the G20 announced the Debt Service Suspension Initiative (DSSI), which allows the poorest countries to suspend debt service payments due between April and December 2020. This initiative comprises of a suspension of interest and principal payments to official bilateral creditors. If needed, it can be extended to 2021. Of the 73 countries eligible for the DSSI, 37 are from SSA. So far, 30 countries have requested support from official bilateral creditors. The suspension of debt service payments provides breathing room and frees up much needed resources to increase health spending and support the most vulnerable parts of the population. The G20 is also calling on private creditors to participate on a voluntary basis, but so far, none have contributed. DSSI borrowers are hesitant to request forbearance of private creditors due the potential consequences for sovereign credit ratings and future market access.

Challenging and uncertain outlook

The SSA region is heading for a challenging year. Most countries are facing a severe economic downturn or contraction and have hardly any fiscal room to soften the impact of Covid-19 on their economies and societies. Lacking the fiscal space to provide support, economic growth will recover only gradually. The most affected countries (tourism dependent and oil exporting), will particularly see a slow recovery. The three largest economies in SSA will hardly provide any support to neighbouring countries, because the structural weaknesses in their own markets will constrain economic recovery. Economies such as Senegal, Cote d'Ivoire and Uganda that recorded high growth rates in the years before the Covid-19 crisis will recover more strongly. They benefit from the diversified economic structure and their relatively good starting position.

Not only will Covid-19 have an enormous impact in the short-term, economic growth will also be constrained in the medium-term. Limited fiscal space and prioritizing government expenditure toward social spending results in less public investments in the much needed infrastructure. Therefore, the sizeable financial assistance from multilaterals is very welcome and can help most African countries to weather this storm.

Nevertheless, the pace and strength of the recovery is surrounded by an unusually high level of uncertainty. Vulnerabilities remain, and for some countries, debt sustainability is threatened by elevated debt levels and riskier composition, which could enforce sovereign debt crises. Countries which have a high level of foreign currency denominated debt, like Zambia and Angola, are particularly vulnerable.

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