

**AFRICA RISK CONSULTING****Zambia Monthly Briefing October 2020**

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**Zambia Summary 23 October 2020**

*Zambia begins talks with its Eurobond holders after an investor committee rejects the country's request for an interest-payment standstill, saying it needs more information on restructuring plans. A group holding 40% of Zambia's \$3 billion in outstanding Eurobonds, abstains from voting rather than rejecting outright the country's debt-standstill proposal. United States-based ratings agency S&P Global Ratings (S&P) cuts Zambia's credit rating to selective default, after the government misses an interest payment. Copper mines in Zambia have halted \$2 billion of planned investments because of a royalty tax introduced in 2019 that makes mining projects unviable. South Africa-based Mbuyisa Moleele Attorneys and United Kingdom-based law firm Leigh Day lodge a class action suit on behalf of Kabwe region families against multinational mining company Anglo-American over an alleged toxic lead legacy during mining between 1924 and 1975.*

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**Zambia teeters on the brink of debt default ...**

Finance minister **Bwalya Ng'andu** has attempted to ease bondholders' concerns by assuring them that the **Zambian** government has budgeted to meet its interest payments and will not default on them. The government entered talks with its bondholders on 1 October, a day after its representatives, **Lazard Freres** and **White & Case**, met with representatives of its **Eurobond** holders.<sup>1</sup> The investor committee rejected Zambia's request for a six-month suspension of coupon payments of as much as \$120m, saying it needed more information on the country's restructuring plan.<sup>2</sup>

Despite its earlier reassurance to bondholders, Zambia defaulted on 14 October on payment of a \$42.5m coupon on one of its Eurobonds, activating a 30-day grace period. However, after saying the government was cash-strapped and couldn't meet the interest payment, Ng'andu told parliament that the Treasury "*could have made the payment if it wanted to*",<sup>3</sup> doing little to boost investors' confidence in the country's willingness and ability to tackle its debt.<sup>4</sup> On 21 October, a group that holds 40% of Zambia's \$3 billion in outstanding Eurobonds, abstained from voting as opposed to outright rejecting the country's debt-standstill proposal,<sup>5</sup> a move reported as a "*lifeline*" for the Zambian authorities.<sup>6</sup>

Zambia's decision to miss the payment has set the tone for a hostile restructuring process. Its external public debt burden amounts to nearly \$12 billion, with \$3 billion of outstanding Eurobonds, \$3.5 billion of bilateral debt, \$2.9 billion of other commercial debt and \$2.1 billion owed to multilaterals. A quarter of its debt is owed to **China**, which is concerning for other external bondholders.<sup>7</sup> Holders of Zambia's Eurobond are concerned about a lack of equitable treatment and are demanding clarity on how the Zambian authorities intend to deal with its other creditors:

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<sup>1</sup> Business Day, 1 Oct 2020

<sup>2</sup> Reuters, 1 Oct 2020

<sup>3</sup> Lusaka Times, 14 Oct 2020

<sup>4</sup> Business analyst, Zambia

<sup>5</sup> Business Day, 21 Oct 2020

<sup>6</sup> Lusaka Times, 21 Oct 2020

<sup>7</sup> Reuters, 20 Oct 2020

*“The core sticking points remain exactly the same: a lack of clarity over the treatment of the Chinese loan holders compared to Eurobond holders, and the potential trajectory of an [International Monetary Fund] IMF programme.”<sup>8</sup>*

According to the so-called “Yellow Book”, which provides a more detailed version of the budget speech delivered on 25 September, Zambia will spend 4.7 billion kwacha (\$230m) in Eurobond payments in 2021. This accounts for nearly half of the total budget set aside for external interest payments.<sup>9</sup> **South Africa**-based **NKC African Economics** analyst **Irmgard Erasmus** reports that, given other fiscal pressures, Zambia will struggle to meet payments during the six-month grace period it is seeking:

*“We believe that a distressed-debt exchange for Eurobond holders is inevitable, but considering the short time frame, Zambia has less than two months before being officially classified by ratings agencies as being in default.”<sup>10</sup>*

Meetings have been rescheduled to 13 November, which coincides with the expiry of the 30-day grace period. Zambia will enter default unless it pays an already overdue coupon on its \$1 billion of dollar notes due in 2024.<sup>11</sup> The finance ministry has assured investors and bondholders that it remains committed to finding a prompt solution.<sup>12</sup>

Zambia has a careful balancing act to ensure it is not the first **African** country to default during the **coronavirus** pandemic. Other African countries considering debt relief will be watching the situation in Zambia, while investors are no doubt concerned about where the next potential debt default will arise. Zambia has accumulated nearly \$12 billion in external debt over the past decade, flouting IMF warnings that the country is at high risk of debt distress.<sup>13</sup>

With Zambia heading to a general election in 2021, the country faces an uncertain path of trying to negotiate deals with private creditors and Chinese state-owned banks, while simultaneously trying to win favour with the IMF and electorate alike.<sup>14</sup> While Ng’andu remains hopeful that a deal can be struck in months, neighbouring **Mozambique** took three years to reach an agreement to restructure a single Eurobond.<sup>15</sup>

### ... as S&P cuts credit rating to selective default

**United States (US)**-based ratings agency **S&P Global Ratings (S&P)** has slashed Zambia’s credit rating to ‘selective default’ following the government’s missed interest payment on 14 October and its announcement that it would suspend debt service to external commercial creditors.<sup>16</sup> S&P previously rated Zambia’s long and short-term foreign currency sovereign credit ratings at ‘CCC-/C’, which signalled the prospect of an imminent default.<sup>17</sup>

Prior to the impact of the coronavirus pandemic on global markets, Zambia was already struggling with ballooning debt, despite being of the world’s top copper producers. In a statement released on 21 October, S&P indicated that Zambia is heading for messy and protracted default:

*“We view the nonpayment of debt service and the statement that the government will not make debt service payments as a default on its commercial debt obligations. We forecast that Zambia*

<sup>8</sup> Business Day, 1 Oct 2020

<sup>9</sup> Business Day, 1 Oct 2020

<sup>10</sup> Irmgard Erasmus quoted by Bloomberg, 1 Oct 2020

<sup>11</sup> Reuters, 21 Oct 2020

<sup>12</sup> Lusaka Times, 21 Oct 2020

<sup>13</sup> Bloomberg, 20 Oct 2020

<sup>14</sup> Business analyst, Zambia

<sup>15</sup> Reuters, 21 Oct 2020

<sup>16</sup> Fin24, 14 Oct 2020

<sup>17</sup> Financial Times, 14 Oct 2020

*will remain in payment default for at least the six months of the standstill period, during which the government hopes to complete a broader debt restructuring.”<sup>18</sup>*

S&P warned that it could also slash the domestic ratings, currently at ‘CCC-/C’, although it is unlikely that the government would suspend payment on local debt.<sup>19</sup> However, by March, Zambia had built up domestic debt amounting to ZK 25.4 billion (\$1.25 billion), reflecting fiscal stress in the local currency. The majority of the debt is comprised of unpaid value added tax (VAT) refunds and obligations due to suppliers of goods and services.<sup>20</sup>

### Royalty dispute halts \$2 billion copper mine investment

Canada-based **First Quantum Minerals** says it will halt plans to invest \$1 billion to extend production capacity at its **Kansanshi** operation until the Zambian government scraps the royalty tax.<sup>21</sup> **Lumbabe Copper Mine** (backed by **EMR Capital**) has also suspended plans to invest a similar amount in a new mining project.<sup>22</sup> **Zambia Chamber of Mines (ZCM)** CEO **Sokwani Chilembo** said the royalty payment stifles investors’ confidence in the country:

*“We need this royalty payment regime removed for progress to begin (and) if the government thinking is otherwise, good luck.”<sup>23</sup>*

The chamber of mines has advised the government to treat mineral royalty payments as a deductible expense, in order to avoid double taxation and attract investment. In 2019 the government stopped treating mineral taxes as a deductible expense in the calculation of corporate income tax.<sup>24</sup> The provision remained unchanged in the government’s latest budget delivered on 25 September.<sup>25</sup>

In its guide to understanding the mineral royalty tax, the ZCM notes that since tax is levied on revenue rather than profits, it is payable even when mines are marginal or loss-making. The tax is intended to ensure the government receives a stable flow of tax revenue throughout the life cycle of a mine: mines can take several years to become profitable and pay profit-based tax, so mining royalty tax is an effective way for governments to get upfront short-term tax revenue. Unlike a profits-based tax, mining royalty tax is a cost to the business. A rate that is too high can stifle economic activity and employment, discourage further investment, and diminish the long-term tax pipeline.<sup>26</sup> Finance minister Ng’andu claims that Zambia does not benefit enough from its mineral resources but says the government is open to considering the mining companies grievances over the royalty.

Zambia’s relationship with mining investors has gradually deteriorated over the past 12 months. The government clashed with **Switzerland**-based **Glencore** in April over plans to temporarily suspend operations at its **Mopani Copper Mines** (see *ARC Briefing Zambia April 2020*).<sup>27</sup> The government has become increasingly hostile over the country’s key export, which will do little to attract investment and boost investor confidence. President **Edgar Lungu**’s (2016 -present) actions reflect his struggle to deal with the economic challenges ahead of next year’s elections.<sup>28</sup>

Zambia is Africa’s second largest copper producer and depends on the metal for about 70% of its export revenues. However, the chamber of mines expects the coronavirus to cut output this year to about 764,188 tons, considerably short of the government’s one million-ton target.<sup>29</sup>

<sup>18</sup> S&P, 21 Oct 2020

<sup>19</sup> Bloomberg, 21 Oct 2002

<sup>20</sup> Fin24, 21 Oct 2020

<sup>21</sup> Mining Weekly, 28 Sep 2020

<sup>22</sup> Mining Weekly, 28 Sep 2020

<sup>23</sup> Business Daily, 28 Sep 2020

<sup>24</sup> Business Day, 28 Sep 2020

<sup>25</sup> CNBC Africa, 28 Sep 2020

<sup>26</sup> Chamber of Mines Guide, “A guide to understanding Mineral Royalty Tax”

<sup>27</sup> MiningMx, 28 Sep 2020

<sup>28</sup> Mining Analyst, Zambia

<sup>29</sup> Bloomberg, 28 Sep 2020

## Kabwe residents sue Anglo-American over lead poisoning

South Africa-based **Mbuyisa Moleele Attorneys** and **United Kingdom**-based law firm **Leigh Day** filed a class action law suit on 12 October against multinational mining company **Anglo-American Plc** on behalf of 100, 000 plaintiffs from **Kabwe District**.<sup>30</sup> The suit, filed in the **Gauteng Division of the High Court of South Africa**, alleges that Anglo-American caused widespread lead poisoning from a mine it operated in Zambia until 1974.<sup>31</sup> The group is demanding compensation and a clean-up of the area. Anglo-America has responded by saying it would defend its position.

The lawsuit is the latest in a series of suits in recent years that aim to hold the mining industry accountable for its actions and legacies. There is growing pressure on the mining industry and shareholder awareness around environmental, social and governance issues (ESGs). In a statement, Mbuyisa Moleele Attorneys and Leigh Day noted particulars of the claim:

*“The claimants – principally young children – are suffering from alarming levels of lead poisoning which, depending on various factors including the blood lead level (BLL), causes a range of significant conditions, from psychological, intellectual and behavioural damage to serious and permanent physical damage to their bodily organs, neurological systems and fertility.”<sup>32</sup>*

The suit alleges that generations of women and children are feeling the effects of widespread lead contamination from the Kabwe mine in the soil and aqua reserves and transmitted through the air. The class action alleges that a substantial amount of lead leaked into the environment and that the mine operators were aware of the environmental degradation at the time. Anglo-American operated the mine, one of the most productive lead mines at the time, from 1925 to 1974. The mine was transferred to state-owned **Zambia Consolidated Copper Mines Limited (ZZCM)** in 1974 however, two thirds of lead was mined during the period when Anglo-American was mining.<sup>33</sup>

Anglo-American said it is “sensitive” to the situation that developed, but since nationalisation of the mine took place more than 40 years ago, the current situation rests at the feet of the Zambia-controlled mine. The company claims it was only one of a number of investors in the company that owned the Kabwe mine, and was never close to being the majority shareholder. In its statement, Anglo-American said:

*“In the early 1970s the company that owned the mine was nationalised by the government of Zambia and for more than 20 years thereafter the mine was operated by a state-owned body until its closure in 1994.”<sup>34</sup>*

Lead poisoning can cause a range of health problems ranging from learning difficulties to infertility, brain damage and death. A report by US-based non-governmental organisation **Human Rights Watch (HRW)** published in 2019 noted that a third of the population of Kabwe lives in lead-contaminated areas.<sup>35</sup> The report highlighted that the area is one of the areas most affected by lead pollution.<sup>36</sup>

<sup>30</sup> Daily Maverick, 21 Oct 2020

<sup>31</sup> Al Jazeera, 21 Oct 2020

<sup>32</sup> Daily Maverick 21 Oct 2020

<sup>33</sup> Al Jazeera 21 Oct 2020

<sup>34</sup> Business Day, 21 Oct 2020

<sup>35</sup> Human Rights Watched, accessed on 21 Oct 2020

<sup>36</sup> Human Rights Watched, accessed on 21 Oct 2020

## Planner

13 Nov 2020 **Lusaka (Zambia) Eurobond** meeting and vote on six-month deferral

16-17 Nov 2020 **Lusaka (Zambia) Bank of Zambia website Bank of Zambia** Monetary Policy Committee meets;

18 Nov 2020 **Lusaka (Zambia) Bank of Zambia website Bank of Zambia** Monetary Policy Committee statement media briefing;

2021 **(Zambia)** Presidential and legislative elections.

## Chronology

22 Oct 2020 **Lusaka (Zambia) Business Day**. Global ratings agency **S&P Global** cuts its assessment of **Zambia's** debt to selective default after Zambia says it cannot meet payments and skipped a coupon on its Eurobonds last week;

20 Oct 2020 **Lusaka (Zambia) Business Day**. Key group of investors representing 40% of **Zambia's Eurobond** holders abstain from voting rather than outright rejecting Zambia's debt-standstill proposal, postponing the decision to 13 November.

19 Oct 2020 **Lusaka (Zambia) BBC**. Construction of the \$259m structure **Kazungula Bridge** connecting **Zambia** and **Botswana** across the **Zambezi River** and started in 2014, is complete;

16 Oct 2020 **Lusaka (Zambia) Lusaka Times**. Finance minister **Bwalya Ng'andu** tells parliament that the **World Bank's** recently released 2021 international debt statistics report, quoting Zambia's government debt as \$27.34 billion, is incorrect;

15 Oct 2020 **Lusaka (Zambia) Lusaka Times**. President **Edgar Lungu** calls on engineers in Zambia to be professional, claiming that the **Engineering Institute of Zambia (EIZ)** has not been proactive in inspecting the quality and durability of infrastructure being implemented in the country;

14 Oct 2020 **Kabwe (Zambia) Lusaka Times**. **The United States Government** has given a K39 billion (\$1.9 billion) grant to Zambia under the new five-year **Country Development Cooperation Strategy**;

14 Oct 2020 **Kansanshi (Zambia) Lusaka Times**. The **Zambian** government informs its creditors including **Eurobond** holders that it will not be able to meet its obligations if they do not agree to its proposed interest payment holiday on debt;

12 Oct 2020 **Lusaka (Zambia) Lusaka Times**. Former finance minister **Felix Mutati** officially launches a new political party, the **Movement for Democratic Change (MDC)**, with former **Zambia Congress of Trade Unions (ZCTU)** president **Leonard Hikaumba** as vice president;

2 Oct 2020 **Lusaka (Zambia) Reuters**. **Lubambe Copper Mine**, which is controlled by **Australia-based EMR Capital**, says it is in discussions with the **Zambian** government over concessions and a tax break ahead of developing a \$1-billion copper mine;

1 Oct 2020 **Lusaka (Zambia) Reuters**. Parliament ratifies appointment of new **Bank of Zambia** (central bank) governor **Christopher Mvunga** despite criticism from some opposition members that he is not qualified for the post.

29 Sep 2020 **Lusaka (Zambia) Business Day**. Finance minister **Bwalya Ng'andu** outlines a six-month timeframe for a restructuring deal with creditors and the **International Monetary Fund**, but analysts warn it is likely to take much longer;

28 Sep 2020 **Lusaka (Zambia) CNBC Africa**. **Zambia Chamber of Mines** says **Zambia** should treat mineral royalty payments as a deductible expense in order to avoid double taxation and attract investment;

### About Africa Risk Consulting:

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