Economic Recession and Risk of Debt Distress

by

Ms. Alice Konga
Senior Economist
Bank of Zambia

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD
INTRODUCTION

- The world has undergone tremendous economic and financial shock as a result of the global financial crisis.

- Globally trade and output contracted sharply particularly in the fourth quarter of 2008 and first quarter of 2009.

- Projections suggest global growth contraction of 1.4% in 2009 and recovery to 2.5% in 2010.

- Growth in Sub-Saharan Africa is projected to decelerate to 1.5% in 2009 from 5.5% recorded in 2008.
However there is evidence that the worst may be over with the United States and Europe showing signs of growth in output and other leading indicators.

Important Euro Area economies such as Germany and France have posted positive GDP growth in the second quarter of 2009.

Increase in production output and broad based recovery in commodity prices suggests that the global economy is on a recovery path.
Impact of the Global Financial Crisis on Africa

- Reduction of fiscal space leading to challenges in implementation of critical investment expenditures.

- IMF estimates a drop of budget surpluses from 2.8% of GDP in 2008 to deficits of 5.4% of GDP in 2009 across both oil and non-oil commodity exporters.

- There has been a marked slow-down in real GDP from an estimated 5.5% in 2008 to a projected 1.5% in 2009 and the projected growth of 4.1% in 2010 is less than the minimum 7% growth required to achieve the MDGs by 2015.
Foreign Direct Investment Flows and commercial lines of credit have been negatively impacted.

For example FDI inflows to Africa are projected to fall by 18% in 2009 from the 2008 inflows.

African countries have had difficulties in raising long term financing in international markets. An example is the Ghana telecom bond issue of US $300 m which did not materialize.

Eurobond issues for Kenya, Nigeria, Tanzania and Uganda have also been delayed.
Impact of the Global Financial Crisis on Africa (cont.)

- Overall effect on Africa has been a drop in budget balance from a surplus of 2.8% of GDP in 2008 to a deficit of 5.4% of GDP in 2009. A decline in government revenues.

- Deterioration in current account balance. Foreign Direct Investment Flows and commercial lines of credit have been negatively impacted.

- For example, FDI inflows to Africa are projected to fall by 18% in 2009 from the 2008 inflows.
Impact of the Global Recession on Zambia

With regard to Zambia, Government revenues during the first half of 2009 were 25% below projections in the 2009 budget as a result of reduced tax revenues from the major export (copper).

Non resident holdings of Treasury Bills declined from 16% of outstanding bills in September 2008 to almost nil by end March 2009 due to the negative portfolio inflows resulting from the financial crisis.

Foreign Direct Investment Flows and commercial lines of credit have been negatively impacted.
Impact of the Global Recession on Zambia (cont.)

- Slow down in domestic credit growth during the first half of 2009 to 2.4% compared to an increase of 36% in the second half of 2008.
- In the external sector, total export receipts for the first half of 2009 declined by 37.8% compared with the same period in 2008.
- There was a sharp contraction of the trade balance mainly on account of reduced metal prices on the international market.
- Job losses in especially in the mining industry.
- Depreciation of the domestic currency by 60%.
The response from the G20 in mobilising resources to address liquidity and fiscal challenges for developing countries and Africa in particular is commendable.

A significant amount of these funds have been channeled through multilateral institutions such as IMF.

Zambia for example has taken advantage of these resources and has received US $627 million SDR allocation from the IMF in August 2009.

Further, Zambia has been able to draw on its PRGF resources to compensate for revenue shortfalls.

Confidence in the banking system with registration of 5 new banks
The risk of debt distress has greatly reduced for countries such as Zambia following the post HIPC/MDRI as the debt to GDP ratio dropped to below 30% in 2006 and was 24% in 2008.

However, this perspective had created borrowing space in many low income countries with the potential for re-accumulation of unsustainable debt.

This is because development challenges remain since there is need to fund large investment projects.

However, countries face macroeconomic vulnerabilities due to a variety of shocks as a result of the global crisis.
Possibility of Debt Distress (cont.)

- The global crisis has negatively affected the availability of resources to service public debt as revenues have declined.

- Kwacha depreciation has also affected the burden of debt servicing.

- Cost of borrowing has increased as witnessed by higher interest rates.
Zambia’s interest rate risk is related to the short term maturity structure of the domestic debt.

Meanwhile the currency risk is on the external debt as it could lead to an increase in the debt to GDP ratio following depreciation of the Kwacha.

Use of the Medium Term Debt Strategy (MTDS) tool for cost/risk analysis.
Zambia’s debt management policy and strategy is to ensure debt sustainability.

- Improve risk management (interest rate and currency risks).
- Support development and deepening of financial markets.
- Facilitate effective coordination between monetary, fiscal and debt policies.
In conclusion, there is need for countries like Zambia to pursue and sustain sound macroeconomic and prudent fiscal policies which will quickly reverse the negative effects of the global economic recession.

This would improve the debt servicing abilities since resources are still needed by countries for investment expenditures.

High growth rates are necessary for poverty reduction.

Need to promote regional integration in order to provide a wider market.
Lastly, do visit Zambia and enjoy one of the seven natural wonders of the world, the Victoria Falls.

Thank you!