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China's $145bn 'Brady Bonds Plan' for African debtors may trigger Eurobond defaults

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China's June 17, 2020 announcement that it is seeking to use a 'Brady Bond-type' vehicle to restructure and manage its $146 billion dollar African debt portfolio may yet have the unintended consequence of accelerating defaults on nearly $50 billion of Eurobond debts issued by the same African nations on a pari pasu basis with the Chinese debt restructuring terms.

Following the recent G20 pledge for debt relief for FM/EM markets, only a third of eligible countries accepted the proposal leaving the risk of massive debt default intact. China's role is underestimated given its status as no. 1 provider of credit in the world – particularly under the Belt Road Initiative. Like the US in the 1980s and the lost decade of Latin America, China has no choice but to establish a Chinese Brady Plan for Africa and beyond.

The G20 debt relief plan goes no where

On 15 April 2020, with the support of IMF and the World Bank, the G20 declared a debt relief plan for the most indebted and COVID-19 frontier (FM)/emerging (EM) markets. Effective from 1 May, principal and interest payments are to be suspended and repaid over a 4-year period – with initial payment holiday in the 1st year. The freed-up payments is supposed to help fight Covid 19 in each EM/FM nation.

However out of 77 eligible countries, only about 25 countries have accepted the plan due to two draconian conditions:

- *Disclose all public sector financial commitments (e.g. debt), while respecting commercially sensitive information.*
- *Contract no new non-concessional debt during the suspension period, other than agreements under the Initiative or in compliance with limits agreed under the IMF Debt Limit Policy or World Bank Group policy on non-concessional borrowing.*

The provisions create a number of perhaps unintended problems for international creditors and debtors such as:

- *Risk of contract breach if suspend or defer payments under private lending contracts.*
- *Risk of cross-default provisions if one or more creditors or group of creditors accept debt relief which could trigger default under private lending contracts.*
- *Risk of rating change as any debt relief/deferment to creditors would have to be taken into account by international rating agencies related to country and bond ratings. Furthermore, recipients need to pledge any fiscal legroom created by the debt relief to be monitored by global agencies to ensure it being* reinvested in approved way. It is also likely to cover state-owned enterprises which would be restricted on raising new debt.

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Chinese Loans to African Governments vs. Eurobond Debts

Country	China Eximbank	CDB	China Supplier's Credits	TOTAL Chinese Debt	Total Eurobonds as of 2019	Total Chinese Debt as % of Eurobonds	DaMina Risk of Eurobond Pari Pasu Default following China 'Brady' Plan
Angola	$ 8,272	$ 26,589	$ 22	$ 43,145	$ 5,000	*863%*	*High*
Cameroon	$ 5,034	$ 2	$ 2	$ 5,561	$ 750	*741%*	*High*
Tanzania	$ 2,378	$ 200	$ -	$ 2,640	$ 600	*440%*	*High*
Mozambique	$ 2,018	$ 179	$ -	$ 2,290	$ 727	*315%*	*High*
Zambia	$ 3,760	$ 1,002	$ 673	$ 8,634	$ 4,250	*203%*	*High*
Benin	$ 1,686	$ -	$ -	$ 1,909	$ 1,089	*175%*	*High*
Kenya	$ 7,878	$ 867	$ -	$ 8,900	$ 7,000	*127%*	*High*
Rwanda	$ 222	$ -	$ -	$ 290	$ 400	*73%*	*Medium*
Senegal	$ 1,998	$ -	$ -	$ 2,019	$ 4,189	*48%*	*Medium*
Namibia	$ 270	$ -	$ 223	$ 538	$ 1,250	*43%*	*Medium*
Cote d'Ivoire	$ 2,710	$ -	$ -	$ 2,783	$ 8,113	*34%*	*Medium*
Ghana	$ 1,585	$ 1,000	$ 599	$ 3,499	$ 11,082	*32%*	*Medium*
Nigeria	$ 4,903	$ -	$ 390	$ 5,293	$ 18,642	*28%*	*Medium*
Gabon	$ 450	$ -	$ -	$ 735	$ 3,409	*22%*	*Medium*
Seychelles	$ 34	$ -	$ -	$ 34	$ 169	*20%*	*Medium*
Morocco	$ 1,022	$ -	$ -	$ 1,030	$ 6,695	*15%*	*Low*
Egypt	$ 767	$ 2,600	$ -	$ 3,421	$ 29,014	*12%*	*Low*
South Africa	$ -	$ 3,131	$ -	$ 3,819	$ 40,176	*10%*	*Low*
Mauritius	$ 414	$ -	$ -	$ 492	$ 7,020	*7%*	*Low*
Liberia	$ 50	$ -	$ -	$ 50	$ 950	*5%*	*Low*
Tunisia	$ 143	$ -	$ -	$ 146	$ 8,038	*2%*	*Low*
Sudan	$ 5,027	$ -	$ 598	$ 6,495	$ -	*649500%*	**No Eurobonds*
Rep of Congo	$ 4,812	$ -	$ 238	$ 5,070	$ -	*507000%*	**No Eurobonds*
DRC	$ 3,325	$ -	$ -	$ 3,345	$ -	*334500%*	**No Eurobonds*
Zimbabwe	$ 2,692	$ 40	$ 290	$ 3,288	$ -	*328800%*	**No Eurobonds*
Uganda	$ 3,110	$ -	$ -	$ 3,181	$ -	*318100%*	**No Eurobonds*
Equatorial Guinea	$ 1,198	$ -	$ 478	$ 1,699	$ -	*169900%*	**No Eurobonds*
Djibouti	$ 1,261	$ -	$ 150	$ 1,467	$ -	*146700%*	**No Eurobonds*
Mali	$ 909	$ -	$ -	$ 989	$ -	*98900%*	**No Eurobonds*
Botswana	$ 90	$ -	$ -	$ 931	$ -	*93100%*	**No Eurobonds*
Togo	$ 773	$ -	$ -	$ 853	$ -	*85300%*	**No Eurobonds*
Niger	$ 332	$ -	$ 352	$ 703	$ -	*70300%*	**No Eurobonds*
Guinea	$ 273	$ -	$ 335	$ 646	$ -	*64600%*	**No Eurobonds*
Eritrea	$ 589	$ -	$ -	$ 605	$ -	*60500%*	**No Eurobonds*
Chad	$ 586	$ -	$ -	$ 590	$ -	*59000%*	**No Eurobonds*
Madagascar	$ 435	$ -	$ -	$ 435	$ -	*43500%*	**No Eurobonds*
Mauritania	$ 381	$ -	$ -	$ 431	$ -	*43100%*	**No Eurobonds*
Malawi	$ 262	$ -	$ -	$ 262	$ -	*26200%*	**No Eurobonds*
Sierra Leone	$ 48	$ -	$ 176	$ 224	$ -	*22400%*	**No Eurobonds*
South Sudan	$ 158	$ -	$ -	$ 158	$ -	*15800%*	**No Eurobonds*
CAR	$ -	$ -	$ 60	$ 103	$ -	*10300%*	**No Eurobonds*
Burundi	$ 36	$ -	$ -	$ 86	$ -	*8600%*	**No Eurobonds*
Cape Verde	$ 43	$ -	$ -	$ 49	$ -	*4900%*	**No Eurobonds*
Comoros	$ 39	$ -	$ -	$ 39	$ -	*3900%*	**No Eurobonds*
Lesotho	$ 27	$ 2	$ -	$ 37	$ -	*3700%*	**No Eurobonds*
Ethiopia	$ 8,069	$ 655	$ 4,165	$ 13,796	$ -	*1380%*	**No Eurobonds*
Algeria	$ -	$ -	$ -	$ 9	$ -	*900%*	**No Eurobonds*
TOTAL	**$ 80,561**	**$ 36,772**	**$ 8,751**	**$ 145,729**	**$ 158,563**	*92%*	

Source: Johns Hopkins SAIS/BIS/ DaMina

China No. 1 global creditor

China plays a pivotal role for EM/FM markets. That is since WTO-membership in 2001, China's economy has been on fire and its 'largesse' has created a situation where it is now **No.1 global official creditor with outstanding claims in 2017 exceeding the loan book of the IMF, World Bank and of all other 22 Paris Club governments combined**, according to estimates by a recent report published by Centre for Economic Policy Research (CEPR).

The trouble with China's loan portfolio is that much is undocumented/not made public. China gets away with this as it is neither member of the Paris Club, nor OECD (where its Creditor Reporting System is the main source for investors/creditors/debtors).

Until now, Chinese debt restructuring has been done on *bilateral* and *ad hoc basis* involving only the debtor government. And most of it has been debt maturity extensions rather debt cancellations being limited to very zero interest loans, according to CEPR.

Another crucial feature is that many official Chinese loans have collateral clauses, meaning that Chinese institutions may be treated *preferentially* in case of repayment problems. One famous case occurred in Sri Lanka in 2017, which saw China take over a major port after the government failed to service its debt.

Under Chinese law a foreign court judgement will only be recognized on following grounds: (1) International convention – Whilst a signature of **Hague Convention of Court** Agreement (courts of member states subject to limited exceptions, recognize and enforce judgments with exclusive choice of court agreements in civil and commercial matters of the courts of other member states), China yet to *ratify* the convention; (2) Bilateral treaty – As of 2018, has bilateral treaties with 39 countries in form of judicial assistance in civil matter, of which 34 include judicial enforcement of civil judgements.

However, it has **no bilateral treaty with the US regarding reciprocity**. And for other countries China pursue a policy of de factor reciprocity" – e.g. Chinese courts will consider recognizing reciprocity between two countries only if the requesting country has previously enforced Chinese judgements.

Similarities with US from 1970 and 80s elicit Chinese Brady Plan

In the 1970s and the 80s, the US economy was buoyant and US/Western banks lent generously (helped by petrodollar recycling) to resource rich countries in EM/FM economies, particularly in Latin America. Investments were going to infrastructure, commodities extraction and other growth projects. A lot of the loan data was not registered in official data, and structure of loans opaque and priced at premium/unfavorable for debtors.

When commodity prices fell sharply and banks stopped extending their loans in the early 1980s countries faced problems servicing their loans, paving the way for a period of lost decade. However, after the Wall Street crash of 1987 lenders and government officials were forced to come up with fresh ideas, which eventually gave birth to US Treasury Secretary Nicholas F. Brad's debt restructure plan – 'Brady Plan' – in March 1989.

The Brady Plan contained three key features: (1) bank creditors would grant debt relief in exchange for greater assurance of collectability in the form of principal and interest collateral; (2) debt relief needed to be linked to

some assurance of economic reform and (3) the resulting debt should be more highly tradable, to allow creditors to diversify risk more widely throughout the financial and investment community.

As in Latin America in the 80s, many EM/FM markets particularly in Africa are facing falling/weak commodity prices, bloated loan exposures to foreign private and government creditors and need to undertake structural reforms. Chinese overseas loans have decelerated and the normal large current account surplus which has generated large foreign reserves – mostly held in $ - and used for its lending, particularly to countries involved in the Belt Road Initiative, is now turning negative for May.

Furthermore, the new export order sub-index for China's official manufacturing PMI remained near-record low at 35.3 in May, though rising slightly from 33.5 in April, well below the 50-mark separating growth from contraction for five consecutive months; averaging 50.3 % Jan 2005 to May 2020. Alas, China's traditional role as factory of the world is still

The local Chinese financial markets, including Hong Kong, have been weak as after the crash of Wall Street in 1987. And the first phase of the US-China trade war resolution is facing setbacks following reluctance from China to purchase farm products and US clamp down/restrict semiconductor/technology exports. The right time for a Chinese Brady Plan is coming.

China's domestic bond market is worth nearly 15$ trillion, making it one of the biggest in the world. Credit Agricole sees the domestic bond market to grow to $47-55trn by 2025 – putting it on par with the US - allowing it challenge US's primacy as the largest and most liquid and heavily traded.

Foreign bond investors are nibbling into the market and now own c. 2.6% of the market, helped by index inclusions: the Bloomberg Barclay Global Index in September 2019 and JP Morgan's bond indices in February this year.

Last year Deutsche Bank and BNP Paribas were awarded 'type A-license', allowing them to act as lead underwriters on corporate debt issued by domestic non-financial institutions. Finally, but not least Standard & Poor's was awarded the first local credit rating license last year.

China's GDP/capita of $10,099 (2019) means it is facing risk of the middle-income trap, which can only be overcome with an efficient domestic and offshore bond market to allocate capital more efficiently.

Africa: China's Latin America

The most pressing region for a Chinese Brady Plan is Africa given huge exposure to the Eurobond market and China's economy – detailed in "$13 trillion debt default 'pandemic' stalks G-7 asset managers, emerging and frontier markets" (6 April, 2020).

The Eurobond data is downplaying the true picture of Africa's indebtedness.

According to John Hopkins's China-Africa Research Initiative (CARI), from 2000 to 2017 (latest available data), China has extended $146bn in loans to African governments and their state-owned enterprises. Angola is top recipient with over $43bn over 17 years.

The CARI data is insufficient as research reports from the World Bank and other agencies found that more than 50% of the loans given by the four biggest government-controlled commercial banks, Export–Import Bank of China and China Development Bank, Silk Fund and other government-linked entities are unreported.

China-Africa trade duds INDOPAC strategy

Following the global financial crisis of 2007/08 China overtook the US as Africa's biggest trading partner. In 2019 the trade reached $209bn, supported by the BRI project. However, in 1Q20, the trade slipped by 14% year-on-year and hit $41bn. Consisting of mostly commodities Africa's export dropped 17.5% to $19.8bn whereas China's export 10.5% to $21.4bn.

For comparison, the US-Africa trade was only worth a *quarter* of the China-Africa trade at 56.8bn in 2019. And perhaps more tellingly it reached a peak in 2008 ($141.8bn) and since been on a sharp downtrend, according to US Census Bureau.

The last year's enactment of INDOPAC strategy – the biggest single geopolitical change in US policy since WWII – which tilted the US interest from Pacific (PACOM) to Indo-Pacific (including Africa) – have yet to see any significant fresh economic resources/policies to stem the relative decline of US economic interests in Africa. Until that happens, investors are best served to regard any debt relief plan – whether in the name of G20 or any other Western agencies which lacks *real* buy-in from China – as work-in-progress.

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