

Towards 2022

Options for paying
back Zambia's
Eurobond Debt



Executive Summary

On 20th September 2022, Zambia's first Eurobond will mature. The Government will be required to settle its principal payment amounting to US\$750 million in full. Twenty months later in April 2024, the Government will have to settle the second Eurobond worth US\$1 billion. The third US\$1.25 billion Eurobond will be paid back in three instalments in July of 2025, 2026 and 2027. With less than three years before the first Eurobond matures, there is no clear indication of how and where the money to pay back these Eurobonds is going to come from. This paper considers several options that will mitigate the possibility of a default when the principal payments on the Eurobonds are due.

The lack of a payment strategy has made the bondholders jittery about whether they will get their money back. Bondholders have communicated their consternations by dumping the Zambian bonds which are perceived to be risky. With increasing yield rates on the three Eurobonds, of about 17% by end-September 2019, the market seems to have already priced in a default – only nations already in default, such as Venezuela, have yields as high as Zambia's¹. The yield rate is the barometer used to assess the risk inherent in the bond. In general, higher yields mean the bond has higher risk and corresponds to a decline in the value of the bond. There have been efforts made towards establishing a Eurobond Redemption Strategy, but its contents are yet to be publicised. Also, the failure to release the 2020-2022 Medium Term Expenditure Framework by September 2019, and the absence of the 2020-2022 Medium Term Debt Strategy to show a clear borrowing plan have added to the market apprehension.

By just about every measure, the Zambian economic fundamentals are fragile. Growth is ailing, prompting the authorities to revise their growth projection targets from 4% to 2% in 2019. Agriculture has been in recession for several quarters now. The 2019 mining fiscal regime that has significantly raised the tax burden on mining companies to unsustainable and uncompetitive levels, coupled with reduced ore grades, has resulted in 8.4% reduction in mining value added in the second quarter of 2019. The electricity load management which commenced in mid-2019 continues to have adverse economy-wide effects. This has implications on revenue targets. Tax revenues in September 2019 were 17% lower than projected, a trend likely to continue at least up to the end of the year. Further, the recent weakness of the Kwacha is not helping either as it has increased the cost of external borrowing and debt servicing, making it prohibitively more expensive to service foreign-currency denominated loans, which include the Eurobonds.

Interest repayment and other needs are growing. Gross external financing² requirements for the 2019 Budget are estimated at K24.6 billion (approximately US\$1.9 billion³), with external debt service (approximately US\$1.2 billion) contributing significantly to gross external financing requirements in 2019. The external financing requirements are projected to be even higher in 2020 at K27.5 billion (approximately US\$2 billion). However, the funds required to repay the interest keep dwindling. By end-August 2019, gross international reserves were at US\$1.4 billion, well below the estimated financing costs in 2020.

With all these pressures, Zambia is sliding closer and closer to a sovereign default - where the country may fail to make a full payment of the Eurobond on the prescribed date or within the specified grace period. The Government can choose to fold its arms and do nothing for the next three years and then choose not to make the redemption payment of US\$750 million when the first Eurobond becomes due. But a default has catastrophic consequences and should be avoided. It should only be considered if the economic and financial situation deteriorates to unsustainable levels. A default would result in the country being excluded from accessing credit in international capital markets, reduced international trade, court cases compelling the country to pay back, and a tainted reputation.

1 <https://clubofmozambique.com/news/zambian-bonds-reach-another-grim-milestone/>

2 Gross external financing is defined as net external financing plus amortisation.

3 Author's own calculation based on the Bank of Zambia official average exchange rate between January and May 2019.

There are several options that could be considered before the Eurobond maturity if the Government wants to avoid a default:

- a) **Rolling over:** If it can find new buyers for a new Eurobond, the Government would aim to issue another Eurobond in September 2022 upon maturity, with a total value of US\$750 million and use the money raised to pay the holders of the current Eurobond. However, given the low credit rating and the current debt sustainability levels, it would be a challenge to find buyers of a new Eurobond at maturity. This is not an option that the Government should be considering. At worst, it is unfeasible; at best it is extremely expensive.
- b) **Refinancing:** Under this option, the Government would seek to change the terms of the 2022 Eurobond before maturity, including extending its duration so that it does not have to be redeemed in September 2022. This could be challenging as it would mean negotiating with a wider range of players, and could be a long process – perhaps too long given the precarious nature of the Zambian Government’s position. As a first step, Zambia needs to establish who holds the country’s bonds and understand their priorities before entering any negotiations.
- c) **Redeeming:** Under this option, the Government would pay the Eurobond when it became due in September 2022. This requires the Government to have US\$750 million available at the time. The main issue is where these funds would come from. Basically, there are three options: higher taxes or increasing other revenues (or cuts to other spending), further borrowing or selling assets. The sale of some assets seems to be the most viable of the three options, but it is not a costless option. The Government would permanently lose control of these assets and any future dividend payments on them. The Government may also have to sell the assets at below their market value to ensure a successful sale in a short period of time, particularly if the assets are a large stake.
- d) **Bond buyback:** If the Government chooses to redeem the Eurobond in September 2022, it would have to find US\$750 million to do so. A bond buyback would allow the Government to pay for the principal at the current market value of the Eurobond which is only around US\$500 million. To avoid default or refinancing the Eurobond, it would appear to make sense, therefore, for the Government to start buying back the Eurobond before redemption because of its lost value. But with no sufficient sources of financing for this option, the Government would need to raise funds for a buyback. Options for this are limited, but include trying to issue a new bond (though this will encounter the same challenges as a roll over) or the sale of assets.

Purchasing Eurobonds early through a bond buyback using money raised from the sale of assets seems to be the most viable option. The Government has a significant and varied portfolio of financial assets and a range of public sector bodies have a role in managing these assets on behalf of the Government. For example, the Industrial Development Corporation (IDC), with an asset portfolio in excess of US\$8 billion, represents a potentially significant source of funds for the Government. IDC has a 60% stake in ZCCM-IH which in turn has significant shareholding in various mines. Offloading of some shares in Kansanshi and Konkola Copper Mines, for example, could be enough to cover all the three Eurobonds.

Given the profile of Zambia’s Eurobonds, which will mature periodically until 2027, and the country’s precarious wider debt position, the other options also need to be considered. Given the risks and uncertainty associated with each option, as well as investor uncertainty around Zambia’s debt sustainability, the Government may need to pursue a combination of refinancing and bond buybacks to reduce coupon payments and the 2022 bullet payment, depending on which option is politically and financially viable. Government could use this fiscal space to rebuild credibility, which would enable it to rollover the outstanding Eurobonds, preferably in one long-term bond. Government’s strategy needs to consider Zambia’s wider debt position and take a long-term approach to debt sustainability.

But before all these things can happen, the markets want to see a commitment from the Government to stabilise the fiscal and macroeconomic environment. They want to see credible fiscal consolidation, which is key to bring down the fiscal deficit and slow down debt accumulation. With little or no access to the international sovereign bond market, the case for seeking a credit facility from the IMF is overwhelming. The markets also want to see an endorsement from the IMF, while the IMF wants to see prior commitment

to debt sustainability. With or without an IMF deal, the Government will have to turn the economy around. The IMF sends missions, the markets don't: instead, they dump the bonds in the secondary market. The markets also want to see more transparency by, among other things, publishing of **detailed** debt numbers on a regular basis, making the Eurobond Redemption Strategy, the 2020-2022 Medium Term Expenditure Framework and the Debt Management Strategy publicly available, and laying out the borrowing plans for the near term.

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Acronyms

BOZ	Bank of Zambia
HIPC	Highly Indebted Poor Countries
IDC	Industrial Development Corporation
IDR	Issuer Default Rating
LuSE	Lusaka Securities Exchange
IMF	International Monetary Fund
MOF	Ministry of Finance
SOE	State Owned Enterprise
ZCCM-IH	Zambia Copper Consolidated Mines – Investment Holdings

1 Introduction

In the face of dwindling access to concessional financing after becoming a lower-middle income country in 2011, Zambia entered the international sovereign bond market in 2012. Between 2012 and 2015, the Government issued three Eurobonds totalling US\$3 billion mainly to finance infrastructure development. Zambia first issued a ten-year US\$750 million Eurobond at a coupon rate or interest rate of 5.375% in 2012. The issuance of the sovereign bond was meant to finance several infrastructure projects in energy, transport, rehabilitation of tertiary hospitals and access to finance to sustain growth (Ministry of Finance, 2012). In order to augment funding to the selected investment projects under the first Eurobond, Government successfully issued a second Eurobond amounting to US\$1 billion in 2014 at a coupon rate of 8.5%. A third Eurobond, amounting to US\$1.25 billion was issued in 2015 at a coupon rate of 8.97%.

The issuing of Eurobonds has led to a change in the composition of external debt. Commercial debt, at 53% of total external debt, now accounts for the largest share of the external debt portfolio from creditors (Figure 1). In turn, the Eurobonds account for 57% of commercial debt, and are therefore the largest component of external debt (30%).

Figure 1: Evolving structure of external debt, 2008-2018



Source: Constructed from Ministry of Finance Annual Economic Reports

The issuance of Eurobonds is not necessarily a bad thing, provided a country can ensure sound fiscal governance. Eurobonds increase transparency and scrutiny by international market participants - Zambia had to acquire credit ratings before its issuance of the bonds. Eurobonds may also be used as a benchmark for pricing subnational bonds to minimise the sovereign's risk exposure in cases where the subnational bonds are guaranteed by central government. Additionally, Eurobonds also diversify the country's financing portfolio - this has been especially true following the dwindling of concessional financing for Zambia, among many other developing countries. And, unlike concessional financing which is generally limited, issuing Eurobonds gives the country access to exceptionally high liquidity with no conditionalities as is the case with the traditional concessional financing.

However, the Eurobond debt comes with several risks. These include repayment and exchange rate risks due to the structure of the Eurobonds. Because of increased debt servicing costs, Zambia has reduced spending in other critical economic and social areas. Pressure on government finances have resulted in the rapid accumulation of payment arrears, leading to an economic slowdown as liquidity challenges continue to mount. This has resulted in sovereign credit rating downgrades which have contributed to the waning investor confidence, leading to the international sovereign bond markets already pricing in a default as yields on the Eurobonds soar. With so much of the country's funds being currently channelled to the repayment of the interests on the bonds and other debt servicing obligations, Zambia risks a default on its Eurobond principal repayment.

Zambia is faced with a possibility of a default on the principal debt. This paper assesses various options that could help the country avoid a default. The study heavily relies on the review of literature from elsewhere

and lessons learnt from other developing countries that have defaulted or have avoided default.

The rest of the report is structured as follows: Section 2 considers the structure of the Eurobonds and the inherent risks that come with the Eurobond issuance. Section 3 lays out the conditions that must be put in place to restore market access. Section 4 discusses the options available for repaying the Eurobonds in 2022 while Section 5 weighs these options. Finally, Section 6 concludes and offers some recommendations.

2 The Eurobond Structure and Inherent Risks

Eurobonds are a type of bond denominated in a foreign currency, usually the United States dollar. That entails that the issuing country's exchange rate is of cardinal importance as payments must be made in foreign currency. Interest payments, also referred to as coupon payments, which are made twice yearly, are due in US dollars. So, when the local currency depreciates substantially (as has been the case since 2015), the cost of servicing this debt increases. While the average coupon rates on Eurobonds seem low at around 7.6%, the effective borrowing costs which include the rate of exchange rate depreciation is a lot higher. Table 1 shows the structure of Zambia's Eurobonds.

Table 1: Structure of Zambia's Sovereign Bond Issuances

	2022	2024	2025-2027
Amount (US\$ million)	750	1,000	1,250
Payment structure	Bullet	Bullet	Back-end amortising in 3 instalments
Coupon rate	5.375%	8.5%	8.97%
Coupon amount per year (US\$ million)	40	85	112
Issue date	13 Sept 2012	14 April 2014	23 July 2015
Coupon frequency	Twice per year	Twice per year	Twice per year
Tenor	10 years	10 years	11 years (average)
Date of maturity	20 Sept 2022	14 April 2024	30 July 2027
Sovereign rating on issue date	B+(S&P); B+(Fitch)	B+ (S&P); B (Fitch); B1(Moody's)	B(S&P); B (Fitch); B1 (Moody's)
Current sovereign rating (November 2019)	CCC+(S&P); CCC (Fitch); Caa2 (Moody's)		

The structure of Zambia's Eurobonds poses repayment risks. The 2022 and 2024 Eurobonds have bullet repayment structures. This means that the borrower does not pay the principal over the life of the loan, but rather makes a lump sum payment at maturity. With Zambia currently expending on interest repayments every 6 months, and with little foreign reserves and no sinking fund, the country is presently ill-prepared to make the lump sum payments when they fall due.

Additionally, increased debt servicing costs have crowded out other critical economic and social payments. The high debt servicing costs have had a telling impact on the state of government finances. According to Treasury figures, interest payments on external debt were 48% higher than projected in the first nine months of 2019. This is as much a reflection of the government's head in the sand forecasting as it is of higher debt repayments. More importantly, interest payments accounted for 29% of domestic revenues (or 62% of domestic revenues if principal payments are also added). Every extra Kwacha paid on interest means one Kwacha less on other critical spending such as on the use of goods and services, grants and other transfers and social benefits.

The spending cuts have resulted into the accumulation of payment arrears⁴. In the first nine months of 2019, the non-interest recurrent spending was K8.3 billion (approximately US\$640 million) lower than planned. The diversion of resources to settle interest payments has forced Government to reduce the amount of supplies purchased or volume of services delivered. Some public services/projects have been halted where providers of essential services/materials suspend supplies. On the other hand, the non-payment for the supply of goods and services has also imposed difficulties on the operations of businesses in the private sector. Unable to meet their liquidity needs such as the payment of statutory obligations when access to credit from financial institutions remains difficult, has resulted in a reduced pace of economic activity. Ultimately, this means many companies risk being forced to downsize and/ or lay off workers.

In the same vein, some programmes such as the Sinking Fund, have not been funded at all. Government established a Sinking Fund that was meant to ensure that a reserve was built up for the timely repayments of the principal amounts of the three Eurobonds. However, tough times have befallen the country, with a rapid increase in debt servicing costs caused by continuous accumulation of debt and a depreciating Kwacha, as well as a perpetually widening fiscal deficit driven by low revenues and higher than projected expenditure. With little or no revenue savings, the Sinking Fund has not been actualised. The Sinking Fund required Government to set aside US\$638 million per year between 2018 and 2022. Figure 2 shows that over the years, debt servicing costs and personal emoluments have taken up a greater share of domestic revenue, leaving very little to fund other spending. With debt service payments and the wage bill taking up a greater share of domestic revenue, it has been a challenge to actualise the Sinking Fund.

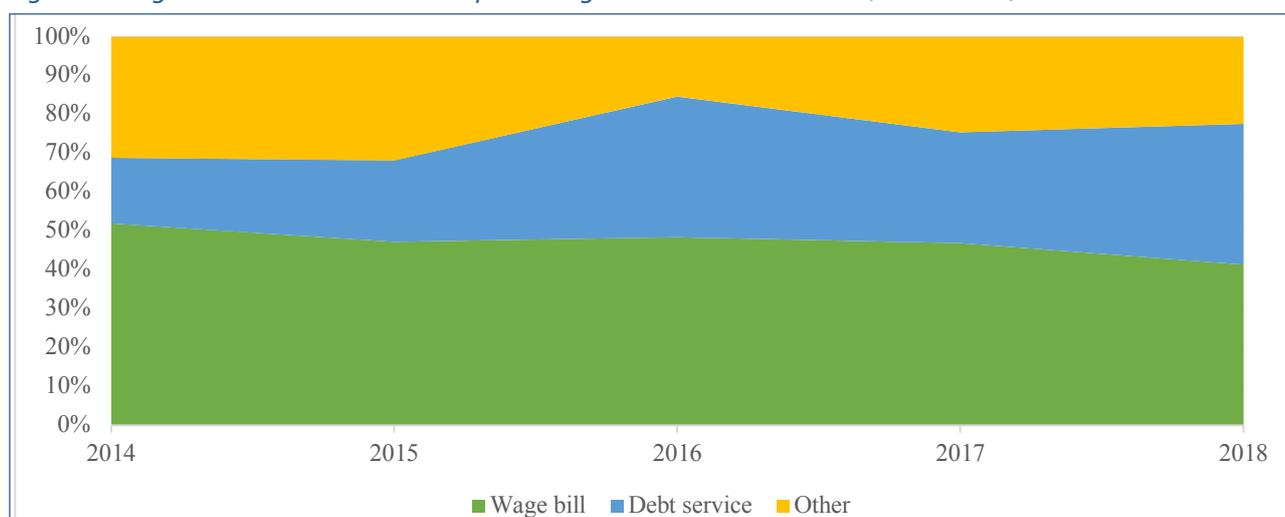
Text Box I: Eurobonds

The Eurobond is a special type of bond issued in a currency that is different from that of the country or market in which the bond is issued. Actually, the name 'Eurobond' is a misnomer. Although the euro is the currency used by participating European Union countries, Eurobonds refer neither to the European currency nor to a European bond market. It instead refers to any bond that is denominated in a currency other than that of the country in which it is issued.

Eurobonds are issued by supranational organisations, governments and large companies. In return for their purchase, investors receive a guarantee that they will have the principal amount repaid by a certain future date, and that they will receive interest payments at certain intervals. The date when the principal is due for payment is referred to as the date of maturity. Coupon payments, the annual interest payment that the bondholder receives from the bond's issue date until it matures, vary for Eurobonds according to the credit rating of the issuing country and the maturity of the bond.

Eurobonds can have bullet repayment structures or back-end amortisation. The risk that a debtor may default on its bonds is assessed by sovereign credit rating agencies – the main ones being Standard & Poor's, Moody's and Fitch. Eurobonds are traded in the secondary market. The yield rate is the barometer used to assess the risk inherent in the bond. In general, higher yields mean the bond has higher risk and corresponds to a decline in the value of the bond.

Figure 2: Wage bill and debt service as a percentage of domestic revenues (2014 - 2018)



Source: Constructed from Ministry of Finance Fiscal Tables 2014 -2018

4 Domestic arrears excluding VAT arrears as at end June 2019 increased to K20.2 billion from K15.6 billion in December 2018 as per the 2020 Budget Speech.

External vulnerability and liquidity risks have intensified. The country's foreign exchange reserves have been declining despite mineral royalties being remitted in US dollars. With this narrow buffer of reserves, the country is now exposed to even small shocks such as a fall in the copper prices, adverse business environment developments, or climate-related shocks, which can severely cripple the Government's ability to meet its external debt obligations. The drain on the foreign exchange reserves is due to the high external debt servicing costs and a huge current account deficit. As at end August 2019, foreign exchange reserves stood at US\$1.42 billion which represents 1.6 months import cover⁵, which is below the recommended threshold of three months. The build-up of reserves may also remain elusive with lower economic growth and inadequate revenues.

Zambia has further gone down the international credit rating "junk status" ladder. Zambia's creditworthiness was downgraded by the three major international credit rating agencies: Moody's, Fitch and Standard and Poor's.⁶ In May 2019, Moody's downgraded Zambia's credit rating with a negative outlook moving the country from 'Caa1' to 'Caa2' status. This was followed by a downgrade in June 2019 by Fitch, where Zambia's Long-Term Foreign Currency Issuer Default Rating (IDR) was reduced to 'CCC' from 'B-'. The most recent downgrade was by S&P in August 2019 where the country was given a negative outlook moving from B- to CCC+. This meant that at the time of these assessments, a default on Zambia's Eurobond debt was a stronger possibility. The downgrades reflected increasing external and liquidity pressures, that were impairing the Government's ability to service debt over the medium term. All three credit rating agencies have contended that the Government's high external interest payments combined with a continued fall in official foreign exchange reserves, constrained access to domestic and external financing, and a further rise in government debt in the context of an ambitious capital expenditure programme were all rather unfavourable outcomes and would jeopardise the country's ability to make full payment of the principal.

Investor confidence has fallen. The Government's inability to stick to its fiscal consolidation targets, the deteriorating fiscal position, the drain on international reserves, the failure to actualise the Sinking Fund and the credit rating downgrades are among several factors that have led to falling investor confidence. Particularly, the credit rating downgrades reflect the view that the risk of default has increased. In some cases, investors are restricted in the bonds that they can hold depending on their credit rating and may be forced to sell bonds when they are downgraded. This adds to any direct impact of the downgrading in terms of pushing down prices or the value of the bond and pushing up yields.

And the market has already priced in a default. There is a strong correlation between external vulnerability and Government's liquidity risks. The decline in reserves, coupled with low fiscal policy credibility and no progress with the IMF entails that the country has limited market access. The last few months have shown increasing yields on the three Eurobonds as shown in Figure 3. This means that the bonds are becoming riskier and can be seen as an indicator of how concerned investors are about the debt situation⁷. The high yields are mainly attributed to the market's sell-off or dumping of Zambian bonds thereby reducing the price of the bonds. Sentiments surrounding the debt position of the country have had an adverse effect on investor appetite. Most of the countries that have defaulted on their sovereign debt have usually had high yields, such as those on the Zambian Eurobonds, which are currently the worst performing in Africa.⁸

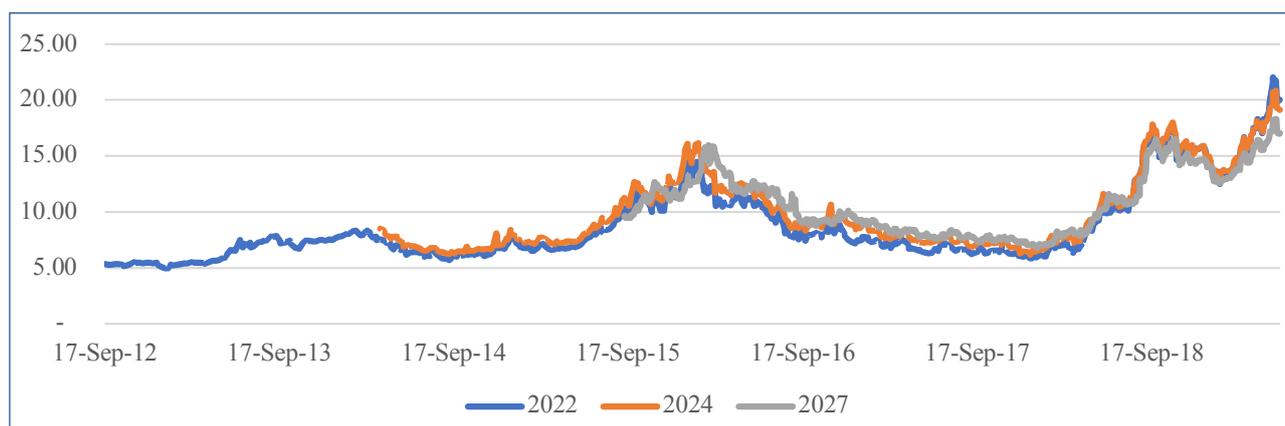
5 Update in Economic Developments in the Second Quarter of 2019, Ministry of Finance

6 Credit agencies are an objective assessment of the country's vulnerabilities (political, economic, regulatory, and other unique factors) that determine the likelihood of default.

7 Moorad, C., 2006. Understanding and Appreciating the Yield Curve. ResearchGate

8 Ministry of Finance (2019). Monthly Economic Indicators, September 2019.

Figure 3: Yield-To-Maturity of Zambia's 2022, 2024 and 2025-2027 Eurobonds



Source: Bloomberg, 2019

3 Pre-conditions for a successful resolution to Zambia's debt situation

The Government must undertake action to stabilise the fiscal and macroeconomic environment, given the foregoing. This is to convince investors of their credibility between now and 2022. Among the different measures that could be taken three stand out, and they include: (i) the establishment of credible fiscal consolidation by cutting back on expensive capital spending, (ii) clinching an IMF bailout package and (iii) accountability and transparency.

3.1 Fiscal adjustment

Fiscal adjustment is key to bring down the fiscal deficit and slow down debt accumulation. This entails strengthening domestic revenue mobilisation and containing capital spending - which is presently the biggest source of higher than planned expenditure in Zambia. Over the last few years, the Government has pronounced several fiscal consolidation measures. A wage freeze effected in 2014-15 helped to lower the wage bill to 8.5% of GDP and 48% of domestic revenues in 2015. The partial hiring freeze (restricting hiring to frontline workers in health and education) effected since 2017 has helped to reduce the wage bill as a percentage of domestic revenues even more. Furthermore, the removal of fuel and electricity subsidies and the streamlining of the Farmer Input Support Programme, among other measures, were effected in 2016 and 2017. However, some expenditures such as Infrastructure spending continue to be sacred cows, defeating the gains made on reining in of other expenditures and driving more debt accumulation.

The Government's announced austerity measures in June 2018 and May 2019 were meant to reduce the fiscal deficit and establish a sustainable debt position. The austerity measures included indefinitely postponing the contraction of all pipeline debt until debt was brought down to moderate risk of debt distress, and cancellation of some current contracted loans that were yet to be disbursed to reduce the debt service outlays. Despite this, the 2018 Economic Report shows an increase in the contraction of new external loans from US\$1.75 billion in 2017 to US\$2.63 billion in 2018 – hardly a sign that the Government is cutting back. Therefore, enhanced implementation of austerity measures (including revenue enhancement) will be key to attaining the medium-term growth and stabilisation goals. Over the medium term, annual projected saving from implementing austerity measures is aimed at an overall US\$500 million per annum which will be highly cardinal to return to a more sustainable path⁹. This will also increase the disbursements to the social sectors, which will eventually reduce developmental inequalities and enhance human development.

⁹ Macroeconomic overview, outlook and review of 2019 Budget Performance presented by Mr Mukuli Chikuba, Permanent Secretary, Economic Management and Finance, Ministry of Finance.

Arguably, the most important fiscal adjustment will be lowering the borrowing ambitions by reducing the fiscal deficit targets. For example, the authorities plan to reduce the fiscal deficit from 6.5% of GDP in 2019 to 5.5% of GDP in 2020. This is not nearly as enough as the 3.4% of GDP recommended by the IMF for 2020. The authorities also need to reduce the deviations between cash-basis and commitment-basis fiscal deficit. The disparity basically means the Government is committing too much more than just the cash borrowing, including raking up new arrears. The Government needs to religiously stick to these targets.

Further, without a medium-term expenditure framework and a debt management strategy, it is hard to decipher what the Government's plans are for paying back the Eurobond debt in 2022, and this has made the markets nervous. In order to establish credibility and restore market confidence, the Government must finalise and publish these documents and clearly lay out its borrowing plans and how it intends to service the Eurobonds.

3.2 IMF bailout package

IMF assistance to Zambia has been an on-going debate for the past 4-5 years considering the increasing debt levels both internally and externally, and the emergence of fiscal-side macroeconomic instabilities. Zambia has not defaulted on any of its loans yet, but with the huge burden of debt servicing costs, the country is faced with fiscal constraints and duress from the weight of a heavy debt overhang. Many other African Eurobond issuers have a programme with the IMF, and the package is now better designed. As they thought through the financial and political costs of reform better than they did in the 1980s and 1990s.

Zambia is entitled to a maximum quota of US\$1.312 billion as IMF support of interest-free or low-interest financing. With this standby facility, Zambia will be able to pay off the full amount of the US\$750 billion in 2022, and then also pay US\$562 million of US\$1 billion in 2024. In addition, the standby facility will help relieve Zambia on a big part of the growing debt service costs. The authorities need to quickly get an IMF package to move towards medium risks of debt distress. This will put Zambia back on the path of economic recovery and better improve the living standards of its citizens as well as signalling foreign investors and other development partners of Zambia's commitment to fiscal consolidation. Therefore, it is inevitable to consider an IMF bailout package for restored fiscal sustainability.¹⁰

Despite downplaying this issue in the recent past, the damage to favourable investor perceptions on Zambia has been colossal as demonstrated by the price hikes in the secondary Eurobond market and the negative headlines in the international media. Zambia needs to take steps to re-engage with the IMF to signal its seriousness to deal with issues that are in contention, including the country's near-term borrowing plans. In a nutshell, the IMF emphasizes to its members to engage in a collaborative process with their creditors when seeking refinancing or debt restructuring options.

3.3 Accountability and transparency

Policymakers need regular and reliable debt information to make informed borrowing decisions. Creditors, donors, analysts, and credit rating agencies need the information to assess sovereign creditworthiness, and to appropriately price debt instruments. Citizens need information to hold the Government accountable. However, this has not been the case.

There has been a deterioration of debt numbers in the annual economic reports. Since 2017, there has been a break in the domestic arrears series as there is no detailed information on the arrears. Domestic debt has been reported without arrears since 2017. The 2018 annual economic report does not include descriptions of the contracted loans as has been the case in previous reports.

For example, most of the allegations of hidden debt, centre on the scale of government borrowing from China. In recent years, Zambia has encouraged Chinese firms' involvement in its economy through incentives and offering exclusive bidding rights for infrastructure projects. Much of this investment has been financed by borrowing from China on a project-by-project basis. There is very little transparency around these deals and consequently it is very difficult to put an accurate figure on their scale¹¹.

10 Cheelo, C & Mungomba, N. (2019) In Further Pursuit of an IMF – Programme ZIPAR <http://zipar.org.zm/research/our-publications/working-papers/121-possible-pathways-for-zambia-to-imf/file>

11 Dolphin, T. and Saasa, O. (2018). How to Avoid Zambia's Public Debt Toppling the Economy into Crisis

4 Available options for paying back the Eurobonds

In the last few years, the Government has proffered two main options for paying back the Eurobonds: setting up a Sinking Fund to redeem the bonds when they are due as well as refinancing. This section proposes and discusses additional options for dealing with the three Zambian Eurobonds that are due to mature between 2022 and 2027 and, in particular, the first Eurobond, which matures in September 2022 and has a total value of US\$750 million.

The Government can choose to fold its arms and do nothing for the next three years and then choose not to make the redemption payment of US\$750 million when the first Eurobond becomes due in September 2022. The failure of a government to make a principal or interest payment within a stipulated grace period is considered a default¹². While defaulting can free up resources for other public spending purposes in the near term, this would likely have significant negative implications for the economy in the medium-term. Among the effects that could be expected are an increase in the Government's borrowing costs in the domestic market; bilateral lending becoming harder and more expensive to secure; a weaker exchange rate and reduced overseas investment in the economy. Moreover, with the Government finding finance very hard to raise, it would be forced to cut spending or raise taxes substantially.

The consequences would be an extended period of weak or no economic growth and higher inflation. The negative effects on the lives of Zambians would be devastating. It is also likely that the Government would also face legal action from the holders of the Eurobonds. Creditor lawsuits have become an increasingly common feature of sovereign debt markets (Text Box II). It is hard to see why the Government would actively choose to default, but we have now reached the point where there is a very real possibility that it could drift into it through its inaction.

Basically, four options are considered for Eurobond repayment to avoid default:

- i. Roll-over the Eurobond when it matures;
- ii. Refinancing the Eurobond before it matures;
- iii. Redeem the Eurobond when it matures;
- iv. Buy-back the Eurobond before it matures.

4.1 Rolling over the Eurobond

The term "rollover" refers to the practice of "carrying over" a loan, wherein the borrower pays the lender an additional fee in order to extend the loan's due date. Rolling over is similar to refinancing but refinancing has a slightly different connotation – it involves taking out a loan before maturity with either better terms and/or extended payback period. Under the roll-over option, the Government would aim to issue another Eurobond upon maturity in September 2022 with a total value of US\$750 million and use the money raised from the issue to pay the holders of the current Eurobond.

However, there are several problems with this option. Most fundamentally, the Government might not be able to find buyers of a new Eurobond at maturity. Zambia's credit rating has been cut substantially by all the credit rating agencies since the Eurobond that is due to mature in 2022 was issued in 2012. These downgrades preclude some investment funds from buying a new bond because they are prevented by their rules from holding bonds that have low ratings; and it will deter other investors.

Additionally, it is likely to be a very expensive option for Zambia. Those investors that are prepared to purchase a new Eurobond will want a much higher yield. The 2022 bond pays a coupon of 5.375%. By comparison, the current yield on the same bond is around 17%. A new bond might not have to have a coupon rate as high as 17% because its longer maturity would mean that investors could believe the

¹² <https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf>

risk of default was lower. But the coupon that would have to be paid by any new Eurobond would have to be significantly higher than 5.375% because the Government's fiscal position is very much weaker than in 2012. Debt servicing costs would therefore increase significantly, which would mean either higher taxes or a further cut in other government spending.

Even if the Zambian authorities took decisive action to rein in fiscal policy, and so regained some investor confidence, the rolling-over option would always be vulnerable to factors outside their control that might, by 2022, make investors more wary of buying Zambian debt. A downturn in the global economy, or in the Chinese economy specifically, might lead to a sharp fall in international copper prices. This would raise concerns about the Zambian Government's ability to service its debts, and so push up the cost of borrowing. Alternatively, one or more other African countries might run into financial difficulties during the next three years, making investors less willing to purchase the debt of African countries generally – the *contagion effect*: If one country gets into trouble and it faces the possibility of defaulting on its loans, or has already defaulted, investors may assume that similar countries with similar problems may suffer similar fates. At the moment, therefore, this is not an option that the Government should be considering. At worst, it is unfeasible; at best it is extremely expensive.

4.2 Refinancing the Eurobond

Under this option, the Government would seek to change the terms of the 2022 Eurobond, including crucially extending its duration so that it does not have to be paid off in September 2022. Text Box III explains the broad concept of debt restructuring which includes refinancing. It would be a good idea to change the terms of the other two Eurobonds at the same time so that the Government does not have to go through the same renegotiation process three times. As is the case with the third Eurobond whose repayment structure is through amortising in three equal instalments in the last three years, the first two Eurobonds' bullet repayment structure could be changed to the back-end amortising structure.

Refinancing would require negotiating with the current holders of the Eurobond, which presents a challenge. The mechanism through which these bondholders can be brought together to agree to the refinancing – or even be identified – is not obvious. These practical terms of renegotiation would depend on the relevant clauses in the bondholder agreements. The bondholders may be permitted to form a committee to represent their interests with the issuer, so-called bondholder committees. How and when to bring investors to the table would require careful planning and consideration. On the one hand, investors will be more inclined to renegotiate if they think the alternative is a default – under which scenario they will not get any money back or will get a partial refund after a lengthy legal battle. On the other hand, transparency and communication with investors would generate space for productive negotiation, build investor confidence and ultimately may reduce the bond yield which will be in the interest of bondholders.

Even if investors were brought to the table, there is no guarantee that they would agree among themselves a deal that was acceptable to the Government. In Mozambique, a deal to refinance the Eurobonds was made with a committee made up of 50% of bondholders and approved by 75% of bondholders. In the case of Zambia, the bondholders may have competing demands depending on when and for what price they purchased the Eurobonds. If most of the original bonds have been offloaded on to the secondary market, which means those holding them bought them for below their original value, the return on their

Text Box II: Examples of Creditor Litigations

Argentina was taken to court by dozens of hedge funds who litigated for full repayment of its debt following its defaulting on US\$82 billion in 2001. The default was followed by a complex debt restructuring that included a settlement with about 92% of its bondholders and a long legal dispute with so-called “vulture funds” and other holdout creditors. The full resolution of the sovereign default took almost 15 years. A favourable court ruling for the investors in 2015 forced the Argentine government into a settlement of more than US\$10 billion.

The Republic of Congo was forced to pay on its default of 20 years in August 2017, when a creditor convinced a New York court to freeze a bond coupon payment to other bondholders. This development followed a 20-year legal dispute with creditors which had filed a variety of litigation attempts in the US, England and France.

Since 2017, crisis-plagued Venezuela has defaulted on most of its external and internal creditors. In August 2018, a judge in the U.S. authorised the seizure of Venezuelan assets to satisfy debts owed by Venezuela to a Canadian mining company. The U.S. court action followed a similar move in Curacao, a small Dutch Caribbean island, where more than 15% of Venezuela's crude exports were stored and refined before being sold to international customers.

Text Box III: Debt Restructuring

A sovereign debt restructuring is an exchange of outstanding sovereign debt instruments for new debt instruments or cash through a formal process. Debt restructuring usually involves relief for the debtor from the original terms and conditions of debt obligations it has entered into. This may be in response to liquidity issues, where the debtor does not have the cash to meet looming debt service payments, or sustainability issues, where the debtor is unlikely to be able to meet its debt obligations in the medium term.

There are generally two main elements in a debt restructuring: (i) debt reduction, and (ii) debt rescheduling or refinancing. Debt reduction is a reduction in the face (nominal) value of the old instruments. The reduction of the debt stock is considered when there are solvency concerns - where the country is no longer able to meet the present value of its debt obligations without indefinitely accumulating debt. This is debt forgiveness and does not apply to commercial debt such as Eurobonds.

Debt rescheduling and refinancing involve a change in an existing debt contract and replacement by a new debt contract, generally with lengthening of maturities of the old debt, preferably with lower interest rates and rescheduling the payment of arrears, if any. This is often done in situations of liquidity challenges – when a country's liquid assets and available financing are insufficient to meet or rollover its maturing obligations, but there are good prospects that market access will be restored. The difference between the two is that debt rescheduling involves rearrangements on the same type of instrument, with the same principal value and the same creditor as with the old debt, while debt refinancing entails a different debt instrument, generally at different value, and may be with a creditor different than that from the old debt. While debt restructuring is a broad concept that may include refinancing, it is typically done when a sovereign goes through some form of debt distress and usually involves debt holders taking a loss. Debt refinancing does not involve any losses but is just taking one loan to pay another.

Source: Nalishebo, S. & Halwampa, A (2015). A Cautionary Tale of Zambia's International Sovereign Bond Issuances: Zambia Institute for Policy Analysis and Research.

investment, if they were to receive the full repayment value, would therefore be much higher than the current interest rate of 5.375%. Given this option, investors could therefore be open to refinancing the Eurobond if it would reduce the risk of default while guaranteeing a positive return on investment.

The Government has three variables to negotiate with: the coupon rate (5.375%), the tenor (10 years) and the value of the bond (\$750m). A palatable refinancing deal for the Government would amend all three variables to relieve pressure on its finances, whilst still offering investors a positive rate of return. For example, if investors agreed to a new bond at the same coupon as the old bond, this would mean the Government would be giving investors new bonds to a value that is more than the current market price, but less than US\$100 for every US\$100 face value of bond that they hold (known as a 'principal haircut'). Alternatively, if the coupon rate were to be higher, the value of new bonds would be even lower to achieve the same result. The exact coupon and price would be the subject of negotiations between the Government and bondholders. It would also be necessary to agree a new redemption date. This could be a long process – perhaps too long given the precarious nature of the Zambian Government's position.

For the refinancing or debt restructuring options to be triggered, there would be need to look at the legal fine lines of the bond agreements. Most bondholder agreements are negotiated between the issuer and the lead underwriters. The structure of the bonds is one of the major determining factors in terms of refinancing especially if it has been sold to retail investors. Therefore, the main hindrance in this case is that the trading of the bonds occurs over the counter and no central agency registers the holders of bonds at each point in time. This would entail that it becomes imperative for the authorities intending to restructure to clearly identify the holders of bonds and initiate a form of dialogue with them, and also find out what the clauses say about Zambian Eurobonds say about bondholders.

The bondholder agreements may have clauses that empower the bondholders to form a committee to represent their interests with the issuer, so-called bondholder committees. Typically, this committee is formed by at least 50% of the bondholders, and provided that at least 25% of the bondholders do not

object to such an arrangement. To minimise opposition to the refinancing option and ensure a credible process, bondholders would have to be communicated to first, rather than them hearing about it in the media as was the case with the alleged "Turkey refinancing option". The Ministry of Finance, in response to the Turkey refinancing news, have hinted towards talking to bondholders first. This will reassure the bondholders who are presently seemingly nervous about their investments in the Zambian Eurobond market. Bondholders are usually sceptical of a refinancing proposal made by the issuer unilaterally.

4.3 Redeeming the Eurobond

Under this option, the Government would pay the Eurobond when it became due in September 2022. This would require the Government to have US\$750 million available upon maturity, so the main issue would be - where would these funds come from? Basically, there are four options to garner the funds: improving tax collections or other revenues; cuts to other spending; borrowing; or selling assets.

Improving collections from taxes would be the first point of call but however, could be a tall order. Presently, US\$750 million is the equivalent of about 3% of Zambian GDP. Given the subdued economic growth at present and in the medium term, the Government could not raise taxes by that amount in one year (i.e. in 2022). Similarly, spending on items other than debt servicing has already been squeezed and a further cut to provide funds to repay the Eurobond holders would be very difficult politically. Spreading the burden over three years (i.e. 2020, 2021 and 2022) and using the Sinking Fund that was talked about previously to accumulate the funds would make this idea a little more feasible, but still seems impracticable. This could have been an option if had been implemented earlier, but risks injuring the businesses that would be required to pay taxes and the services to be delivered to the people.

Cuts to other spending are already taking place with the soaring interest payments. Increased spending on debt servicing payments has crowded out critical spending including spending on social benefits (which include spending on pensions and social cash transfers) and empowerment programmes¹³. The inadequate funding to service provision has most likely caused a gradual degradation of human capital investments and has a negative bearing on human development.

Other forms of borrowing are available but would also be difficult. There are already signs of strain in the domestic debt market, with bond issues being undersubscribed and yields increasing. Bilateral lending might be a possibility, and it might be expected to be cheaper than any finance that would be available in the Eurobond market, but the Government already has substantial loans that come due in the next three years and these will need to be rolled over. Seeking another US\$750 million from this source may not be feasible. And even if it was, it would still be considerably more expensive than the current coupon on the 2022 Eurobond. It would therefore mean higher debt-servicing costs and more cuts in other government spending.

The Government could however pursue raising debt from small investors using mobile money platforms. The volume of transactions processed through the mobile money platform in 2016, increased by 60.9% to K102,971,002. The value also increased by 13.3% to K2.8 billion. By removing restrictive requirements for would-be-purchasers of government bonds such as a high minimum threshold (lowering the minimum value to purchase the bonds), removing the requirement of a bank account and making the interest very attractive (such as the 10% tax-free interest as is the case in Kenya), the Government could target raising a significant amount of the value of mobile money transactions. A target of, say, 25%, could potentially raise over K700 million in 2018¹⁴. Government could leverage on the existing infrastructure of the Lusaka Securities Exchange for the small investors to buy and sell these bonds via their smart phones or basic features phone. The coupon could be paid directly to the phone automatically on the maturity dates. However, this option may take time to establish because it may require a legal framework and time for sensitisation.

The better option, therefore, would appear to be asset sales. The Government could raise the required US\$750 million by selling state assets. Specifically, the Government could, for example, consider the offer by First Quantum Minerals to dispose of its 20% shares in Kansanshi Mine. However, this is not a costless option. The Government would permanently lose control of the asset and any future dividend payments on it. It may also be that the Government would be required to sell the asset at below its market value to ensure a successful sale in a short period of time, particularly if the asset is a large stake. Furthermore, because redeeming the Eurobond tackles only one aspect of Zambia's debt problem (paying back the debt), it may mean that the wider problem (higher debt servicing costs, rapid debt accumulation, etc.) still

13 Nalisho. S & Banda-Muleya. F (2018) Debt Servicing and the Delivery of Social Services – Mid-year review of the 2018 Budget. ZIPAR <http://zipar.org.zm/research/our-publications/working-papers/debt-servicing-and-the-delivery-of-social-services/file>

14 Nalisho. S & Banda-Muleya. F (2017) Scaling the Eurobond Debt Wall. ZIPAR <http://zipar.org.zm/research/our-publications/working-papers/scaling-the-eurobond-debt-wall/file>

goes unresolved. But if the Government wants to avoid default and refinancing is not practicable, it does not appear to have any other choice but to sell its assets.

4.4 Buying back the Eurobond

Debt buyback can be defined as the process of repurchasing own debt by a debtor at a price lower than the original price thus reducing both interest cost and the outstanding balance. Under this option, the Government would buy-back the Eurobond in the secondary market before its redemption date of September 2022.

If the Government chose to redeem the Eurobond in September 2022, it would have to find US\$750 million to do so. But the current market value of the Eurobond is only around US\$500 million. If the Government is not going to default or restructure the Eurobond, it would appear to make sense, therefore, for the Government to buyback the Eurobond before redemption.

Buying back the Eurobond early would rule out higher taxes and cuts in non-debt service spending as a funding option. And it would almost certainly rule out borrowing from elsewhere too, because there is no time for the Government to take the fiscal actions needed to bolster investor confidence and bring down the likely cost to a reasonable level. It would, therefore, have to follow the asset sale route, either raising sufficient funds immediately for a quick buyback or bringing in funds more gradually and buying bonds as and when extra funds come in.

The Bank of Zambia or a different agent would be given the responsibility of conducting the buyback operation, using funds provided to it by the Government. Initially, the buyback price would likely comprise the market price plus a premium to entice investors to sell.

Of course, once it became clear that the Government, or its agents, were buying the Eurobond, its price would increase. Because the current market price is building in a high possibility of a default; buybacks would signal that default was much less probable. So, although this is likely to prove to be a cheaper option than waiting till September 2022 and paying the full price, the gains would not be as great as implied by the gap between the current market price and the face value of the Eurobond unless undertaken secretly. As with the redemption option, buying back the Eurobond tackles only one aspect of Zambia's debt problems and is far from a comprehensive solution. But it appears to be the best course of action for a government that has no attractive next move available to it.

5 Weighing the options

The possibility of a default calls for a serious consideration of the options offered above as there are no easy options. Rolling over the debt is probably not possible, and it would be extremely expensive. Refinancing the bond which is held by several investors requires a mechanism by which they can be brought together to agree to the restructuring. This maybe a complicated exercise and there may not be enough time to execute this. So, the available options are either redemption or an early buyback. In either case, the best source of funds is asset sales, though these are not without issues.

Asset sales may be undertaken through an outright sale or alternatively through debt capitalisation. The latter is an arrangement where a shareholder converts debt instruments into shares. The capitalisation of debt in exchange for the issuance of shares is a common occurrence internationally. The Zambian Government has a significant and varied portfolio of financial assets and a range of public sector bodies have a role in managing these assets on behalf of the Government. For example, the Industrial Development Corporation (IDC), with an asset portfolio in excess of US\$8 billion, represents a potentially significant source of funds for the Government.

The IDC is an investment holding company owned by the Government of the Republic of Zambia. Incorporated in 2014, IDC was established to create and maximise long-term shareholder value as an active investor and shareholder of state-owned enterprises (SOEs). The IDC's portfolio is two-fold: it

includes 28 entities where IDC is the majority shareholder – the SOEs, and 5 entities where IDC is the minority shareholder – the investee companies. Table 2 shows the SOEs and investees, with their respective activities and shareholding structure. To buy into this option, investors would have to be convinced about the viability of the companies in which they are to get shares. They can only get that assurance if the said companies were listed on the local securities exchange. Turning the companies around to make them investable could take a long time.

Table 2: SOEs and investees, with their respective activities and shareholding structure

Sector	Company	Portfolio type	Activities	Ownership structure
Agriculture	Nanga Farms	Investee	Sugar cane	Zambia Sugar 85.7% IDC 14.3%
	Zambia Forestry & Forest Industries Corporation	SOE	Tea, pine & eucalyptus, treated poles	
Education	NIEC School of Business Management	SOE		
Energy	Afrox	Investee	Gases & welding products	Linde Group 70% IDC 30%
	INDENI	SOE	Crude petroleum refinery	
	ZESCO	SOE	Electricity	IDC 100%
Financial Services	Indo-Zambia	Investee		IDC Ministry of Finance Bank of Baroda Bank of India Central Bank of India
	Zambia State Insurance Corporation	SOE		IDC 100%
	ZANACO	Investee		Rabo Intl. Advisory Services 45.6% IDC 25% NAPSA 8.9% Other 20.5%
Infrastructure	Engineering Services Corporation SOE			
Manufacturing	Lusaka South Multi-Facility Economic Zone	SOE		
	Mulungushi Textiles	SOE		
	Mupepetwe Development Company	SOE		
	Nitrogen Chemicals	SOE		
	Zamcapitol Enterprises	SOE		
Medical	Lusaka Trust Hospital	SOE		
	Medical Stores	SOE		
Mining	Kagem Minerals	Investee	Gemstone mining	Gemfields 75% IDC 25%
	Kariba Minerals	SOE		Gemfields 50% ZCCM-IH 50%
	ZCCM-IH	SOE		IDC 60.3% Ministry of Finance 17.3% NAPSA 15% Other 7.4%
Real Estate	Mulungushi Village Complex	SOE	Real estate and hospitality	100% IDC

Sector	Company	Portfolio type	Activities	Ownership structure
Information and Communication	Times Printpak	SOE	National daily newspaper	
	Zambia Daily Mail	SOE	National daily newspaper	
	Zambia Printing Company	SOE		
	Zamtel	SOE		
Tourism	Mukuba Hotel	SOE		
	Mulungushi International Conference Centre	SOE		
	Zambia International Trade Fair	SOE		
Transport and Logistics	Mpulungu Harbour Corporation	SOE		
	Zambia Railways	SOE		

Of the IDC's portfolio, only ZCCM-IH is presently listed on the Lusaka Stock Exchange. IDC has a 60% stake in ZCCM-IH which in turn has significant shareholding in various mines including a 20.6% stake in KCM; 20% each in Kansanshi, CNMC Luanshya Copper Mines, Lubambe Mine; 15% each in NFC Africa Mining and Chibuluma Mines; and 10% each in Chambishi and Mopane Copper Mines.

A better option will be the direct sale of shares in some of the mines in which ZCCM-IH has stakes. Examples abound regarding the buying and selling of shares in the mines – Zambia's chief resource. In September 2019, media reports showed that China-based Jiangxi Copper Company Limited bought a stake of almost 10% in First Quantum Minerals on the secondary market. According to some analysts, a minority stake in First Quantum's assets could fetch about US\$2 billion¹⁵. ZCCM-IH, which had previously acquired a minority 2.2% stake worth US\$30 million in Lumwana from Australia's Equinox Minerals Ltd (the first owners) in 2006, sold off its stake in the mine for US\$167.5 million in 2011 when Lumwana was taken over by Barrick Gold¹⁶.

In February 2019, media reports revealed that FQM had made an unsolicited offer to the Zambian Government to buy off ZCCM-IH's shares in FQM's Kansanshi mine for about US\$700 million¹⁷. Currently, Kansanshi Mine is the largest Copper mine in Africa which has capacity of 350,000 metric tonnes of copper and over 120,000 ounces of Gold per annum. If ZCCM-IH sold its 20% stake in Kansanshi, the sale would require it to report to the Lusaka Stock Exchange and a commission paid as Kansanshi is on the LuSE Quoted Tier and its shares registered with the Securities and Exchange Commission (SEC).

Following FQM's offer, there has been a welling up of negative sentiment regarding this issue. The Ministry of Finance confirmed receiving multiple unsolicited offers, including from FQM, for the Government to sell off their shares in ZCCM-IH. But they cautiously advised that such a move would have to be approved by Cabinet. The Ministry of Mines were more categorical in stating that they would not entertain FQM's offer to buy off ZCCM-IH's minority shareholding in Kansanshi. They further indicated the Government's intention "to continue to have a stake in various mining houses, if not to increase so that we own this in trust of the people of Zambia"¹⁸.

An extractive resources watchdog, the Southern African Resource Watch, is opposed to the sale of the 20% shares in Kansanshi, as it departs from the aspirations of the African Mining Vision which encourages African countries to increase state participation¹⁹. An undisclosed source contends that FQM's offer to buy

15 <https://af.reuters.com/article/idAFKBN1W90ZR-OZABS>

16 <http://gold.1prime.biz/bulletin/mmining20110606.pdf>

17 <https://diggers.news/business/2019/02/06/fqm-offers-to-buy-govts-20-shares-in-kansanshi-mine-for-700m/>

18 <https://diggers.news/business/2019/02/20/govt-wont-entertain-fqms-offer-to-buy-shares-in-kansanshi-musukwa/>

19 <https://www.lusakatimes.com/2019/02/12/dont-sell-zccm-ih-shares-sarwatch-pleads-with-zambian-govt/>

the Zambian Government's stake in Kansanshi mine was illegal as no cautionary notices were issued on either the Lusaka Securities Exchange where ZCCM-IH is listed and the London Stock Exchange and the Toronto Stock Exchange where FQM is listed²⁰. Further, the Mineworkers Union of Zambia urged Cabinet to reject the unsolicited offer by FQM²¹.

However, if the sale of government assets is crafted properly, and implemented, it offers an alternative to the current liquidity problems that the country is facing. While the decision to offload some or all the stake could be unpopular and risky, given the public's sentimentalism over national assets, the Government could consider this option but tread carefully to ensure its success. A major plus would be to reel in support from various quarters as stakeholder support or resistance could make or break any opportunity for asset sales. It would be important to anticipate and carefully manage opposition from within government ranks, civil society, labour unions and special-interest groups.

6 Conclusions and recommendations

Over the last few years, the Government's efforts to reduce the country's infrastructure gaps, poverty and developmental inequalities, made it incur large spending overruns in the face of low and flat domestic revenues. So, the Government resorted to massive external borrowing to finance its projects, including issuing three Eurobonds worth US\$3 billion. Commercial debt now accounts for the largest share of the external debt portfolio. Unlike the traditional concessional borrowing, Eurobonds came with significant rollover, refinancing and exchange rate risks due to their structure and repayment terms.

With less than three years before the maturity of the debut Eurobond, the possibility of a default looms ominously on the horizon. This is because the country is presently undergoing a fragile macroeconomic environment. This has made bondholders nervous about getting their money back. Investor confidence is low due to, among other things, the presently high gross external financing requirements, downgrading of the sovereign credit rating, weakening Kwacha and the lack of medium-term plans. The Government has to meet several pre-conditions to win back the market confidence. These include undertaking credible fiscal consolidation measures and clinching a credit facility deal with the IMF.

The fiscal position of the country needs to be adjusted and slowdown the pace of debt accumulation. Government should continue strengthening domestic revenue mobilisation and contain expensive capital spending, which is presently the biggest source of higher than planned expenditure. In this regard, the implementation of the austerity measures is cardinal at a point like this in order to move back to moderate risk of distress.

The Government should court the IMF and seek a bailout package which has affordable and sizeable financing. Currently, Zambia is entitled to US\$1.3 billion as IMF support of free interest financing. Utilizing this funding toward external debt servicing would secure fiscal space for Zambia to maintain spending on social protection and infrastructure programmes, thus smoothening the recovery. In addition, the facility could also help to amortize as much of the external debt as possible by replacing the expensive loans with cheaper ones.

At all costs, Zambia should avoid a default. Default should only be considered if the economic and financial situation deteriorates to unsustainable levels. The short-term and long-term costs of defaulting are immense and would be catastrophic for the ordinary Zambians. We proffer several options for dealing with the three Eurobonds due to mature during 2022-2027, and particularly the debut US\$750 million Eurobond which matures in September 2022.

- a) **Rolling over:** If it can find new buyers for a new Eurobond, the Government would aim to issue another Eurobond in September 2022 with a total value of US\$750 million and use the money raised to pay the holders of the current Eurobond. With current debt sustainability levels, this is

20 <https://www.themastonline.com/2019/02/07/fqm-offer-to-buy-govt-stake-in-kansanshi-contravenes-stock-exchange-rules-source/>

21 <https://tiozambia.com/muz-urges-govt-to-reject-fqms-unsolicited-bid-to-buy-out-zccm-ih/>

not an option that the Government should be considering. At worst, it is unfeasible; at best it is extremely expensive.

- b) Refinancing:** Under this option, the Government would seek to change the terms of the 2022 Eurobond, including crucially extending its duration so that it does not have to be redeemed in September 2022. This could be very length as it would mean negotiating with a wider range of players, and could be a long process – perhaps too long given the precarious nature of the Zambian Government’s position. As a first step Zambia needs to establish who holds the country’s bonds and understand their priorities before entering any negotiations.
- c) Redeeming:** Under this option, the Government would redeem the Eurobond when it became due in September 2022. This requires the Government to have US\$750 million available at the time, so the main issue is where these funds would come from. Basically, there are four options: higher taxes or other revenues; cuts to other spending; borrowing; or selling assets. The sale of assets seems to be the most viable of the four options, but it is not a costless option. The Government would permanently lose control of the asset and any future dividend payments on it. The Government may also have to sell the asset at below its market value to ensure a successful sale in a short period of time, particularly if the asset is a large stake.
- d) Bond buyback:** If the Government chose to redeem the Eurobond in September 2022, it would have to find US\$750 million to do so. But the current market value of the Eurobond is only around US\$500 million. Should the Government choose not to default or refinance the Eurobond, it would appear to make sense, therefore, for the Government to buyback the Eurobond before redemption. But with no sufficient alternative sources of financing, the buyback may have to be financed by the sale of assets.

Of all these options, redeeming of the Eurobond through bond buyback using money raised from the sale of assets seems to be the most viable option. The Government has a significant and varied portfolio of financial assets and a range of public sector bodies have a role in managing these assets on behalf of the Government. The Industrial Development Corporation (IDC), with an asset portfolio in excess of US\$8 billion, represents a potentially significant source of funds for the Government. IDC has a 60% stake in ZCCM-IH which in turn has significant shareholding in various mines. Offloading some shares in Kansanshi, for example, could go a long way in redeeming the first Eurobond.

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