Trip Notes

Southern Africa Policymaker Meetings

View from Johannesburg Airport

Aktia

Southern Africa Policymaker Meetings

- Countries visited: Angola and Zambia
- We visited Luanda and Lusaka spending two days in each city in early February. We met with representatives of governments, central banks, regulators, state-owned enterprises, supranational organisations, international financial institutions, embassies, and local businesses.
- Angola's investment story continues to be only about oil. There have been challenges to maintain the level of oil production, but the encouraging growth of the non-oil sector has had a positive impact on fiscals. However, starting from low levels it will take a long time to diversify Angola's economy. There is an urgency for Angola to diversify its economy and create jobs to its people in the world that is heading to decarbonisation.
- Zambia was full of optimism and anticipation for the great future. The New Dawn Government led by President Hakainde Hichilema is committed to reforms with the IMF support. The economy's backbone is copper production, but opportunities exist also in other sectors like in agriculture value chain. The main issue to overcome is energy production to provide reliable electricity supply. However, the most pressing issue is to reach an agreement on external debt restructuring.

View from the Bank of Zambia

Overview

Both countries are very dependent on commodity exports – Angola on oil and Zambia on copper. But Zambia has a more diversified economy with its own agricultural production to feed its people whereas Angola imports about half of its food. The upcoming green transition also requires metals which Zambia has in abundance whereas Angola's oil sector will eventually lose out when economies finally shift away from fossil fuels. Before that happens, Angola must succeed in diversifying its economy on a larger scale. Both countries have been struggling to sustain current production levels of their most important commodities.

Both countries also have very young populations: in 2021 nearly 48% were under the age of 15 in Angola and 47% in Zambia according to World Bank data. Both are struggling with high youth unemployment with more than a fifth of young people unemployed in both countries. In addition, both countries' governments are facing an increasingly growing need to create jobs, because both countries' populations are growing annually at fast paces of 3.2% in Angola and 2.8% in Zambia. Angola's population is 34.5 million and Zambia's is nearly 19.5 million.

Another common denominator in these countries is the large amount of Chinese debt. Angola, the largest African debtor to China, owes China around USD 20 billion which accounts for over 40% of Angola's external debt. Zambia owes China USD 6 billion accounting some 20% of its external debt. Sub-Saharan Africa is of importance to China due to its vast natural resources and Chinese companies are very active on the continent.

In Zambia, sentiment on the ground was optimistic and in anticipation of the future with the new government unlocking the country's potential, whereas in Angola sentiment was more mixed and uncertain regarding whether the government will improve people's lives during their second term. Both countries have potential, but a lot of work and commitment to structural reforms is required from their governments to make a lasting change and keep their people, especially the youth, content.

Angola

Angola's investment story continues to be only about oil. The economy lacks diversification which makes it vulnerable to volatility in oil price. The strong rebound in global oil prices following the initial Covid-shock has saved Angola's finances and brought Angola to a relatively strong position. There have been challenges to maintain the level of oil production, but the encouraging growth of the non-oil sector has had a positive impact on fiscals. Reforms were initiated under the three-year IMF program which was approved in December 2018. For this year the government is expecting economic growth of 3.3% that is in line with IMF's projection for real GDP growth of 3.4%. The most recent annual inflation figure published stood at 12.55% in January and the government is expecting inflation to ease to 11.1% while the IMF is projecting inflation to stay slightly higher at 11.8% in 2023.

The share of non-oil sector growth has been increasing from its very low levels. The government was elected for its second tenure in last August's elections and has continued its reform initiatives in increasing the share of the non-oil sector. Importance of developing the agriculture sector is understood by the government and many of the initiatives are targeted towards it through various projects. Angola would be able to feed its own people as of today practically everything is imported. Food accounts for 55% of the weight of the consumer price index (CPI) basket. Agriculture would also generate desperately needed jobs in a country that is struggling with high unemployment. Diversifying Angola's economy will probably take a longer time than the current government's tenure, because infrastructure and other needed formal structures are still missing.

Angola's oil production was at record levels in 2008 when production was 1.9 barrels of oil per day. Since then, production has been in decline. In 2018 Angola produced oil at a rate of about 1 million barrels day. The regulator ANPG (Agencia Nacional de Petroleo, Gas e Biocombustiveis) was established in 2019 and was separated from the Angolan state-owned oil company, Sonangol, with the main goal being to stop the decline in oil production. In 2022 production was above 1.4 million barrel and expected production for this year is 1.18 million barrels per day. The government's budget.

Key Macroeconomic Indicators for Angola	2019	2020	2021	2022F	2023F	2024F
Real GDP (%, end of period)	-0.7%	-5.8%	0.8%	2.9%	3.4%	3.9%
Inflation (%, end of period)	17.1%	22.3%	25.8%	21.7%	11.8%	9.9%
GDP per Capita (current prices USD)	2805	1873	2352	3791	3998	4071
Current Account Balance (% of GDP)	6.1%	1.5%	11.2%	11.3%	5.1%	2.6%
General Gov. Financial Balance (% of GDP)	6.4%	4.9%	8.2%	6.6%	3.9%	3.8%
General Government Gross Debt (% of GDP)	113.6%	136.5%	103.7%	90.8%	83.3%	75.7%
Population (million)	30128	31031	31962	32921	33909	34926
Population growth	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

Source: IMF October 2022

Angola

for this year is set at an average oil price of USD 75 per barrel. The aim is to sustain production of above 1 million barrels per day and the hope is that new explorations will increase the figure further. The oil sector is expected to attract foreign direct investment (FDI) inflows of USD 5-6 billion this year. However, Angola's net FDI figures have been negative for the past few years and non-oil FDI flows have been negligible. There have been oil explorations in several African countries in recent years and competition for investments from international companies has increased.

Angola is a country of great inequalities with a small number of super-rich people benefitting from oil wealth while over 30% of population lives in poverty. The middle class is very small which does not bode well for the country's economy in the long run. Angola's capital city, Luanda, is one of the most expensive cities in the world, with about 9 million people living in the metropolitan area. The ruling People's Movement for the Liberation of Angola (MPLA), which has governed the nation since the independence in 1975, lost ground in August elections specifically in the capital area which has been its stronghold. People are increasingly discontent with rising living costs, weak growth, unemployment, and corruption. The opposition is gaining popularity and is expected to win next elections in 2027. The political pressure is building up on the current government to deliver to the Angolan people and keeping voters happy rather than spending time on recovering the assets stolen during the previous administration of José Eduardo dos Santos.

One politically very sensitive issue has to do with fuel subsidies. Angola spends USD 2-3 billion annually to support fossil fuels. The World Bank and IMF are advocating for the removal of subsidies and are assisting Angola's government with analysing the social impact of the removal of subsidies and providing mitigation management. It is estimated that targeting the vulnerable part of the population with a cash transfer program rather than providing subsidies to all people would annually cost only USD 300-400 million which is considerably less than current subsidies. The challenge is in identifying the most vulnerable people and the having the subsidies reach these people.

Luanda boat pier

Angola

A lot of the discussion were around Angola's declining debt-to-GDP levels and questions on how this was financed as it is difficult to reconcile the current account surplus with the foreign exchange reserves. In the past Angola has had a severe debt problem (total debt-to-GDP 135% in 2020), but at the end of last year the debt level was announced to have fallen below 60% of GDP. Obviously, this is a positive achievement which is expected to continue further should oil prices stay at elevated levels, but the absolute external debt level has not really decreased. Also, the lack of transparency around collateralised debt from China raised questions which could not be answered due to non-disclosure agreements. Apparently, there is an offshore escrow account on which US dollars are deposited to assist in managing servicing Chinese debt if oil prices are higher than a certain threshold level. Furthermore, funds on the offshore account are not calculated in FX reserves. The escrow account had USD 3.5 billion at the end of 2022 and the starting balance for the year was USD 1.5 billion which is pledged. The impression was also made that China is currently not granting new loans to Angola. Regarding Angola's other borrowing plans, the current market environment is not friendly for new Eurobond issuance, so other avenues will be studied until timing is better to enter the Eurobond market. The last program with the IMF was successfully concluded in 2021 and for now Angola does not need IMF financing.

Over 80% of Angola's debt is external and the rest is from the domestic bond market which mostly is composed of domestic banks. Foreign portfolio investors cannot directly participate in Angola's public bond markets. Last year we heard that some foreign investors have been able to invest in Angola's local currency markets, but it turned out that it is through structured notes of an international bank. Angola has moved to a floating exchange rate regime, and they will need to diversify the investor base, but there must be certainty for the authorities' ability to manage swings in foreign portfolio investors' flows. Eventually, foreign portfolio investors will be able to invest directly to Angolan local market, but it will still take some years. Moreover, as an investor, one wants to also know ways to reliably repatriate funds when you want to exit the market. Also, institutional development has not yet reached a level that would make foreign investors comfortable investing locally.

There is an urgency for Angola to diversify its economy and create jobs to its people in the world that eventually is heading to decarbonisation. Then it will be hard for an oil producer and even though Angola has managed to stabilise oil production in the medium term, there will probably be decline in the long term.

View: Currently we are invested in Angola through non-deliverable forwards in our local currency frontier strategy. We have positions in USD bonds in our hard currency strategy as we believe Angola has potential relative to its peers.

Zambia

The people of Zambia voted for change in the elections of August 2021, as the opposition United Party for National Development (UPND) led by President Hakainde Hichilema won. The New Dawn Government embarked on reforms and engaged with the IMF and sounds like it still is very much committed to change. In our meetings there was a lot of optimism and positivity as everyone is anticipating change after five years of rule under former, increasingly authoritarian President Edgar Lungu and his Patriotic Front.

Zambia defaulted on its Eurobonds during the COVID-19 pandemic in 2020 and people were getting angry with the state of the country's economy after years of mismanagement and high unemployment. Many reforms have already started during the past one and half years of five-year term, but there is still a lot to do. It remains to be seen whether the Zambian people have patience to wait or whether reform fatigue will hit and discontent with the government will take place after the honeymoon period is soon over. Delays in debt restructuring has increased uncertainty in financial markets and put the Zambian kwacha under pressure. The central bank, Bank of Zambia, is expecting the annual inflation rate to increase to 11.1% this year. The painful impacts of reforms, such as removing subsidies, are influencing ordinary people, but reforms are necessary to get the economy functioning and levelling the playing field for businesses.

The government has started carrying out reforms by fighting corruption and enhancing social spending like providing free primary and secondary education which is setting a platform for future growth. Zambia's previous government was riddled with rampant corruption, so much so that it became endemic in the system. The new government has started to combat corruption and, for example, set up a fast-track court, but there are no convictions so far. The removal of subsidies has started with subsidies on fuel so far, but the removal of subsidies on electricity and agriculture are still ahead that will be politically very difficult to deliver and will push prices further.

Key Macroeconomic Indicators for Zambia	2019	2020	2021	2022F	2023F	2024F
Real GDP (%, end of period)	1.4%	-2.8%	4.6%	2.9%	4.0%	4.2%
Inflation (%, end of period)	9.2%	15.7%	22.0%	12.5%	9.5%	7.7%
GDP per Capita (current prices USD)	1272	959	1095	1348	1395	1457
Current Account Balance (% of GDP)	1.4%	12.0%	7.6%	-1.8%	-3.7%	-0.7%
General Gov. Financial Balance (% of GDP)	-2.5%	-7.8%	-2.1%	-1.8%	-1.8%	-0.6%
General Government Gross Debt (% of GDP)	97.4%	128.7%	101.0%	106.8%	109.2%	110.3%
Population (million)	18321	18882	19456	20043	20643	21259
Population growth	3.1%	3.1%	3.0%	3.0%	3.0%	3.0%

Source: IMF October 2022

Zambia

Copper production is the corner stone of Zambia's economy and a major source of foreign exchange. The new government has set a very ambitious target for increasing annual copper production to 3 million metric tons by 2030 from the current level of around 800,000. The IMF is expecting a conservative 50,000 annual increase in copper production. Reaching the government's target would require significant improvements in energy production as Zambia has been troubled with loadshedding (interruptions of electricity supply) starting from late last year until now. Other industries will require reliable energy, too. The most promising sectors are energy, agriculture, and telecom. A lot of expectations are especially loaded on the agricultural value chain. Most foreign direct investments in Zambia flow to mining sector. There is demand for additional copper in the world that is moving towards a green transformation, and, for example, electronic vehicles require these metals. The main issue Zambia must overcome to boost its economy is energy production which will require transforming Zambia's largest electricity company, the state-owned company ZESCO.

The most pressing issue is to restructure USD 17 billion worth of external debt in which Zambia's official and private creditors are still trying to reach an agreement. Last July Zambia's creditors gave financial assurances prior to the IMF's USD 1.4 billion deal with Zambia, conditional to a debt reduction that the IMF deems would make debt sustainable. Zambia agreed to carry out debt restructuring multilaterally through the G20 Common Framework, although China was willing to do this bilaterally and had already started negotiations with the previous government. The idea of the G20 Common Framework is to give equal treatment to different creditors. China is new to the process and, therefore, asking questions which has prolonged negotiations. China's debt, amounting to USD 6 billion, is also complex consisting of several different Chinese lenders. Furthermore, the outcome of Zambia's negotiations will set a precedent for future Chinese debt restructurings and, China being a large lender for several other frontier markets, it is very important for China to get it right. However, in the end it must be believed that China is willing to find a resolution as it has significant economic interests in Zambia and elsewhere in the continent and needs natural resources. Everyone is expecting creditors to reach the agreement by end of March when the IMF releases an updated debt sustainability analysis (DSA) on Zambia. However, that might still be too tight of a timeline to get all the creditors on board.

Zambia

The Zambian government has been adamant on not including domestic debt to be part of debt restructuring, although China is questioning why non-resident bond holders should be exempt. China is also publicly questioning why multilaterals should not take a haircut. The inclusion of domestic debt would also have a devastating effect on Zambia's domestic debt markets which has provided them a lifeline while access to international capital markets is closed. Domestic debt composes only a small part (17%) of the total debt stock. Furthermore, it is difficult to identify who is a non-resident holder. Non-residents' share of domestic debt stock has dropped to little over 20% from highs of over 30% last year as foreign portfolio investors have stopped rolling over maturities, which has increased pressure on the kwacha.

Clearly the most pertinent issue to solve is related to debt in order to unlock Zambia's economy's great potential which still requires a lot of structural and economic reforms from the new government. Investments and credit growth are also waiting for debt-restructuring to be done. China will come around eventually, because they will need resources from the African continent to boost their own economy. So, we remain as optimistic as the sentiment was in Lusaka, albeit financial markets might be nervous in the months to come until a debt restructuring agreement is finally reached. There may be some further delays to current expectations of external creditors reaching an agreement in March.

View: Currently we do not have any positions in local or hard currency Zambian government bonds. In our local currency frontier strategy, we are invested through development finance institution bonds and non-deliverable forwards.

Statue of the first president of Zambia, Kenneth Kaunda, in Lusaka

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