Bonds issuance and the current debt crisis in Mozambique

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Introduction

There are various ways and sources from which a country can mobilize resources to finance its development. These sources of funds can be domestic or external. The major sources of external funding are multilateral and bilateral debts. Countries can also borrow from the domestic market. The issuance of bonds is another way of raising funds from both international and the domestic markets. National governments can also guarantee or assume the bonds issued by parastals and other private companies. The 2016 edition of the International Debt Statistics (IDS) notes that there has been a substantial increase in sovereign bond issuance in Sub Saharan Africa. At the end of 2011, bond issuance totaled $1 billion and by the end of 2014, it amounted to $6.2 billion. Steady global market conditions and the potential for higher returns for investors have helped pave the way for more access to international markets, where the average return for these bond issuances is about 6.6%, with an average maturity of 10 years.[1] The period between 2010 and 2015 has seen an increase of Sub Saharan external Debt stock from US$282.9 billion to US$416.3 billion respectively[2]. The growing trend in the guaranteeing and issuance of sovereign bonds has implications on the economic development of the debtor country. This therefore calls for prudent debt management. This policy brief gives an analysis of the so called Tuna Bonds in Mozambique and attempts to determine how they are related to the Mozambican debt crisis. It answers the question whether the tuna bonds have fuelled the crisis or not. Lastly, recommendations to Mozambique will be given.

1 http://blogs.worldbank.org/opendata/sub-saharan-africa-s-sovereign-bond-issuance-boom
2 World bank

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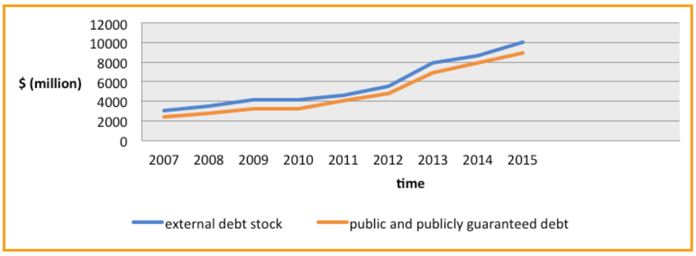
2. Overview of Mozambique public debt

2.1 External Public debt

Despite debt relief granted to Mozambique in 1999 under the High Indebted Poor Country (HIPC) initiative and the enhanced HIPC, data provided by the World Bank shows that in the last two decades its external debt stock is on the rise. As shown in Figure 1, from 2007 to 2015, Mozambique's external debt stock increased by about 230% (from US$3.047 billion to US$10.055 billion). From 2012 and onwards there was a drastic increase in the eternal debt position of Mozambique, demonstrating the country's huge appetite for borrowing. This rise in the external debt stock is partly attributed to the government's sovereign bonds worth $0.9 billion which were issued between 2014 and 2015.

Figure 1: Trends in external and public and publicly guaranteed debt in Mozambique

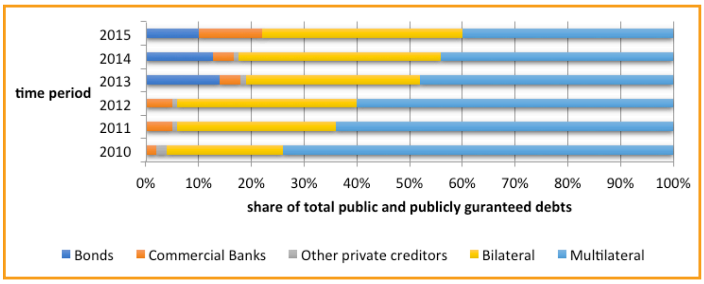


Compiled using World Bank Data

2.2 Composition and patterns of external public debt

In terms of the composition and patterns of Mozambique's external debt, data from the World Bank shows that there is a growing trend in the contraction of bilateral loans and issuance and guaranteeing of bonds. It is important to note that the composition and patterns of a country's external debt stock have implications on the sustainability and the general social and economic development of a country. If a country does not have a good debt management strategy, adequate legal and effective institutional frameworks, it may find itself in a crisis. The figure below shows the composition and patterns of Mozambique's external debt stock.

Figure 2: Patterns and composition of creditors in Mozambique



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As can be noted in the Figure 2, the share of sovereign bonds has increased, resulting in a decrease in multilateral debt and an increase in bilateral loans. In 2013, the share of bonds as a percentage of the total public was 14%, 13% in 2014 and then 10% in 2015. Multilateral loans have decreased from 75% to 45% between 2010 and 2014. This trend is in contrast with Mozambique's borrowing strategy and negotiation which states that multilateral loans should be prioritized over bilateral ones. The increase in the share of bilateral loans is attributed to the suspension of loans by the World Bank and IMF. This has resulted in bilateral loans increasing by 17% between 2010 and 2014. The strong tie between Mozambique and China has resulted in China dishing out loans and making itself Mozambique's largest bilateral creditor. The contraction of commercial bank loans is also a growing phenomenon. In 2015 the share of commercial bank loans was 12% as compared to 2% in 2010.

2.3 Tuna Bonds

Between 2013 and 2014, three Mozambican companies (Empresa Macambicana de Atum, Proindicus and Mozambique Asset Management) were set up by the national security service, Servico de Informacao e Seguranca do Estado (SISE) with the aim of implementing a tuna fish project. This eventually led to the contraction of a US$2 billion loan which was roughly equivalent to 30% the national annual budget of Mozambique. As can be seen in Figure 1, the loans (contracted between 2013 and 2015) exceeded the total amount of external debt raised directly by the government between 2010 and 2012 and breached commitments made to the International Monetary Fund. The London offices of investment banks Credit Suisse and VTB Capital arranged US$850 million in loan participation notes akin to an unlisted bond for Ematun. The intended purpose of the loan was to acquire tuna fish fleet, maritime security and other supplies from Privinvest[3].

Privinvest was contracted to provide 24 trawlers in addition to three patrollers and three interceptors which were designed to be armed with 20mm cannon and 12.7mm machine gun. However, the Chief Executive Officer of the three companies later admitted that the fishing boats were not the only thing on the governments shopping list. It is alleged that part of the loan was used to acquire military equipment. The tuna concept had been the pretext for the defence expenditure. At that same time, Credit Suisse and VTB Capital arranged loans amounting to US$1.16 billion which were not known to the public.

3. Is Mozambique in a debt crisis?

Following the issuance and guaranteeing of the bonds there is need to investigate on how the Mozambican debt crisis is related to the Tuna Bonds. A number of indicators are used to determine whether a country is in a debt crisis or not. This paper will utilize and analyze the following indicators: sovereign debt default, debt service to exports ratio, Debt to Gross Domestic Product (GDP) ratio, Debt to Export ratio and Debt to GNI ratio. It is important to note that the indicators point to a crisis in and after 2013, the period the issuance of tuna bonds.

3 African Research Institute, understanding Africa today, briefing note 1701 February 2017

a) Sovereign default

Defaulting of debts can be an indicator of a debt crisis. In March 2017, Mozambique missed a $119 million payment on a loan to Credit Suisse. This was the second time the country has defaulted. In January 2017 the Ministry of Economy and Finance admitted that they were unable to pay the interests on bonds that were initially issued by Ematum[4]. The failure to honour these obligations is partly attributed to fact that the fishing companies failed to meet their targets and recorded losses and partly due to a downturn in commodity prices[5]. Since 2011, Mozambique has become the first country to default on dollar bonds. The default buy Mozambique has led the Bloomberg Market to raise a red flag on the countries that are likely to default.

b) Debt service to exports

The debt service to export ratio is defined as the total debt service divided by the sum of exports of goods, services, and income plus workers' remittances. This ratio is considered to be a key indicator of the debt burden. A country's finances are healthier if the rate is lower than 5% for developing countries. In the case of Mozambique, the rate was ascending during the period under review. It grew from 1.2% in 2007 to 9.5% in 2015. This growing trend indicates that more export revenue is being used up in servicing. This therefore increases vulnerability when it comes to the payment of debt-service obligations. The 2015 ratio is above the 5% threshold thereby pointing to the fact that there is a crisis in Mozambique.

c) Debt to GDP ratio

The period from 2007 to 2015 saw an increase in the Debt to GDP ratio. Between 2014 and 2015, the debt to GDP ratio rose above the SADC threshold of 60%. This is the same period when the country contracted the controversial US$2 billion loan. As shown in the figure below, in 2014 the ratio rose from 62% to about 86% in 2015. For a country like Mozambique a ratio which is above 60% signals a debt crisis considering the fact that its growth trajectory is on the decline.

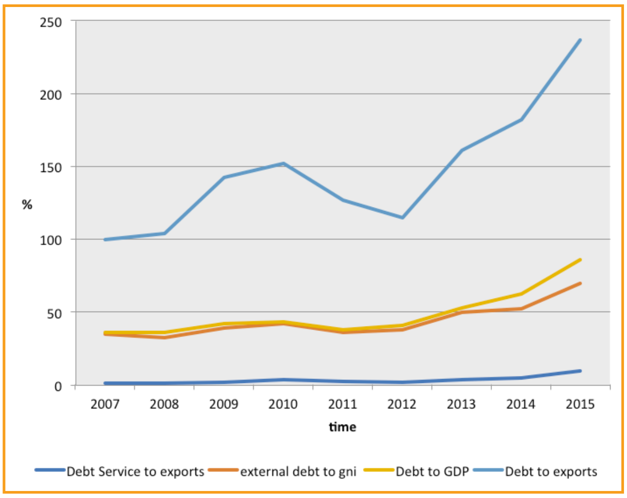
d) External Debt to Export ratio

In the figure below, there is an increase in the debt to export ratio between the periods from 2007 to 2010. However, in 2010 to 2012 the ratio declined from about 152% to 114%. The decline is attributed to economic growth that was experienced. There was a sharp increase in the ratio from 114% in 2012 to 236.7% in 2015 which is above the 1:150 threshold. As shown in the figure, the year 2013 recorded 161%, in 2014 it was 182% and in 2015 it was 236%. A higher ratio above the 1:150 threshold signals the incapability of Mozambique to repay the bondholders therefore a debt crisis. The increase in the ratio is attributed to a decline in the level of exports and an increase in the external debt stock as a result of tuna bond.

4 http://clubofmozambique.com/news/mozambique-confirms-cannot-pay-bondholders-aim-report/

5 https://www.economist.com/news/middle-east-and-africa/21715030-mozambique-fails-pay-its-debts-mozambiques-default

Figure 3: Debt crisis indicators



Compiled from World Bank Data

e) Debt to GNI

The debt to GNI ratio is the total amount of outstanding debt (internal and external) issued by the general government divided by gross national income. This ratio translates to a country's ability to pay interest on its debt and still have a steady economic growth. Between 2007 and 2012 the ratio fluctuated below 50%. However, from mid 2012 to 2013 it grew steadily. From mid 2013 and onwards, it grew above 50%. In 2014 there was a sharp increase. As depicted in the figure above, this ratio is also increasing implying that Mozambique has is consuming its exports and services to repay debts and there is a greater risk to contract more loans.

As can be noted from the indicators given above, the tuna bonds have led to a debt crisis in Mozambique. The indicators are above the expected thresholds. The debt situation has been further aggravated by the declining commodity prices, declining GDP, currency depreciation, and reduced exports.

4. What went wrong?

The debt crisis in Mozambique is attributed to a number of abnormalities. Firstly, the actions of the Finance Minister were unconstitutional as the legislature was not consulted. Article 179 of the Mozambican Constitution requires that the legislature be consulted on sovereign debt guarantees. However, the then Minister of Finance bypassed parliamentary scrutiny processes and went on to sign papers allowing the government to guarantee the loans. This is also against Chapter 1 (1.4) of the AFRODAD Borrowing Charter which stipulates that "Governments must undertake to adopt legislative measures that ensure that all public borrowing and debt management receives parliamentary and public approval".

Secondly, the loan contracts signed were in English and there were no translations into Portuguese which Mozambique's official language. This is also unconstitutional as the constitution of Mozambique requires the translation and authentification of all important government documents in foreign languages.

Thirdly, the lenders did not conduct a thorough investigation to see if Mozambique's actions were constitutional, they however carelessly dished out the loans. This is problematic in that the responsibility of loan repayments are on Mozambique and if anything went wrong the creditors will not take responsibility. In addition to ignoring the legality of contracting the loans, the creditors also provided other loans that they were not asked to provide. It was discovered that Credit Suisse raised US$622 million for Proindicus for offshore gas exploration and shipping despite an absence of demand for these services.

Originally, the bond prospectus was for general cooperate purposes. The repayment conditions were very tough as the money had to be repaid over seven years with a two year grace period and at an interest rate of London Inter-Bank Offered Rate plus 6.5%. It was possible that the companies could meet the debt obligations since the probability of making profit was very high. Since part of the loans were diverted, the fishing companies made losses resulting in them failing to repay. The loans were used in non productive sectors limiting the country's capacity to repay the loans.

Fifthly, the conversion of corporate bonds into sovereign bonds and their subsequent assumption fueled Mozambique's debt crisis as its external debt stock increased. Ematun bonds were converted into sovereign government bonds with a longer repayment time, but at a higher rate (10.5%) under a deal reached with bondholders. The higher rate means that resources that would be potentially be used in the health and education sectors will be diverted to loan repayment. The new arrangement meant that the government would not have to repay the capital until 2023 when the bonds would mature. The government's assumption was that by 2013 revenue will be flowing in from the vast natural gas fields in the Rovuma Basin.

Lastly, a study by commissioned by SADC-COMESA, revealed that the bond market is relatively new and small in Mozambique. This means that Mozambique has little experience and exposure when it comes to the issue of bonds. Both government and corporate bonds exist and are listed on the Mozambique Stock Exchange (MZE), although government bonds dominate both capitalization and trading. However, investors tend to buy and hold and liquidity on both types of bonds is extremely low (1.6% in 2008)[6].

5. Recommendations

There is need for Mozambique officials to uphold the constitution concerning the contraction and guaranteeing of both private and public loans. Measures should be put in place to ensure that the public through parliament, scrutinizes and takes due diligence all the government loans and guarantees before the responsible minister sings them. All government loans should be reported and made public. This will ensure public participation, transparency and accountability.

6 SADC-COMESA Bond Market Mapping Study

All government loan contracts in foreign languages should be translated into government's official language and authenticated. This will ensure that all the officials involved will easily understand the provisions of the contracts and will actually know what they are signing for.

Loans should be used for the specific purposes they have been borrowed for and they should be invested in productive sectors. The Mozambican government should ensure that there are systems to ensure that the loans have not been diverted into non productive sectors where there is no capacity to generate financial resources for repayments.

Public loans should not be guaranteed with unexplored natural resources as it may take time to get revenue from their exploitation. Revenue from these resources may also be affected by the international price volatility and this makes it difficult to honor debt and interests repayments.

Mozambique should have a prudent debt legislation and management strategy. There should be predictable rules and regulations on debt management which include specifying borrowing powers, borrowing ceilings, borrowing approval and the authorization process[7]. Debt management legislation and strategies should guide the guaranteeing and contraction of loans so that officials will not fall into the trap of increasing their stock of sovereign bonds which will increases the public debt stock.

Lenders should conduct through investigations concerning the legality of the loan guaranteeing and contraction. In the event that they ignore this, the responsibilities to pay the loans should be shared between the lenders and debtors. In addition to the legality, lenders should also consider the absorptive capacity of the debtor country and the socio-economic impact of the loans.

7 Chilunjika, Chikova, Uwiyizeyimana 2016

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