KCS Group Europe

Debt distress in emerging markets

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The financial status of some emerging markets is becoming deeply concerning, brought on not only by the fallout from the global pandemic but also as a result of escalating tensions between global superpowers Russia, China and the US. These conditions are exacerbating the debt crisis, causing many countries to default on national debt repayments.

For multinational corporations (MNCs), this creates both chaos and opportunity. Initially, the pandemic severely affected economic trade, leading to a significant reduction in revenue and growing fiscal deficits in countries that were already struggling with large debt burdens. The situation has been made worse by the involvement of major economies operating in these regions, all looking to gain an advantage, and this, more often than not, has resulted in shifting trade alliances.

Impact of COVID-19 on emerging market debt

Step back to 23 March 2020, when COVID-19 caused lockdowns in the UK and spread earnestly across the globe; the effects, like shockwaves, hit emerging markets where they exacerbated existing financial concerns. The pandemic drastically disrupted global economies, resulting in low-income streams and rising financial pressures. For Zambia and Sri Lanka, this disaster deepened pre-existing debt issues, moving them ever closer to financial insolvency.

Foreign direct investment (FDI), a vital source of capital for development and debt management in these regions, went into freefall. The ensuing belt-tightening has forced countries to rethink their economic approaches and desperately seek new funding sources, sadly under less favourable terms. For executives and strategists working for MNCs, acknowledging these changes is crucial.

Such contractions of activity in these markets have repercussions not just locally but also across global supply chains and investment opportunities.

Geopolitical tensions and economic implications

In terms of global finance, the ongoing sabre-rattling between superpowers - Russia, China and the US - plays a role in the debt of emerging markets. The exchange in geopolitical blows has resulted in economic sanctions, trade barriers and revisions to foreign policy which indirectly affect the stability of more vulnerable economies. For example, friction seen between the US and China over trade policies has disrupted markets, causing an unpredictable environment for debt repayments and foreign investments in regions that rely heavily on these economic heavyweights.

Case studies: Zambia, Sri Lanka, Ghana and Ethiopia

Zambia: crisis, restructuring and recovery efforts

Zambia, a beacon of stability in Africa historically, has experienced a significant economic downturn due to its excessive borrowing habits and an over-reliance on copper, which remains its primary economic driver. This situation was highlighted when Zambia defaulted on a US$42 million bond payment in November 2020, marking it as the first African nation to default in the post-pandemic period. This financial misstep was driven by several factors, including an overwhelming external debt load fuelled by Chinese-funded infrastructure projects and a decline in copper prices, which has dramatically affected government revenues.

In response to these challenges, Zambia has initiated negotiations with creditors to restructure its substantial external debt, which is approximately US$12 billion. This restructuring includes US$3 billion in Eurobonds and significant debts owed to Chinese entities. Moreover, the economic downturn has severely impaired the nation's tax collection capabilities, further complicating the government's ability to fulfil its financial obligations and recover from its fiscal crisis.

Sri Lanka: economic turmoil and restructuring efforts

Sri Lanka's economic turmoil has intensified due to mismanagement of sovereign bonds, rampant borrowing and persistent fiscal deficits. These issues were exacerbated during the pandemic as tourism, a crucial source of foreign income for the island, saw a significant decline. The economic woes of Sri Lanka are heavily tied to its large-scale borrowing from China, which has been funnelled into major infrastructure projects such as land development, airports and highways. A notable instance of this is the Hambantota Port development, financed by China, where Sri Lanka was compelled to lease the port back to China for 99 years.

The country is also grappling with a severe foreign currency crisis, leading the government to negotiate the restructuring of US$12.5 billion in sovereign bonds as a measure to stabilise the economy. Compounding these economic difficulties is an unstable government and widespread fiscal mismanagement, which have sparked civil unrest, further obstructing the nation's path to recovery.

Ghana: navigating through fiscal challenges

Ghana's financial predicament is marked by substantial public debt and eroding trust with bondholders, casting this West African nation under intense scrutiny from investors concerned about transparency and the feasibility of its debt servicing strategies. Ghana has secured financing from China for several infrastructure projects, including the construction of roads, bridges and interchanges. While the exact magnitude of the debt owed to China remains unclear, it is significant enough to warrant consideration in discussions about the country's debt sustainability.

Complications in debt negotiations have sparked concerns about Ghana's capability to fulfil its financial commitments, suggesting that intense restructuring or possibly a bailout may be necessary. The crisis level of public debt, further inflamed by expansive fiscal policies and sluggish economic growth, underscores the urgent need for a more sustainable financial strategy to navigate these challenges.

Ethiopia: balancing development and debt

Ethiopia's ambitious economic growth strategy has been overshadowed by escalating debt levels made worse as a result of aggressive infrastructure spending supported by external borrowing. The country's engagement in large-scale projects, such as hydropower developments, has strained its fiscal resources.

Ethiopia has established a significant partnership with China, channelling borrowed funds into extensive infrastructure projects including roads, dams and manufacturing sites. These loans from China have been pivotal to Ethiopia's ambitious development plans but have also contributed significantly to its debt burden. This has led to Ethiopia seeking debt restructuring under the G20 Common Framework to address its fiscal challenges.

Additionally, the implementation of IMF and World Bank-backed reforms has had mixed impacts. While these reforms have provided necessary financial support, they have also necessitated tough economic adjustments for the public, including increased taxes and reduced spending, further complicating the nation's economic landscape.

Russia’s activities in terms of fiscal support to these countries is less significant compared to China. Moscow has historically not acted as a major lender; most of its involvement in regions like Africa has been through facilitating its own development interests in natural resources and energy as opposed to loans.

The debt these countries have with China identifies a greater trend of Chinese financing playing an important role in emerging market development strategies. This raises questions surrounding debt sustainability over economic sovereignty and the uninvited compromises and sacrifices it brings.

Conclusion: Strategic recommendations

In summary, it is evident that the combination of the global health crisis, geopolitical tension, economic policy reforms, over-ambition, excessive borrowing and mismanagement has significantly handicapped the fiscal abilities of these regions.

For executives, the takeaway is clear: strong engagement with emerging markets requires a proactive approach to understanding local conditions and global influences. Doing so will better mitigate risks and maximise potential for growth in these volatile but important markets.

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