How banks assess African risk in their sovereign lending

Internal models, local knowledge, the unintended effects of regulation and the importance of investors relations

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SUSTAINABLE SOVEREIGN DEBT HUB

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The Sustainable Sovereign Debt Hub (SSDH) is a convening platform designed to address the critical sustainability challenges of global sovereign finance. The Hub was launched at COP27 and focuses on embedding sustainability risks and rewards into sovereign debt markets, ensuring that countries' efforts to improve resilience to climate and nature-related challenges are appropriately designed and incentivised. Through this innovative approach and by bringing together key players, the SSDH helps build a more resilient, sustainable global economy, with a particular focus on supporting emerging markets and vulnerable nations. The SSDH relies on generous support from the Swiss State Secretariat for Economic Affairs and the Children's Investment Fund Foundation.

Plato Group is a global economic and geopolitical consultancy founded in 2024. It is a network of expert advisers who have held senior positions in governments and central banks across the world, as well as with the United Nations, the World Bank and the International Monetary Fund. They provide hands-on technical assistance, analysis and advisory support to governments, UN agencies, international non-governmental organisations and international banks across Europe, the Middle East and Africa.

[i] Margaret Muthoni, Patrick Mokaya, Mike Williams, and Dilan Saujani.

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Abbreviations

CRA	Credit ratings agency
EAD	Exposure at default
EMDE	Emerging markets and developing economies
GDP	Gross domestic product
IIF	The Institute of International Finance
IMF	International Monetary Fund
LGD	Loss given default
PD	Probability of default
SSDH	Sustainable Sovereign Debt Hub

Executive summary

Banks play a critical role in connecting African sovereigns with capital markets, supporting project financing and providing liquidity. Recent economic shocks, from the COVID-19 pandemic to geopolitical tensions, have raised default risks across sub-Saharan Africa, and lending decisions have become more complex. More specifically, risk management when it comes to lending to emerging markets and developing economies (EMDEs) has become tighter. Against this backdrop, the Sustainable Sovereign Debt Hub (SSDH) at NatureFinance initiated this study to explore a specific question: ***how do commercial banks' internal risk models and decision-making processes influence their lending to African sovereigns, and are there biases or structural factors that affect capital flows and costs?***

For this study, interviews were conducted with 13 international and pan-African banks operating across sub-Saharan Africa, as well as two finance ministries, two development banks and the Central Bank of Kenya. The study examined banks' internal risk assessment models, compared them with the approaches used by credit rating agencies (CRAs) and analysed the factors driving lending decisions, including how regulatory frameworks such as Basel III shape capital allocation. To provide wider context, data drawn primarily from the African Debt Database were analysed to identify key trends in sovereign borrowing costs, maturities and lending patterns over the past two decades.

Our research revealed several key findings. The most important are as follows:

1. **International banks with local presence are increasingly lending to African sovereigns in local currency with shorter tenors and higher borrowing costs – creating a vicious cycle for debt sustainability.** This shift ultimately creates a self-reinforcing problem: governments struggle to invest for growth in such short timeframes, budget constraints deepen, default risk increases and the risk profile that prompted the short tenor in the first place becomes entrenched.
2. **Banks rely on sophisticated internal risk models that can override CRA assessments, especially when they have stronger local information.** These internal models focus on perceived willingness to pay rather than just likelihood of default. Where banks have local presence and market insights, they often rely more on their own forensic analysis than external ratings. Interviewees highlighted that some banks continue to lend despite credit downgrades and have been able to identify debt sustainability problems before CRAs flagged them. Local knowledge is key.
   .
3. **Basel III regulations inadvertently constrain international banks' capital allocation for foreign currency when lending to riskier economies.** While banks view Basel III as essential for financial stability, international banks looking to lend foreign currency must give more weight to CRA assessments when allocating capital. Since almost all African countries sit below investment grade, this requirement acts as a disincentive for foreign currency lending from international banks. This regulatory requirement can partially explain the shift towards local currency lending with its associated shorter tenors and higher costs.

Together, these findings reveal a troubling dynamic. African sovereigns need foreign currency to bridge their domestic savings gaps but they can only access it at high cost and short maturities from international banks that are constrained by regulatory requirements. Governments then turn to local currency borrowing, where shallow local capital markets mean even higher costs and shorter timeframes. The expense of servicing this debt further squeezes budgets, reinforcing the very risk profile that caused banks to shorten tenors in the first place. To break this vicious cycle, a better understanding is needed of the underlying conditions and the cost at which banks will lend, as well as the structural factors that are driving those decisions.

This study makes three recommendations:

- **Develop local capital market infrastructure.** Shallow local markets, the domestic savings gap and the growing allocation of local pension assets to offshore investment all play a role in creating this cycle of unsustainable debt. Increased reliance on foreign currency financing heightens exposure to exchange rate risk and amplifies refinancing pressures during periods of global stress. A deeper diagnostic assessment of local capital market architecture is therefore essential, particularly the extent to which regulatory, institutional and market infrastructure constraints inhibit depth, liquidity and domestic investor participation.

- **Thoroughly assess the impact of Basel III on African lending.** Basel III requires international banks to heavily weight CRAs when allocating capital for foreign currency lending. Further investigation is required to determine if this adversely affects short-to-medium-term growth prospects for Africa.

- **Build investor relations capacity in African governments.** In interviews, multiple banks highlighted that limited investor relations capacity directly contributes to high lending costs. Additional analysis could examine whether building this capacity might improve pricing and reduce borrowing costs.

Report structure

This study examines the wider context of the current situation to provide additional background before looking at the key findings of the engagement and analysis. It then offers a set of conclusions, along with recommended actions to address the challenges that have been uncovered.

Scope of engagement

This assessment examines how commercial banks' internal risk models and decision-making processes shape their lending to African sovereigns. This paper tests whether limitations, and even biases, in these models and processes skew not just the pricing of sovereign credit but also its allocation and term of the debt.

Interviews were conducted with 13 commercial banks operating across Africa, the Gulf Cooperation Council and the United Kingdom: ABSA Group, Access Bank, Bank of Africa, Citibank, Ecobank, HSBC, Kenya Commercial Bank (KCB), NCBA Bank, Nedbank, Rand Merchant Bank, Standard Bank, Standard Chartered and United Bank for Africa. These conversations covered key financial centres in Kenya, Nigeria, South Africa, Togo, the United Arab Emirates and the United Kingdom.

Perspectives from policymakers were also gathered at the Central Bank of Kenya, Kenya's Public Debt Management Office at the Ministry of Finance and Economic Planning and His Majesty's Treasury in the United Kingdom. The International Finance Corporation and the Trade and Development Bank added views from the development finance angle. All these organisations play prominent roles in Africa's commercial sovereign debt, whether as investors, regulators or policymakers.

Banks do not all operate the same way, and these differences matter for our findings. An international bank with local subsidiaries in Africa approaches sovereign risk differently than one operating from overseas only. Similarly, South African banks with subsidiaries across the rest of the continent benefit from local insights and tend to be less risk-averse than purely international players.

A further distinction worthy of note is that some African banks have institutional shareholders or strategic partners in China, which gives them better access to foreign currency than banks that rely mainly on Western markets. Although Chinese financing has undergone a "Great Reversal", shifting from a net provider of US$48 billion to developing countries a decade ago to a net extractor of US$24 billion,[1] banks with direct Chinese ties may still secure funding on more favourable terms. When some of these lower costs are passed on to borrowers, they can help reduce sovereign vulnerability risks that are closely linked to the price of external financing.

[1] ONE Campaign, *The Great Reversal* (Washington, D.C.: One Campaign, 2026), https://data.one.org/resources/report/greatreversal.

Introduction

The problem: Understanding capital flows to emerging and frontier markets

Introduction

The problem: Understanding capital flows to emerging and frontier markets

Capital flows are essential for sovereign debt dynamics in emerging and frontier markets, shaping both borrowing capacity and vulnerability to shocks. Sovereigns typically rely on a mix of international bonds, official financing and commercial bank lending. This paper looks at commercial banks' lending and the distinct role it plays within this sovereign debt framework, often serving as the marginal or "bridge" source of financing when bond markets are closed or volatile. Banks provide syndicated loans, bilateral facilities and commodity-linked credit, particularly to frontier sovereigns. One of the key drivers of these lending decisions by commercial banks to African sovereigns is the internal risk assessment models of these banks.

According to the International Monetary Fund (IMF), government debt across emerging and frontier markets has increased sharply over the past two decades. Africa has not been exempt from this trend. Africa's debt burden has increased significantly over the 15 years since the global financial crisis. The general government gross-debt-to-GDP (gross domestic product) ratio on the continent has increased by over 30 percentage points, reaching 63.5% as of 2026, according to the IMF World Economic Outlook Database. This trend is also evident in sub-Saharan Africa, where the external debt-to-GDP ratio has more than doubled, from about 20% in 2010 to over 45% in 2024, according to data from the African Debt Database (Figure 1A).

An important observation is that debt accumulation has outpaced GDP growth. As a result, debt burden indicators have deteriorated. Interest payments as a share of GDP have risen from about 0.5% in 2015 to over 1.2% in 2024 (Figure 1D). The combination of rising debt levels and escalating interest costs has heightened fiscal vulnerability across the region. Several countries now face elevated risks of debt distress.

Africa's external debt stock has also more than doubled over the past decade, with Africa's external debt (official debt) reaching 25.91% of GDP as of 2026, according to the IMF World Economic Outlook database. A similar upward trend is observed in sub-Saharan Africa, broadly mirroring Latin America and the Caribbean, although at different magnitudes (Figure 1A). After a period of relative stability in the early 2000s, supported in part by debt relief initiatives, external debt ratios began climbing steadily from the mid-2010s onward. The COVID-19 shock further accelerated this upward trend as governments increased borrowing to cushion economic fallout.

While external debt service as a share of GDP and exports has grown more gradually (Figure 1C), there has been an upward trend in interest payments. This steady increase in debt service costs sits at the heart of the region's vulnerability, as multiple recent analyses have highlighted.[2] Yet focusing only on aggregate data ignores critical nuances – such as the differences in borrowing instruments, maturity profiles, borrowing costs and external and domestic debt markets.

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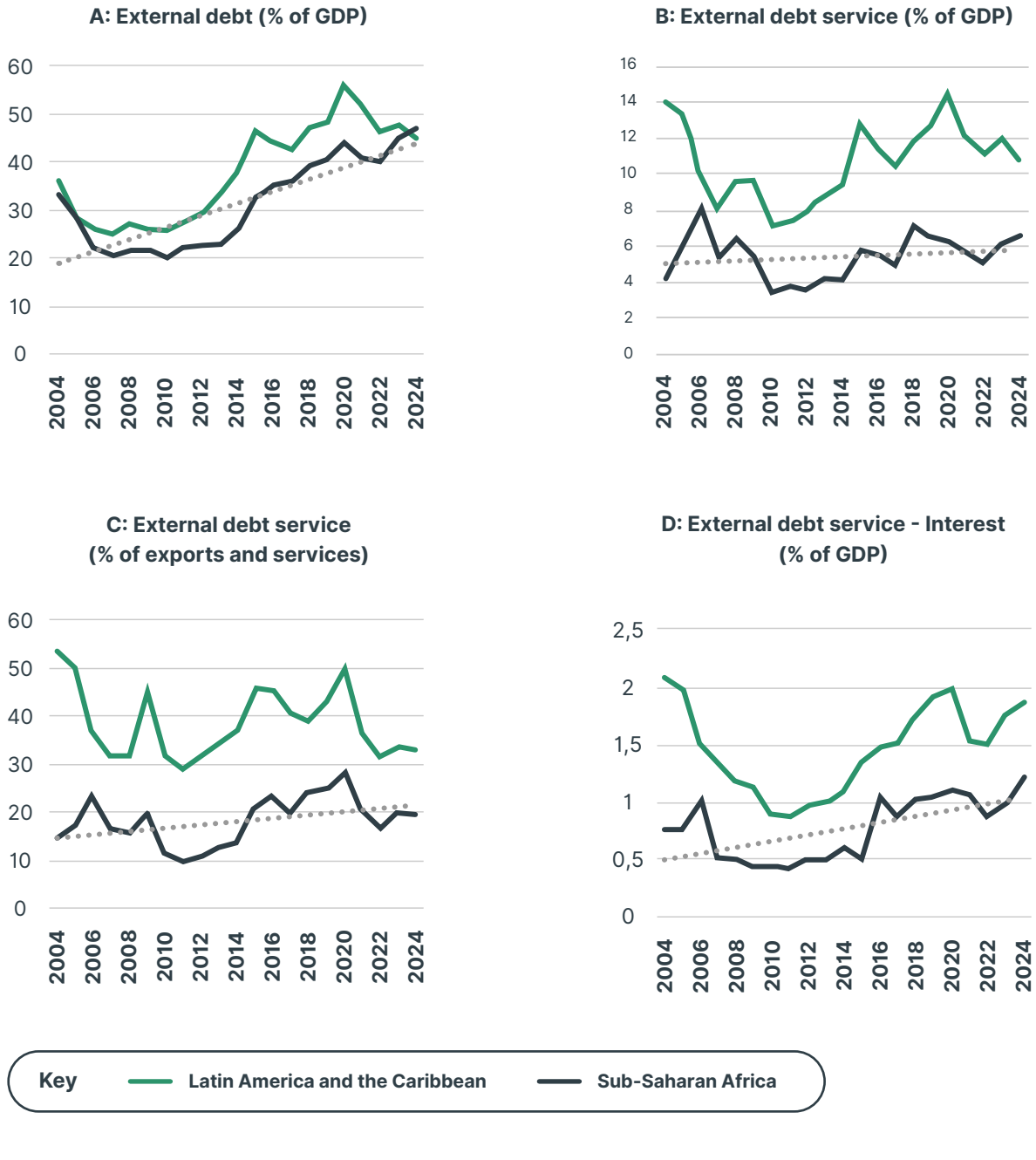
[2] M. Zucker-Marques, R. D'orsi, K. Ramburuth, P. Njoroge and K. Gallagher, *Diverting Development: The G20 and External Debt Service Burden in Africa,* Institute for Economic Justice Sovereign Debt Working Paper Series No 1 (Johannesburg: Institute for Economic Justice, 2025), https://iej.org.za/wp-content/uploads/2025/04/IEJ-G20-Diverting-Dev-Prospects.pdf; A. Alter, K. Khandelwal, T. Lemaire, H. Mighri, C. Sever and L. Tucker, *Navigating the Evolving Landscape of External Financing in Sub-Saharan Africa*, IMF Working Papers 139 (Washington, D.C.: IMF, 2025), https://www.imf.org/en/Publications/WP/Issues/2025/07/04/Navigating-the-Evolving-Landscape-of-External-Financing-in-Sub-Saharan-Africa-568248.

Figure 1
External debt trend



Source: IMF, World Economic Outlook database (Washington, D.C.: IMF, 2026).

Context

The shifting landscape of lending: A sharp rise in borrowing costs and a shift in debt composition

Context

The shifting landscape of lending: A sharp rise in borrowing costs and a shift in debt composition

The cost of African sovereign borrowing has changed considerably over time, showing a significant uptick over the last 2 decades. In the early 2000s, average borrowing costs were relatively low: around 1% between 2000 and 2001. By 2016, average interest rates had climbed to around 10.1%, reflecting a significant increase in borrowing costs and higher risk premium. Although interest rates eased to around 8.5% during 2020–2022 due to liquidity support during the pandemic, they surged again to 12.3% in 2024 before moderating slightly to 11.3% in 2025 (Figure 2).

Figure 2
Average interest rate and instrument composition of African sovereign debt (2000–2024)

	2000	2024
Domestic bill	12.55%	55.80%
Domestic bond	13.72%	21.41%
Multilateral loan	61.77%	13.72%
International bond	5.38%	7.67%
Paris Club loan	3.0%	1.21%
Non-Paris Club loan	0.0%	0.19%
China loan	3.58%	0.60%

Source: Authors' computation based on M. S. Manger et al., *Africa's Domestic Debt Boom: Evidence from the African Debt Database*, CEPR Discussion Paper 20747 (London: Centre for Economic Policy Research, 2026), https://africandebtdatabase.com; Boston University Global Development Policy Center, Chinese Loan to Africa Database, 2025, https://www.bu.edu/gdp/chinese-loans-to-africa-database-data-download/.

In analysing the composition of debt between 2000 and 2024, Figure 2 shows a fundamental shift in how African governments borrow. Over time, total debt composition has gradually moved away from multilateral lenders, Paris Club members and non-Paris Club creditors towards domestic bonds and bills, Chinese loans and international bonds.

Figure 2 shows that in the early 2000s, Africa's borrowing was relatively balanced between external loans and domestic debt, with multilateral loans making up a large proportion of the total debt. Between 2018 and 2023, there was a significant shift toward domestic financing, with domestic bills now dominating the landscape, accounting for over 55% of all borrowing, while multilateral loans have dropped to about 13.72% of total borrowings. This suggests a move toward local currency debt, though often at higher interest rates as shown in Figure 2, and shorter maturities. While domestic borrowing can involve higher interest rates and shorter maturities, local currency debt issuance also has its benefits where a country has developed debt frameworks. A deeper local currency debt market with a robust debt framework has the capacity to support macroeconomic growth and provide buffers against external shocks.

With respect to Chinese loans over the years, Africa has witnessed both a rise and a plateau in Chinese lending to the continent. Between 2000 and 2005, Chinese lending was less than 4% of total borrowing. However, between 2010 and 2016, there was a significant surge in Chinese lending, peaking in 2013 and 2015 at about 9% (US$27 billion) and 10% (US$32 billion) of total borrowings.[3] More recently, Chinese financing has witnessed a significant shift, moving from China being a net provider of capital to developing countries a decade ago to a net extractor of capital.

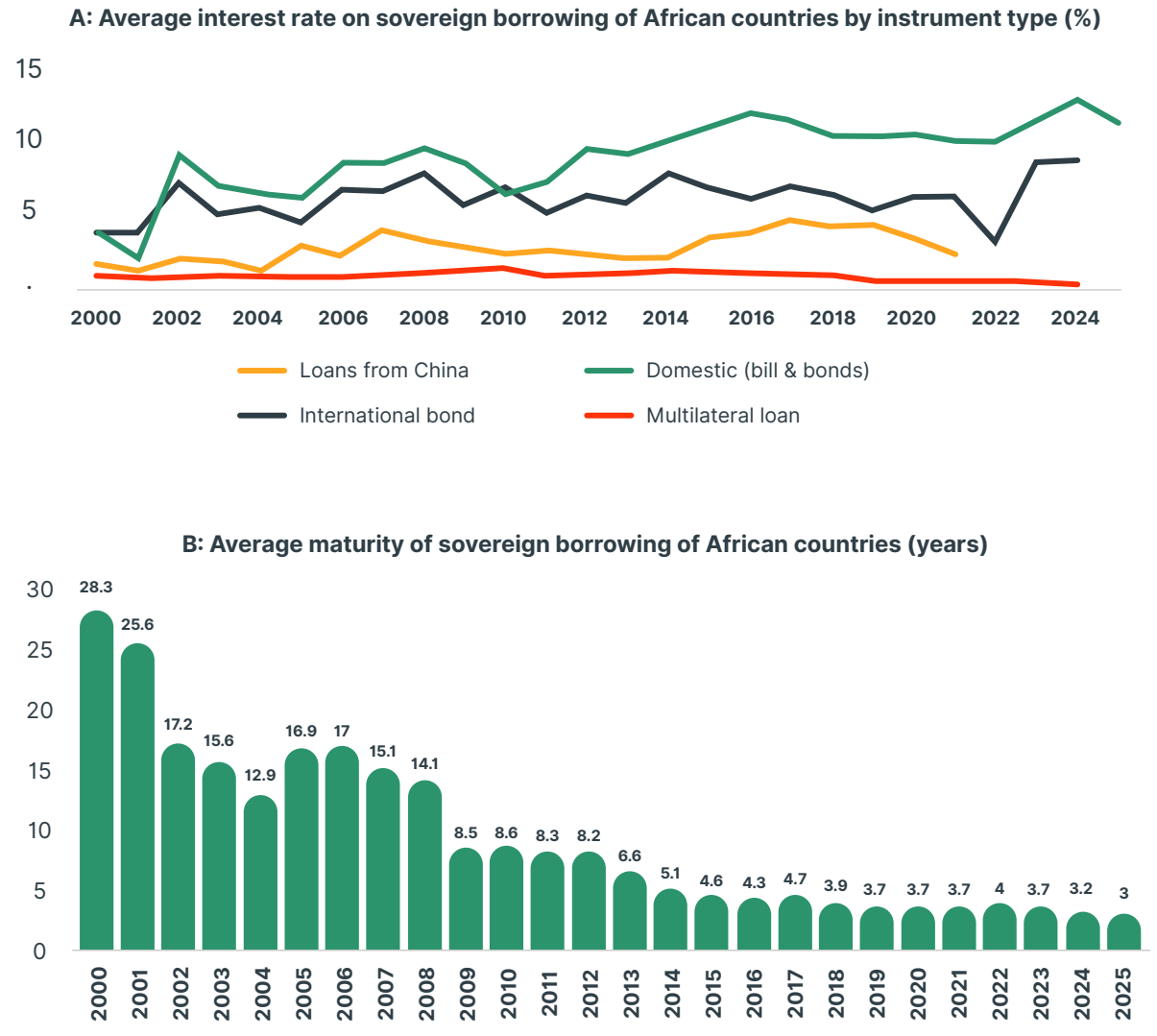
This shift helps explain why international and Africa-based commercial banks now play a much more prominent role in sovereign financing as governments increasingly rely on domestic bills, international bonds and other market-based financing debt instruments. Banks interviewed for this study noted that they have developed internal models and risk frameworks that allow them to pursue these opportunities while protecting their capital. That balancing act has become considerably more complex as the lending landscape has evolved.

The actual cost of debt

Borrowing costs vary widely depending on the instrument: multilateral loans are the cheapest and most stable, followed by loans from China. International bonds are a middle ground and domestic bills and bonds are consistently the most expensive (Figure 3).

[3] M. Onen, H. S. Shin and G. von Peter, Overcoming Original Sin: Insights from a New Dataset, BIS Working Papers No 1075 (Basel: Bank for International Settlements, 2023), https://www.bis.org/publ/work1075.pdf.

Figure 3
Average interest rate on sovereign borrowing of African countries by instrument type and average borrowing maturities

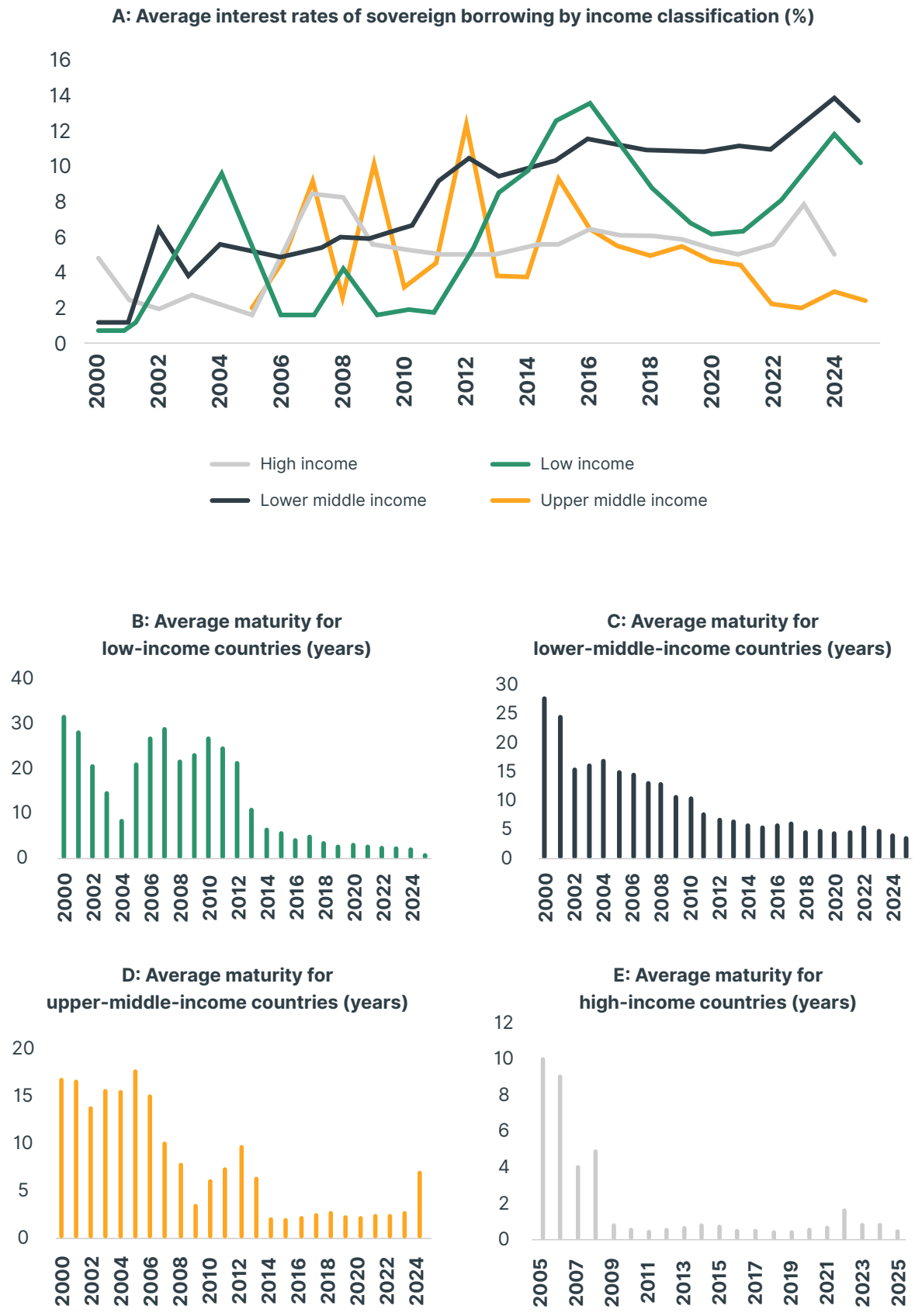


Source: Authors' computation based on Manger et al., *Africa's Domestic Debt Boom: Evidence from the African Debt Database.*

As interest rates have been increasing, especially on domestic bills and bonds and international bonds, average maturity of instrument issues across the continent has been falling. The combination of these two trends – rising costs and declining maturities – creates a debt sustainability problem that banks factor into every risk assessment they make when considering lending to these sovereign issuers.

These factors create a vicious cycle. Shorter tenors and higher costs increase the risk of debt unsustainability, which pushes lenders towards even shorter tenors and higher costs to compensate for the risk. Borrowers find themselves trapped. Figure 4 shows how vulnerability tracks with national income. Low-income economies pay higher interest rates and face sharper drops in average maturities.

Figure 4
Average interest rate and maturity by income classification



Source: Authors' computation based on Manger et al., *Africa's Domestic Debt Boom: Evidence from the African Debt Database*.

Low-income and lower-middle-income African sovereigns pay the highest interest rates in most years, with particularly sharp spikes in 2015–2017 and again in 2023–2024, while upper-middle-income economies face mid to high single-digit rates and high-income issuers generally pay less, though with notable volatility. Analysis across all groups shows that maturities have shortened, but the trend hits poorer economies hardest, creating challenges for countries already struggling with financing constraints.

Interviews were conducted with 13 international and pan-African banks. All participating institutions indicated that they have embedded income as a key variable in their risk assessment models, recognising that debt distress is closely linked to what can be described as an income-tenor trap. High risk perceptions linked to weak growth led to shorter maturities, which created rollover risks, which in turn reinforces the perception of high risk — a cycle that perpetuates itself and becomes increasingly difficult to escape.

How banks make their decisions

The banks interviewed explained that they deploy sophisticated risk assessment models to estimate probability of default (PD), exposure at default (EAD) and loss given default (LGD). These models share core structural parameters with CRAs, but the banks said they benefit from something the rating agencies do not have: market insights from their day-to-day banking operations beyond sovereign lending.

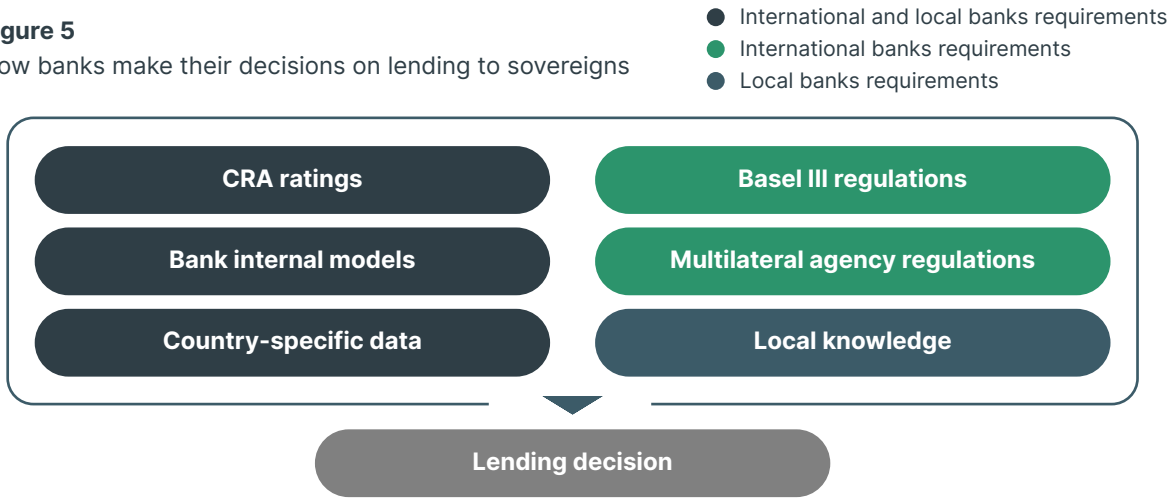
It is worth noting that CRA sovereign ratings reflect relative default risk and probability of default.[4] But the banks' perspective is that investment in Africa's sovereign debt is driven mainly by investors' risk appetite and the viability of efficient capital deployment as they see it.

Most African sovereigns are rated below investment grade, and higher capital buffers are required, raising the effective cost of capital allocation to these jurisdictions. Banks interviewed indicated that ratings are rarely the sole determinant of lending decisions. They stressed that they assess both ability to pay and willingness to pay, particularly in distressed or restructuring environments. However, in some cases, banks had continued exposure to some African countries despite ratings deterioration as the banks assessed policy commitment and repayment intent when making lending decisions.

Credit ratings shape liquidity and cost of capital in global debt markets, and both local banks and foreign-headquartered banks use them, though in different ways—local banks model their own internal country risk assessments that sometimes track the CRAs, while foreign-headquartered banks use credit ratings as a complementary tool for assessing sovereign risk on offshore subsidiaries. Either way, ratings affect both the flow of capital and its price, even when their influence on the investment decision has to be balanced with banks' internal assessment and judgement. Figure 5 presents a visual summary of the tools banks use to make decisions on lending to sovereigns.

The area highlighted in dark blue in Figure 5 represents the core factors considered by both international banks and regional banks with a local presence when making sovereign lending decisions. The green boxes indicate considerations that are more specific to international banks, while the blue box highlights factors that are primarily emphasised by regional banks, particularly due to their stronger local market familiarity.

Figure 5
How banks make their decisions on lending to sovereigns



[4] T. Lysenko, *Tracing the Drivers of Sub-Saharan Africa's Low Sovereign Credit Ratings*, Finance for Development Lab Working Paper 7 (Paris: Finance for Development Lab, 2025), https://findevlab.org/sub-saharan-africas-sovereign-credit-ratings/.

Key findings

Key findings

Lending to sovereigns is inherently complex, which makes strong risk assessment models and robust management processes essential. These models and processes allow banks to pursue their objective of participating carefully in sovereign investments. This participation is guided by different priorities for different institutions. International banks prioritise capital preservation, while pursuing a maximum return on investment. Local banks, by contrast, are more focused on managing market risks. However, these two priorities are not mutually exclusive and frequently overlap.

Based on the analysis of the perspectives of this study's respondents, together with historical data and context from other studies, four key findings emerged about how banks assess risk and make lending decisions.

Finding 1

There is a trend towards local currency, short-term, high-cost lending.

Banks consistently highlighted that international banks are enabling sovereigns to access foreign currency through Eurobonds, short-term lending, syndicated lending and currency swaps,[5] as well as in local currencies, but there is a clear shift happening.

All the banks interviewed described tradability, exit and pricing as central to whether they participate in sovereign lending, especially as it relates to foreign currency debt. All the banks also explicitly linked tenor choices to risk limits – that is, when risk rises, they shorten tenors to cap exposure and preserve optionality. With regard to local currency lending, a good proportion of banks interviewed indicated that lending to sovereigns was skewed towards local currency and was based on local presence and on the balance sheet of their local subsidiary banks. Hard currency exposure is pursued only when it improves pricing, tradability and portfolio metrics.

The South Africa-based banks, for instance, see opportunity in foreign currency lending to sovereigns but are increasingly shifting towards local currency lending. The banks explain that this is not arbitrary. When their risk assessment points to elevated risks, they deliberately bias towards shorter tenors to limit exposure. From their income perspective, the higher yields on these short-term local currency loans suit their business models better.

Extreme risk averseness is evident in some cases. One leading international bank told this study that its preference could only be for 12 months, with rollover to a maximum of 3 years possible if there are strong risk mitigants in place. This creates massive pressure on governments who cannot invest for growth in such short timeframes.

While the banks' processes enable them to meet their business objectives, this shift towards local currency with shrinking tenors and higher costs carries serious consequences for debt sustainability. The combination of rising costs and declining maturities creates acute fiscal pressures for African sovereigns, constraining their ability to invest in long-term development priorities and build economic resilience.

The trend towards short-tenor local currency instruments also presents a strategic dilemma for banks. To the extent that it underpins sovereign debt sustainability challenges, banks' exposure to the affected economies is subject to heightened risks. When the risks crystallise – as, for instance, in the cases of Ethiopia, Ghana and Zambia – the losses that banks incur point to the need to align their risk-return frameworks to sovereign lending decisions, since banks are well aware that the mechanisms for resolving a sovereign default are complex and fraught with challenges.

[5] Commercial banks have from time to time entered into currency swaps with central banks (e.g. Central Bank Nigeria and Bank of Uganda), even though it is typically seen as an arrangement between central banks. See International Monetary Fund, *The Treatment of Currency Swaps Between Central Banks: Egypt Experience*, Discussion Paper for Thirtieth Meeting of the IMF Committee on Balance of Payments Statistics (Washington, D.C.: IMF, 2017), https://www.imf.org/external/pubs/ft/bop/2017/pdf/17-25a.pdf.

Finding 2

Banks' internal models are the primary basis for investment decisions; CRA assessments are only complementary.

Most of the banks interviewed for this study highlighted that they design and use sophisticated models to estimate PD, EAD and LGD. While these models share the same structural parameters as those used by CRAs, they draw on a much richer information set. The suitability of these models has been evaluated by regulators in line with the mandate of assuring systemic stability. Analysis for this paper examined the models in the context of how they inform banks' investment decisions and whether such decisions have any inherent biases that disadvantage allocation of capital to sovereigns.

Banks feed in market insights from their broader operations — for example, trade finance flows, corporate lending patterns, currency movements — that give them leading indicators unavailable to rating agencies. Local banks build their own country risk assessments that sometimes track the CRAs, while international banks treat credit ratings as one input amongst many when assessing sovereign risk. The assessment matrix in Table 1 shows how banks combine quantitative data with qualitative judgements. CRAs' sovereign ratings capture only relative default risk;[6] banks' internal models capture something more nuanced from their presence on the ground.

The pattern is clear: the deeper a bank's roots in the local economy, the more it relies on its own models rather than external ratings. This local embeddedness allows banks to judge what matters most — not just whether a sovereign can pay, but whether it will pay. That distinction shapes whether banks increase, maintain or scale down their exposure. Interviews with commercial banks on the continent show that more than 70% extend lending to sovereigns in countries where they maintain a local presence. In such cases, lending decisions are typically based on the balance sheet of the local subsidiary, while some banks also rely on the balance sheet of the principal entity (the banking group) when structuring sovereign exposures. International banks, on the other hand, told us that structural indicators — GDP per capita and institutional quality — matter most in their lending decisions, but they assess these indicators through their own forensic analysis rather than outsourcing the judgement to rating agencies.

The real-world impact can be seen in the way in which banks sometimes ignore the CRAs entirely. A downgrade does not automatically trigger a retreat; an upgrade does not guarantee fresh investment. Ghana provides a telling example, where banks' internal models led them to decisions that flatly contradicted credit rating signals. Several banks told us that they saw Zambia's sovereign debt troubles coming well before the rating agencies did. This creates an interesting dynamic within the African continent, as capital flows and pricing may sometimes move independently of what the ratings say, reflecting the possibility that banks rely on their own assessment on willingness to pay rather than solely on the CRAs' calculation of default probability.

Table 1
The assessment matrix

	Quantitative assessment	Qualitative assessment
Data-driven indicators	Historical economic data: GDP per capita, real GDP growth, inflation, government debt, fiscal balance, current account balance, exchange rate, FX reserves.	The assessment of external parties, e.g. CRAs; debt transparency.
Forward-looking indicators	Forecasts for growth, exchange rate, debt, interest rate burden, external metrics. Estimates for historical variables if official data are missing.	Institutional quality; (geo)political risk; policy credibility; impact of macroeconomic imbalances; the quality of the business environment; risk of marked deterioration in external financing; significantly weakening monetary transmission mechanism.

[6] Lysenko, *Tracing the Drivers of Sub-Saharan Africa's Low Sovereign Credit Ratings*; Basel Committee on Banking Supervision, *Minimum Capital Requirements for Market Risk* (Basel: Bank for International Settlements, 2019), https://www.bis.org/bcbs/publ/d457.pdf.

Finding 3

Basel III has unintended effects on African sovereigns.

There is a broad consensus among the international and pan-African banks interviewed that a strong regulation framework is both necessary and appropriate. However, evidence suggests that the application of Basel III has unintended consequences for African sovereign borrowing costs. Under Basel III, capital allocation for sovereign exposures is linked to credit ratings from approved agencies. Because most African sovereigns are rated below investment grade, banks must hold higher regulatory capital against these exposures. This reduces risk-adjusted returns and incentivises capital reallocation toward investment-grade or less risky assets. Foreign-owned subsidiaries prioritise capital preservation and are more constrained in deploying balance sheet capacity to poorly rated African sovereigns.

While banks employ robust internal risk models, including assessments of debt sustainability, probability of default and institutional quality, regulatory capital requirements remain ratings- sensitive and can override internal credit views, especially for international banks who have adopted Basel III. As a result, even where internal assessments are supportive, higher capital charges may limit exposure or the tenor that banks are willing to provide.

Local banks have flexibility in their investment decisions, but international banks must add extra layers of assessment for sovereign investments because of Basel III requirements. Specifically, they are required to allocate capital based on the credit rating of the country where they plan to invest. For government paper denominated in domestic currency and funded by the bank in the same currency, a lower capital requirement applies, but for foreign currency instruments, capital allocation depends on whether the credit is rated investment grade by at least two CRAs specified by the regulator. As a result, banks with local presence are more likely to lend in local currency to sovereigns in their region of operation because a lower capital requirement applies. According to the Bank for International Settlements, Basel prudential regulation allows banks to apply lower risk weights to sovereign exposures denominated and funded in domestic currency, creating differential capital requirements relative to international exposures.[7]

Although these Basel III requirements aim to ensure financial market stability and banks generally view them as well-intentioned, they constrain capital flows to economies perceived as risky, a view commonly shared by the South African banks in our sample operating across the continent. South African banks were particularly vocal about this unintended consequence — regulation designed to prevent financial crises ends up driving lending patterns that make debt crises more likely.

Basel III strengthens financial stability but introduces a structural trade-off between prudential resilience and sovereign access to capital. These findings highlight the need for a more nuanced policy dialogue on how global regulatory frameworks interact with frontier market realities.

Finding 4

Constrained sovereign investor relations capacity leads to unfavourable credit terms.

Banks have strong views on the role multilateral institutions could play to optimise their implicit partnership with commercial financiers. They told this study something noteworthy: they acknowledge that the funding provided by multilaterals matters, but to a lesser extent than their support towards capacity enhancement. While funding from the IMF and World Bank gets the headlines, banks see more value in these institutions developing debt management offices and investor relations capabilities in African governments.

The gap here directly affects borrowing costs and access to capital. African sovereigns without strong investor relations capacity might be unable to make the case for better credit terms — which means they become price takers rather than price negotiators. This shows up in the risk premiums that banks charge. When governments cannot effectively communicate their fiscal plans, debt management strategies or reform commitments, banks perceive higher risk and price accordingly. The Institute of International Finance (IIF) has developed a survey-based score tracking sovereign investor relations developments, demonstrating how enhanced investor relations practice acts as a "pull factor" for capital. For instance, in 2025, Kenya achieved an investor relations score of 42.13 (out of 50),[8] a significant improvement of about five points over its 2024 performance, thereby reflecting its

[7] Basel Committee on Banking Supervision, *The Regulatory Treatment of Sovereign Exposures* (Basel: Bank for International Settlements, 2017), https://www.bis.org/bcbs/publ/d425.pdf.

[8] See, for example, Institute of International Finance, *2025 IIF Investor Relations and Debt Transparency Report: Unlocking Affordable Capital For Emerging Markets – The Vital Role of Investor Relations* (Washington, D.C.: Institute of International Finance, 2025), https://www.iif.com/Publications/ID/6219/2025-IIF-Investor-Relations-and-Debt-Transparency-Report-Unlocking-Affordable-Capital-For-Emerging-Markets-The-Vital-Role-of-Investor-Relations.

commitment to enhanced investor relations and improved communication with investors. This institutional progress likely supported Moody's recent upgrade of Kenya's credit rating to B3, facilitating the country's return to international capital markets with its US$2.25 billion dual-tranche Eurobond issuance in February 2026, which was successfully issued with the aim of refinancing maturing debt and supporting the national budget.

Banks recognise that IMF programmes support economic stabilisation and anchor policy credibility and they value the information from the Fund's country-specific publications. But there is a catch: banks also see IMF involvement as a signal of underlying vulnerabilities, marking the Fund as a "lender of last resort". This means IMF involvement is a double-edged sword — an IMF programme can either reassure banks or raise red flags, depending on their judgement of the situation. What matters most to banks is whether multilaterals are helping countries develop the capability to reduce perceived risk through credible investor communications.

Conclusion and recommendations

Conclusion and recommendations

Banks deploy elaborate risk assessment models that focus on a critical distinction: not whether a country can potentially pay, but whether it is willing to pay. This focus on willingness rather than capacity shapes their lending in fundamental ways.

Banks that have local presence consider on-the-ground insights in their lending decisions. Banks embedded in African economies have an information advantage — they see leading indicators from trade finance, currency markets and corporate lending that rating agencies miss. This lets them make calls that sometimes flatly contradict external credit ratings.

Yet Basel III regulations constrain how banks act on their credit risk assessments. The Basel framework makes foreign currency lending to lower-rated countries prohibitively expensive in capital terms, pushing banks toward short-term, high-interest lending in local currency, especially where banks have local presence. While the regulation strengthens financial stability, it also encourages lending patterns that can undermine long-term debt sustainability.

The result, made clear both in the data analysis and direct engagement with banks conducted for this paper, points to a self-reinforcing vicious cycle. Low per capita income levels themselves have become the trap. Higher-cost loans create unsustainable debt, which in turn creates higher risk profiles. This justifies even higher costs and shorter tenors. This cycle is ultimately unstable for all parties – both sovereigns and banks – creating systemic risk that cannot be resolved without further investigation and ultimately policy recommendations to break the cycle.

Against this backdrop, multilaterals play a crucial role — but not necessarily through funding. Banks see the real value of multilateral institutions as lying in capacity-building. When the IMF and World Bank strengthen debt management offices and investor relations capabilities, they help countries communicate effectively with lenders, reduce perceived risk and lower borrowing costs.

Recommendations

The findings of this study have implications for how banks' lending patterns may continue to influence Africa's vulnerability to sovereign debt risks. African economies are constrained not only by access to financing but also by the cost of funds. These findings support the following recommendations aimed at informing policymakers on capacity enhancement, as well as market and regulatory reforms.

Recommendation 1

Build deeper local markets.

The problem stems partly from shallow local capital markets. Policymakers should prioritise developing local capital market infrastructure, deeper markets with stronger institutional investor bases, better trading mechanisms and clearer regulatory frameworks. Deeper, well-established domestic debt markets have the capacity to support macroeconomic growth while providing buffers against economic shocks.

Although there are benefits to deepening domestic markets, some risks exist, especially for countries with vulnerable macroeconomic conditions, shallow markets and less developed debt frameworks, which are forced to rely on high interest short-term

[9] A. Sy and A. Laws, The New Face of African Debt (Washington, D.C.: IMF, 2026), https://www.imf.org/-/media/files/publications/fandd/article/2026/03/sy.pdf.

borrowing due to limited access to long term financing. For example, a recent IMF report shows that since its 2023 domestic debt restructuring, Ghana has issued only T-Bills that have a maturity of less than a year, making it vulnerable to refinancing risks.[9] However, at the other end of the spectrum, Mauritius and Tanzania have managed to lengthen their maturities, generating positive benefits for monetary policy and capital markets.

Overall, countries that have incorporated domestic debt market development into a broader sovereign strategy are better positioned to leverage the benefits of deep capital markets while managing interest rates and maturity risks.

Recommendation 2

Investigate Basel III's African impact.

Does Basel III's requirement for international banks to weight CRA ratings when allocating capital for foreign currency lending hurt long-term economic growth in Africa? There is need for a rigorous, in-depth investigation of how Basel III affects bank decision-making in practice. The regulation achieves financial stability but may inadvertently constrain capital flows to the economies that need them most urgently. Further research should examine whether regulatory adjustments could maintain stability while enabling more sustainable lending patterns. This is not about weakening prudential standards; it is about understanding unintended consequences.

Recommendation 3

Prove the value of sovereign investor relations capacity.

There is a knowledge gap around whether building sub-Saharan African sovereign investor relations capacity could improve price-setting by lenders and reduce borrowing costs. The IIF has developed a survey tracking sovereign investor relations developments, but more work is needed. Rigorous empirical analysis should examine the link between sovereign investor relations capacity and the cost of funding in Africa, drawing on experiences from other regions where governments have successfully built these capabilities. If the link proves strong, it makes the case for multilaterals to prioritise capacity-building over capital provision.

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Appendices

Appendix A

Value of sovereign debt by instrument type in US$ millions (2000-2004)

	Chinese loan	Domestic bill	Domestic bond	International bond	Multilateral loan	Non-Paris Club loan	Paris Club loan	Total
Algeria	50				1,736	295	656	**2,737**
Angola	50,993	9,159	37,170	6,250	16,026	100	2,487	**122,185**
Benin	1,978	2,729	5,332	3,367	8,262	108	493	**22,269**
Botswana	1,060	5,733	3,679		3,399		234	**14,105**
Burkina Faso	216	5,263	5,258		12,501	129	683	**24,049**
Burundi	87	1,514	151		2,720	78	67	**4,617**
Cameroon	7,218	3,764	2,103	2,010	13,935	61	2,438	**31,530**
Cabo Verde	151	288	895		1,418	31	612	**3,395**
Central African Republic	149	102	256		2,448	97	1	**3,053**
Chad	920	4,067	988		5,681	270	114	**12,040**
Comoros	118				1,131	17	3	**1,269**
Congo	4,830	2,584	2,875		2,231		590	**13,110**
Côte d'Ivoire	6,090	16,383	11,923	15,193	17,615	181	3,974	**71,360**
Democratic Republic of Congo	9,936	1,453	1,182	478	12,531		999	**26,579**
Djibouti	1,838				2,968	334	15	**5,155**
Egypt	23,914	2,053,928	1,426,071	35,993	38,525	5,408	12,648	**3,596,487**
Equatorial Guinea	6,897	1,491	822		496			**9,706**
Eritrea	2,476				431	70	93	**3,070**
Eswatini		2,737			548	61	47	**3,393**
Ethiopia	16,447	27,556	145	1,000	37,494	266	2,072	**84,980**
Gabon	2,298	4,780	2,917	5,410	5,144		1,283	**21,832**
Gambia	26	3,010			2,379	214	1	**5,630**
Ghana	7,383	101,663	18,606	15,525	16,092	59	2,496	**161,824**
Guinea	4,266				4,626	132	440	**9,464**
Guinea-Bissau	22	771	702		905	26	2	**2,428**
Kenya	10,715	122,673	51,845	8,600	35,457	54	7,609	**236,953**
Lesotho	262	882	253		1,272	67		**2,737**
Liberia	553	880			3,793	59	119	**5,404**
Libya	300				7			**307**
Madagascar	467	1,351			9,817	66	799	**12,500**
Malawi	635	6,802			6,862	69	8	**14,376**
Mali	1,018	3,981	5,934		8,646	376	706	**20,661**
Mauritania	874	4,803	40		5,773	394	220	**12,104**
Mauritius	654	30,460	17,281		2,107	160	1,587	**52,249**
Morocco	1,418	6,902	24,699	17,635	52,999	454	14,453	**118,560**
Mozambique	4,715	25,166	2,681	1,627	13,776	166	1,782	**49,913**
Namibia	1,784	20,991	4,556	1,372	2,321		759	**31,783**
Niger	2,606	5,572	3,069		10,015	126	516	**21,904**
Nigeria	11,521	319,835	54,975	20,618	44,406		3,222	**454,577**
Rwanda	644	12,035	2,235	1,020	9,430	127	1,142	**26,633**
São Tomé and Príncipe		-	-		429	17	28	**474**
Senegal	3,043	3,869	7,117	6,092	17,297	249	3,259	**40,926**
Seychelles	1	4,708	186	230	423	29	15	**5,592**
Sierra Leone	4,159	3,201	58		4,268	131	99	**11,916**
Somalia					3,482		1,231	**4,713**
South Africa	10,678	746,109	71,121	36,996	17,426		4,039	**886,369**
South Sudan	4,732				225			**4,957**
Sudan	10,864				7,296	600	96	**18,856**
Tanzania	2,426	16,007	13,045	600	25,161	223	3,370	**60,832**
Togo	917	2,850	5,616		4,027	84	298	**13,792**
Tunisia	210			7,667	26,767	707	8,739	**44,090**
Uganda	3,873	7,865	7,947		15,518	66	1,242	**36,510**
Zambia	11,402	17,520	8,944	3,134	7,395	24	474	**48,893**
Zimbabwe	3,278				231	20		**3,529**
Total	**243,112**	**3,613,438**	**1,802,677**	**190,817**	**547,868**	**12,205**	**88,260**	**6,498,377**

Appendix B

Average interest on sovereign debt by instrument type (%, 2000-2024)

	Chinese loan	Domestic bill	Domestic bond	International bond	Multilateral loan	Non-Paris Club loan	Paris Club loan	Total
Algeria	0.0				1.4	4.2	1.5	**1.5**
Angola	4.4	16.1	17.2	8.9	1.5	2.0	0.9	**15.9**
Benin	2.0	5.8	6.4	6.5	0.7	1.8	1.5	**3.6**
Botswana	3.6	5.5	9.4		3.7		1.5	**7.6**
Burkina Faso	3.0	6.0	6.9		0.8	1.9	1.8	**4.2**
Burundi	1.4	5.4	7.0		0.4	1.0	0.0	**5.2**
Cameroon	2.1	3.1	2.2	8.3	1.0	1.9	2.0	**2.1**
Cabo Verde	0.7	1.1	3.3		0.8	2.0	1.0	**2.1**
Central African Republic	0.0	5.7	6.6		0.2	1.0		**2.1**
Chad	2.5	6.6	4.5		0.4	1.6	0.8	**4.4**
Comoros	1.0				0.4	0.8	3.0	**0.5**
Congo	0.6	6.3	4.5		1.2		2.4	**4.5**
Côte d'Ivoire	1.0	4.9	6.4	6.2	1.0	1.8	0.9	**4.5**
Democratic Republic of Congo	3.5	11.4	7.5		0.6		1.3	**4.3**
Djibouti	2.8				1.2	1.8	1.5	**1.5**
Egypt	2.9	14.9	15.4	6.0	2.3	2.0	1.3	**14.4**
Equatorial Guinea	3.8	7.9	4.8		1.8			**6.3**
Eritrea	0.0				0.8	2.0	1.0	**0.9**
Eswatini		7.4			1.9	2.3	0.1	**7.3**
Ethiopia	3.1	8.7	9.8	6.6	0.7	1.2	0.6	**5.1**
Gabon	2.0	4.9	3.8	6.8	1.7		3.6	**4.3**
Gambia	2.0	9.3			0.6	1.7	0.0	**9.0**
Ghana	2.9	20.1	20.2	7.9	1.4	1.5	1.4	**16.6**
Guinea	2.9				0.6	1.8	1.1	**0.9**
Guinea-Bissau	0.0	7.5	7.4		0.4	1.8		**5.7**
Kenya	2.4	10.5	13.3	7.4	1.1	1.9	1.1	**9.8**
Lesotho	1.3	6.3	9.8		1.4	2.5		**6.2**
Liberia	2.0	2.1			0.6	1.4		**1.7**
Madagascar	1.8	6.2			0.6	1.6	1.7	**4.9**
Malawi	1.3	17.3			0.6	1.7	0.0	**15.8**
Mali	0.4	6.7	7.1		0.6	1.8	1.0	**4.4**
Mauritania	0.8	5.1	7.2		1.0	2.2	1.8	**4.5**
Mauritius	0.6	3.2	5.8		0.4	1.3	3.1	**3.7**
Morocco	1.8	2.2	0.0	3.8	2.1	2.8	1.8	**1.3**
Mozambique	2.1	16.2	17.3	7.8	0.5	1.5	1.1	**13.4**
Namibia	1.5	7.2	9.8	7.2	1.1		1.3	**8.8**
Niger	4.2	6.2	6.7		0.6	1.4	1.1	**3.6**
Nigeria	3.3	9.7	12.6	7.5	1.3		1.6	**9.5**
Rwanda	2.0	8.7	11.7	6.1	0.8	1.3	1.3	**7.7**
São Tomé and Príncipe		4.5	5.5		0.3	1.5	1.0	**2.4**
Senegal	1.5	5.2	6.2	6.9	0.9	1.9	1.2	**3.1**
Seychelles	2.0	5.7	4.8	9.1	1.5	2.0	2.2	**5.7**
Sierra Leone	3.3	24.1	32.0		0.5	1.6	2.2	**18.7**
Somalia					0.0		2.3	**0.7**
South Africa	7.5	6.7	5.2	5.5	0.9		3.4	**6.5**
South Sudan	2.7				0.0			**1.6**
Sudan	3.7				0.7	2.1	0.0	**1.9**
Tanzania	2.1	8.1	14.2		0.8	1.7	0.9	**8.1**
Togo	1.9	6.4	6.8		0.4	1.8	1.8	**4.9**
Tunisia	1.0			4.8	1.6	2.0	1.7	**1.9**
Uganda	2.8	11.2	15.0		0.8	1.9	1.5	**9.2**
Zambia	3.2	15.3	24.3	7.5	1.2	2.0	1.3	**16.5**
Zimbabwe	3.0				1.1	1.5		**2.5**
Total	**3.1**	**9.4**	**11.6**	**6.3**	**0.8**	**1.8**	**1.5**	**8.8**

Appendix C

Average maturity of sovereign debt by instrument type (%, 2000-2024)

	Chinese loan	Domestic bill	Domestic bond	International bond	Multilateral loan	Non-Paris Club loan	Paris Club loan	Total
Algeria	13.3				13.8	16.0	22.1	**18.2**
Angola	16.3	0.7	4.0	15.0	19.2	25.0	32.0	**4.2**
Benin	18.5	0.7	4.4	15.4	29.6	25.2	21.9	**14.6**
Botswana	14.5	0.5	10.5		17.0		18.8	**7.3**
Burkina Faso	16.0	0.8	4.3		30.3	23.1	22.6	**12.4**
Burundi	16.3	0.6	1.8		24.3	27.5	30.0	**1.3**
Cameroon	18.8	0.5	4.8	9.3	26.9	24.6	24.2	**14.3**
Cabo Verde	20.0	0.5	6.4		27.2	29.5	28.6	**12.6**
Central African Republic	20.0	0.5	3.4		26.2	24.5		**11.9**
Chad	15.0	0.6	2.7		30.3	27.1	20.0	**6.0**
Comoros	27.5				24.4	30.0	8.5	**23.6**
Congo	17.4	0.5	2.9		22.4		19.4	**6.7**
Côte d'Ivoire	19.1	0.5	4.5	14.6	24.0	27.4	27.7	**7.9**
Democratic Republic of Congo	22.3	0.4	2.7	22.0	32.3		27.8	**16.4**
Djibouti	13.6				27.1	27.8		**25.3**
Egypt	9.5	0.6	4.2	13.0	17.9	20.5	27.4	**3.1**
Equatorial Guinea	9.4	0.9	5.0		15.0			**3.9**
Eritrea	12.5				35.3	19.0	32.1	**31.1**
Eswatini		0.4			20.4	25.6	36.5	**0.9**
Ethiopia	15.9	0.4	1.6	10.0	30.4	30.2	31.4	**12.4**
Gabon	18.5	0.5	3.5	10.6	14.3		15.2	**4.0**
Gambia	20.0	0.6			27.0	26.4	30.0	**1.1**
Ghana	11.4	0.5	3.7	15.1	26.7	29.7	28.9	**5.3**
Guinea	16.7				32.1	22.0	22.9	**28.6**
Guinea-Bissau	20.0	0.7	3.8		29.0	27.0		**7.1**
Kenya	18.6	0.6	10.0	12.0	27.5	25.2	28.4	**5.0**
Lesotho	20.0	0.6	5.7		26.6	23.3		**2.5**
Liberia	17.5	0.1			31.3	26.8		**6.9**
Madagascar	25.0	0.5			30.3	25.8	25.9	**6.9**
Malawi	15.8	0.6			30.5	25.4	30.0	**2.6**
Mali	19.9	0.7	4.1		32.0	24.0	24.4	**12.6**
Mauritania	20.0	0.3	1.8		27.9	24.0	24.0	**3.7**
Mauritius	18.9	0.6	6.5		14.8	19.5	15.7	**2.4**
Morocco	19.1	0.6	7.8	11.9	18.5	20.4	22.4	**13.7**
Mozambique	18.7	0.6	5.6	9.3	30.7	28.0	29.5	**4.8**
Namibia	18.1	0.6	13.4	8.8	12.8		20.3	**9.5**
Niger	13.4	0.7	4.6		31.4	26.4	24.2	**14.4**
Nigeria	15.4	0.5	10.0	13.6	25.4		18.6	**4.7**
Rwanda	20.7	0.4	7.9	10.0	30.2	27.3	29.0	**2.6**
São Tomé and Príncipe		0.9	3.4		21.9	29.0	33.3	**9.5**
Senegal	19.1	0.6	4.5	13.0	29.3	25.4	26.8	**17.6**
Seychelles	10.0	0.6	5.6	4.6	13.8	24.5	16.5	**0.8**
Sierra Leone	17.4	0.8	2.5		29.1	24.5	27.3	**5.8**
Somalia					10.0		17.4	**16.8**
South Africa	10.4	0.6	17.1	16.2	14.5		15.4	**4.6**
South Sudan	6.6				10.0			**8.0**
Sudan	11.7				27.3	26.8	31.4	**18.6**
Tanzania	18.7	0.5	9.9	7.0	31.3	25.6	31.1	**8.3**
Togo	20.7	0.7	4.6		30.9	29.0	17.1	**9.5**
Tunisia	20.8			12.5	18.6	23.5	24.2	**21.5**
Uganda	18.1	0.6	7.7		32.1	25.5	23.6	**9.5**
Zambia	14.6	0.6	7.0	8.5	28.8	24.0	28.8	**5.2**
Zimbabwe	14.5					29.0		**15.1**
Total	**16.1**	**0.6**	**7.9**	**13.3**	**27.5**	**25.0**	**25.0**	**5.3**

Source for all tables: Authors' computation based on Manger et al., Africa's Domestic Debt Boom: Evidence from the African Debt Database.

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