Southern Africa Economic Outlook 2021

Debt Dynamics: The Path to Post-COVID Recovery

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EXECUTIVE SUMMARY

Assuming the COVID-19 pandemic ends or that successful vaccination programs are implemented, Southern Africa is projected to grow 3.2 percent in 2021 and 2.4 percent in 2022. But this recovery will be inadequate given the region's estimated 6.3 percent contraction in 2020. Slow growth in South Africa—the region's largest economy—has meant reduced positive externalities for the region's other countries, which supply inputs to and demand manufactured and processed goods from South Africa. That said, regional inflation is expected to moderate from an estimated 14.2 percent in 2020 to 9.4 percent in 2021 and 6.5 percent in 2022. More stable prices will improve the region's growth prospects.

The region's recovery hinges on how COVID-19 evolves and the policies that countries adopt. Though vaccination is considered the surest way to achieve herd immunity at minimal economic and human cost, Southern Africa's vaccination levels lag those of other developing regions, compromising its ability to reach herd immunity soon. Mauritius leads in vaccinations, with 16 percent of the population fully vaccinated at the start of June 2021, followed by São Tomé & Príncipe at 4 percent and Botswana and Zimbabwe at around 3 percent. The rest of the region's countries are at less than 1 percent. Fast-tracking COVID-19 vaccination programs could help countries ease tourism restrictions and increase visits, boosting the tourism revenues that many Southern African countries rely on.

Pandemic-induced effects on output have been more pronounced in countries that strongly depend on tourism (Botswana, Mauritius, Namibia, Zimbabwe) and commodity exports. Business closures and job losses have caused many people in the region to lose their livelihoods, likely increasing poverty and inequality. Young people in Southern Africa already faced higher unemployment and underemployment before the pandemic, and hence were more vulnerable to declines in labor demand. Similarly, women—particularly poor women—are overrepresented in the most affected sectors (such as hospitality, tourism, restaurants, small farms, and other contact-based services) and so face high risk of increased unemployment and poverty. Thus Southern Africa's already high inequality could amplify because of pandemic-driven setbacks.

Lack of economic diversity is another vulnerability hindering recovery in the region. Commodities play an oversized role in many of the region's economies, such as Angola, Mozambique, and Zambia. Fluctuations in commodity prices create challenges for stable macroeconomic policy. Such risks are magnified by the natural disasters (such as cyclones and droughts) that often ravage the region. With agriculture playing a central role in all Southern African countries, such natural disasters could push some economies off the edge as they wrestle with the pandemic. As recovery from COVID-19 takes hold, countries in the region should pursue structural reforms to engineer faster, more robust economic growth and enhance the resilience of their economies to shocks.

COVID–19 has not only affected the real economy but also caused a surge in public financing needs as governments have spent more to protect lives and jobs. Ballooning expenditures and declining revenues have forced governments to run large primary deficits financed by local and international borrowing. All but four countries in the region have exceeded the Southern African Customs Union (SADC) macroeconomic convergence debt sustainability threshold of 60 percent. Debt dynamics are driven by long-term external debts, depreciations in exchange rates, growing interest expenses, and weaknesses in domestic revenue mobilization. Debt is also shifting to non–Paris Club creditors, multiple lenders, bondholders, and China. Some Southern African countries are in debt distress and debt overhang, and several are struggling to service their debts to non–Paris Club and official creditors. Debt restructuring is needed even though it might be complicated by collateralized loans—mostly from China—that are competing for debt seniority.

The region's debt outlook is of moderate concern because in most countries, government gross debt as a percentage of GDP is expected to increase only mildly. The largest drop in debt as a share of GDP is expected in Angola, where debt in 2021–22 is estimated to fall 11 percentage points, followed by São Tomé & Príncipe by 5 percentage points. Although external debt is expected to fall in 2021 for the region as a whole, exchange rates will continue to depreciate in many countries—pushing up the debt burden. Depreciation will be compounded by expected deteriorations in the current account balances of 7 of the region's 13 countries. This deterioration might put more pressure on exchange rates and inflation, neutralizing the benefits from falling external debt in some countries. The expected increase in spot crude oil, platinum, copper, and gold prices in 2021 should improve export revenues in countries well-endowed with these resources.

Some debt sustainability indicators are expected to improve while others will deteriorate. Debt restructuring is crucial in countries overburdened by debt so that affordable payment terms can be agreed. But this process has to be initiated individually by overburdened countries because most creditors restructure on a case-by-case basis. Debt restructuring would minimize the possibility of countries being forced to cut spending on essential services and other domestic obligations, which could have a counterproductive effect on economic growth.

In line with debt restructuring, the quality and efficiency of government spending should be enhanced to increase value for money. Not all government projects are national priorities. To enhance transparency, governments in Southern Africa should be open to conducting reviews of existing spending programs, either on their own or with the assistance of international organizations. Indeed, more efficient spending is a form of domestic revenue mobilization because it releases resources for use elsewhere without compromising on project delivery. Governments must ensure that funds are used efficiently and for the projects for which they were intended. Effective public financial management systems should be introduced and misappropriation of funds as well as wasteful expenditures should not be tolerated.

In some countries, restoring debt sustainability will require developing comprehensive debt restructuring plans. Mutually beneficial refinancing arrangements should be negotiated with creditors. Given that some countries owe a lot to Paris Club official creditors and non–Paris Club creditors and are not considered Heavily Indebted Poor Countries (HIPCs), they will have to satisfy Evian Approach conditions for debt restructuring by being, among other things, on programs monitored by the International Monetary Fund (IMF). Lack of transparency complicates the sharing of debt burdens (especially on non–Paris Club debt owed to China), and a race to seniority through collateralization could make future debt restructuring difficult. Acceptance of Paris Club terms and IMF-monitored programs may boost international confidence, which could unlock further financial assistance or bridge financing. As of December 2019, Angola, Mozambique, and Zimbabwe together owed more than $1 billion to the Paris Club.

Government policies should enhance revenue mobilization. This challenge predates COVID-19 but is more urgent than ever before. For example, with the possible exception of Botswana, the other countries that make up the Southern African Customs Union (SACU)—Lesotho, Namibia, South Africa, and eSwatini—are heavily reliant on SACU revenues and the performance of the South African economy. With South Africa's economy underperforming since the global financial crisis of 2008–09, COVID-19 has heightened the urgency of identifying alterative revenue sources to buffer future exogenous shocks.

Vulnerabilities can also be detected outside SACU countries either due to commodity dependence or policy and institutional challenges that affect revenue raising. Policies that increase transparency in government budget operations (including tax receipts, spending, and tax concessions), by engendering greater accountability, tend to enhance domestic revenue mobilization. Governments should also make it a priority to deal with weaknesses in revenue administrations. Increased use of digital technologies makes tax revenue collections more efficient by improving compliance and lowering costs. Better training of tax officials—particularly in advanced areas such as audit and transfer pricing—should help reduce tax avoidance and evasion. Finally, governments should consider introducing new forms of taxes where possible. In most Southern African countries, putting in place the African Continental Free Trade Area (AfCFTA) agreement will unlock trade growth, improve export diversification, and boost industrialization. The AfCFTA is an engine for developing regional trade, so countries should start developing trade plans that tap into this potential and boost exports. Effective exploitation of the AfCFTA will reduce the region's vulnerability to global disruptions, promote intra-African trade, boost regional competition and productivity, and thus promote much-needed growth.

CHAPTER 1

RECENT MACROECONOMIC TRENDS AND DEVELOPMENTS

Southern Africa comprises Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, São Tomé & Príncipe, South Africa, eSwatini, Zambia, and Zimbabwe. South Africa is the region's largest economy, accounting for about 60 percent of its gross domestic product (GDP). Angola, the region's second-largest economy, saw its share of regional GDP fall from more than 20 percent in 2013 to about 15 percent in 2019.[1] South Africa is the third-largest economy in Africa (after Nigeria and Egypt), and the region is the third largest contributor to Africa's GDP—accounting for 23.6 percent of GDP in 2019, after West Africa (28.4 percent) and North Africa (27.9 percent). Whereas West and East Africa's shares have increased over time (from 26.8 percent in 2012 to 28.4 percent in 2019 for West Africa and from 10.3 to 14.3 percent for East Africa), Southern Africa and North Africa have seen their shares drop from 27.4 percent and 30.0 percent in 2012 to 23.6 percent and 27.9 percent in 2019.[2] Central Africa's share remained stable during this period (about 5.5 percent).

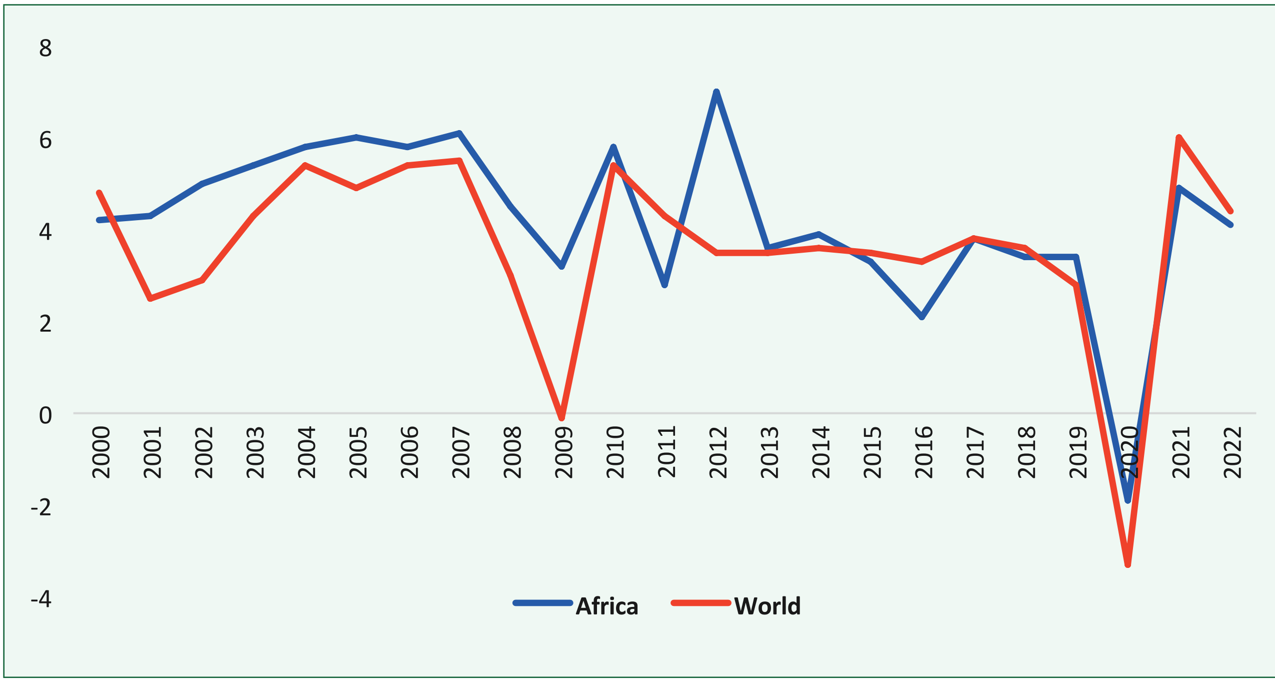
This review assesses regional and country performance relative to peers in a number of areas structured around three chapters. Chapter 1 evaluates growth performance; inflation; fiscal balances; current account balances; poverty, inequality, and unemployment; and intra-African trade. Chapter 2 examines debt dynamics and financing issues in the region. Chapter 3 concludes with policy recommendations.

1.1 GROWTH PERFORMANCE

After uninterrupted expansion since 2000—with real GDP growth averaging about 4.5 percent up to 2019—Africa's economy sharply contracted by 1.9 percent in 2020 because of the COVID-19 pandemic (figure 1.1). In an effort to mitigate the spread of COVID, African governments imposed stringent mobility measures that temporarily curtailed most economic activity and reduced trade (particularly in the second quarter of 2020). While this contraction was the worst for Africa in several decades, it was significantly better than the estimated global GDP contraction of 3.3 percent.

[1] Angola's share is estimated to have declined to about 13 percent in 2020 and is projected to remain there in 2021–22. The other Southern African countries combined contributed about an estimated 26 percent in 2020. Zambia is the region's third largest economy, accounting for 4.5 percent of regional GDP.
Southern Africa's share is estimated to have declined to 20.4 percent in 2020 and is projected to remain around that level over the medium term.
[2] Southern Africa's share is estimated to have declined to 20.4 percent in 2020 and is projected to remain around that level over the medium term.

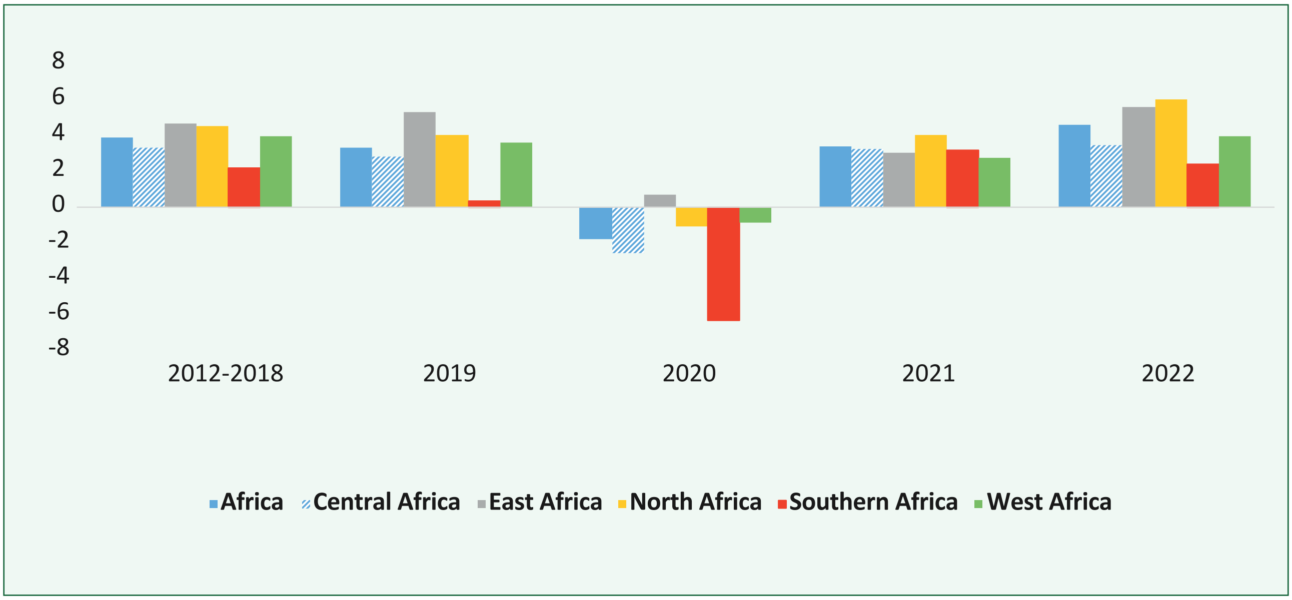
Figure 1.1: Real GDP growth in Africa and the world, 2000-22 (Percent)



Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

Africa's real GDP growth exceeded the global average for most of 2000–20 but fell short of that for emerging markets and developing economies (5.6 percent). Indeed, the continent weathered the global financial crisis of 2008–09 largely unscathed, with GDP growth of 3.2 percent in 2009 compared with the global average of –0.1 percent. Global growth after COVID-19 recovery is projected to be sharper than Africa's recovery (see figure 1.1), largely reflecting base effects. Still, Africa's recovery should benefit from the new "commodity super-cycle," which has seen strong, sustained price increases for most commodities including oil, precious metals, copper, and iron ore.

Figure 1.2: Real GDP growth in Africa and its regions, 2012-22 (Percent)



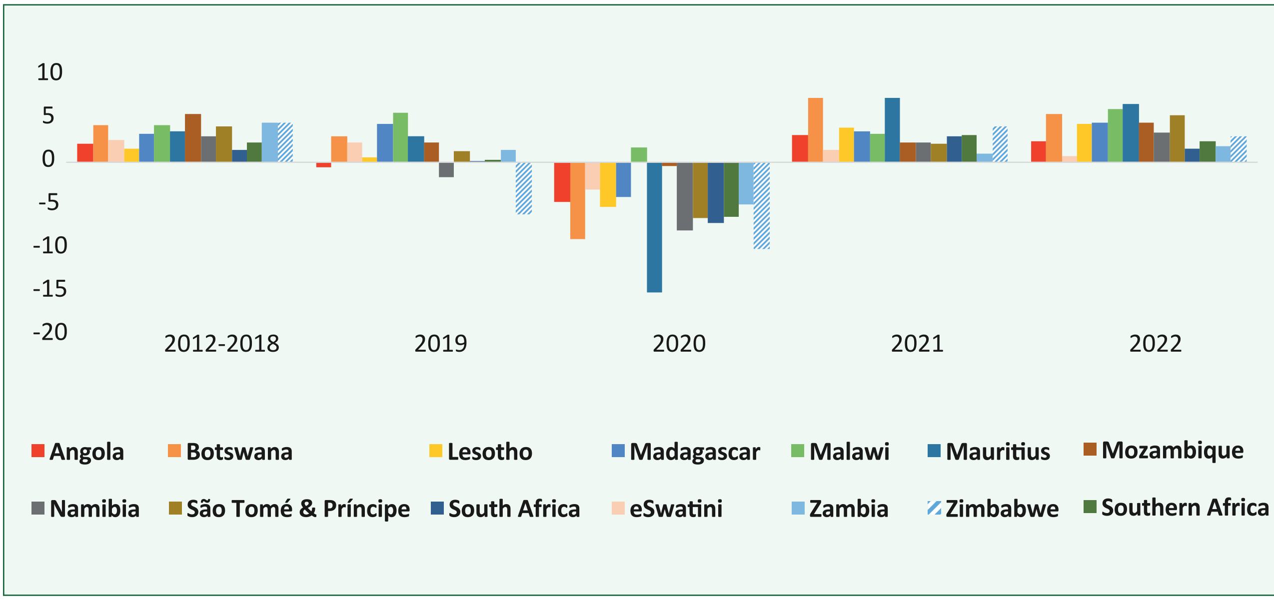
Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

That said, there were notable differences in performance across Africa's regions (figure 1.2). Low growth in South Africa since the global financial crisis weighed on regional growth due to the country's large share of regional economic activity. In contrast, anchor countries like Egypt (North Africa), Kenya (East Africa), and Nigeria (West Africa) grew relatively strongly during the period under review. Southern African countries' growth is largely driven by commodities, and thus was tampered by the collapse in commodity prices around 2014. But East Africa is less affected by commodity prices and boasts a more diversified economy. The large contraction in Southern Africa's GDP in 2020 (–6.3 percent) reflects the large contraction in South Africa's GDP (–7.0 percent) as well as the region's slower growth since the global financial crisis. This reflects the region's structural impediments to growth, including inadequate energy, macroeconomic instability, economic fragility, and harsh business environments.

While East, North, and West Africa averaged growth of about 4.0 percent or more during 2012–18, Central and Southern Africa's performance lagged—with Southern Africa achieving just 2.2 percent. In 2019 Southern Africa grew even more slowly, at 0.3 percent, while Central Africa hit 2.8 percent.[3] In 2020 the outcomes were even starker, with COVID-19 appearing to have affected the regions differently. East Africa is the only region estimated to have grown that year, by 0.7 percent. The other four regions contracted, with Southern Africa again experiencing the largest contraction, at –6.3 percent. The second worst-performing region, Central Africa, contracted –2.6 percent.

[3] Southern Africa's performance is even more underwhelming when one considers GDP per capita. The region's per capita GDP contracted by an average of 0.2 percent during 2012–18. It further contracted 2.0 percent in 2019 and is estimated to have contracted 8.6 percent in 2020, before a projected 0.9 percent increase in 2021 and 0.1 percent increase in 2022.

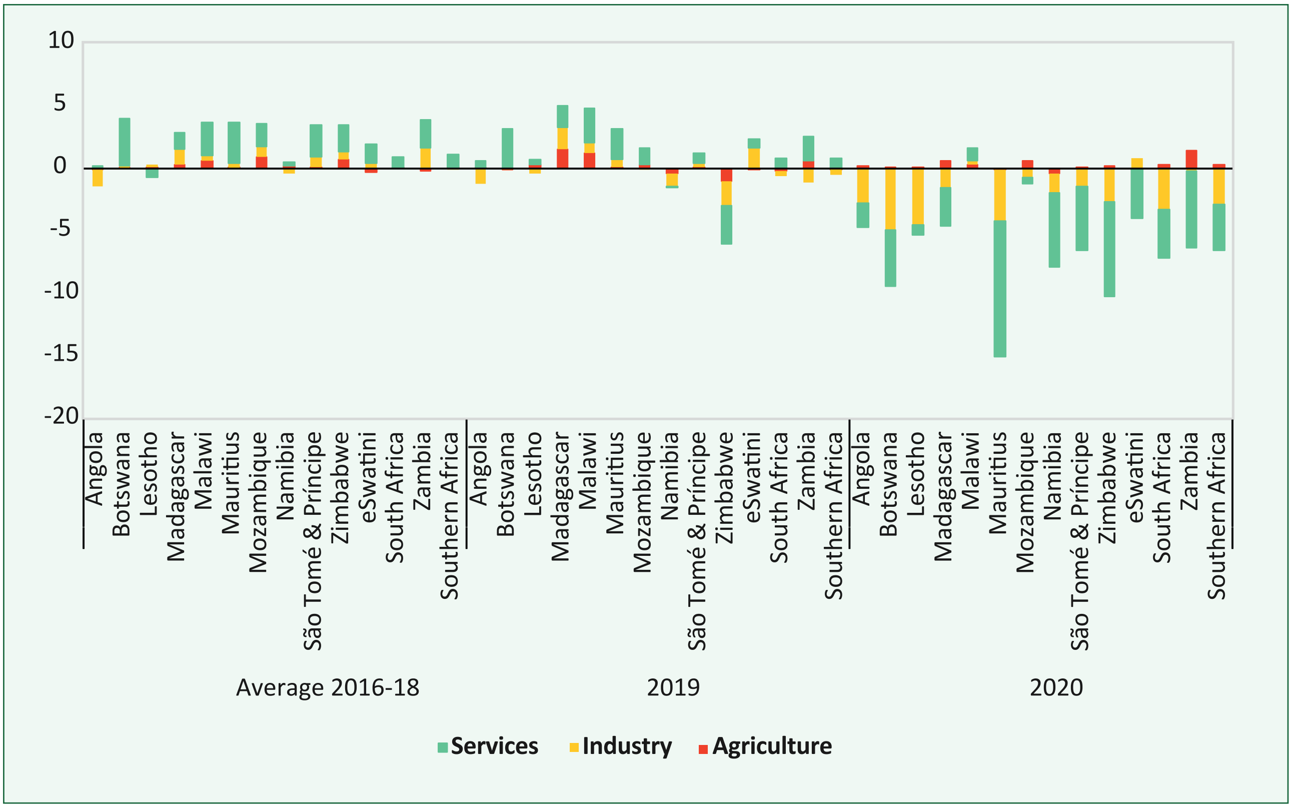
Figure 1.3: GDP growth in Southern Africa by country, 2012-22 (Percent)



Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

Southern Africa's low average growth masked substantial disparities across countries (figure 1.3). In 2019 Malawi stood out with GDP growth of 5.7 percent, followed by Madagascar at 4.4 percent and Botswana and Mauritius at 3.0 percent. But that same year, Zimbabwe's economy shrunk by 6.0 percent, Namibia's by 1.6 percent, and Angola's by 0.6 percent. The other countries in the region registered modest growth, though South Africa barely had any (0.2 percent). These idiosyncratic growth patterns—which also occurred in 2012–18—are not surprising given that many countries in the region depend on mineral commodities or agricultural products, both of which make output volatile.

Figure 1.4: Sectoral contributions to GDP growth (at basic prices) in Southern Africa by country, 2016-20 (Percent)



Source: African Development Bank statistics.
Note: Data for 2020 are estimates.

By sector, services are the main contributor to Southern Africa's economic growth—and contraction (figure 1.4). Of the region's 1.1 percent growth in 2016–18, services contributed 1.0 percentage point while agriculture contributed 0.1. Industry did not contribute to the region's growth during this period.[4] But again, regional performance was not representative of country performance. Countries such as Madagascar, Mozambique, São Tomé & Príncipe, and Zambia had sizable industrial contributions during 2016–18.

While industry detracted from growth in only two countries (Angola and Namibia) in 2016–18, the number of countries with negative contributions from industry rose to eight in 2020.[5] These trends seem to reflect low industrialization in the region (except in South Africa) as well as dependence on commodity exports. As noted, commodities are more susceptible to global demand shocks. Global growth softened from 3.8 percent in 2017 to 2.8 percent in 2019, which partly explains the weak performance of the region's industrial sector, due to attendant subdued demand for the region's industrial products.

[4] In a three-sector economy (agriculture, industry, and services), industry includes mining, manufacturing, electricity/gas, and construction. Here industry is not the same as the secondary sector because it captures mining (a primary activity).

[5] In 2019 Madagascar, Malawi, Mauritius, São Tomé & Príncipe, and eSwatini had positive industry contributions, while in 2020 only Malawi and eSwatini did.

But idiosyncratic factors were also at play. For example, South Africa experienced a severe energy crisis in 2019, which hurt the performance of its energy-intensive industrial sector. Zambia and Zimbabwe also experienced severe electricity shortages due to low water levels in the Kariba Dam, which affected power generation. In addition, poor rainfall during the 2018/19 season—called the driest for the region since 1981 by the World Food Programme (2019)— hindered agroprocessing, further constraining industrial activity.

Most countries in Southern Africa have leveraged the services sector, including tourism, for growth. In 2019 Botswana's growth was entirely due to services, as was 80 percent of that in Mauritius, about 70 percent in São Tomé & Príncipe, and 50 percent in Malawi. The combination of poor industry performance and decline in the contribution of the services sector explain the region's lackluster performance in 2019. Agriculture's contribution also declined marginally in 2019, but supported growth in 2020 thanks to favorable weather conditions.

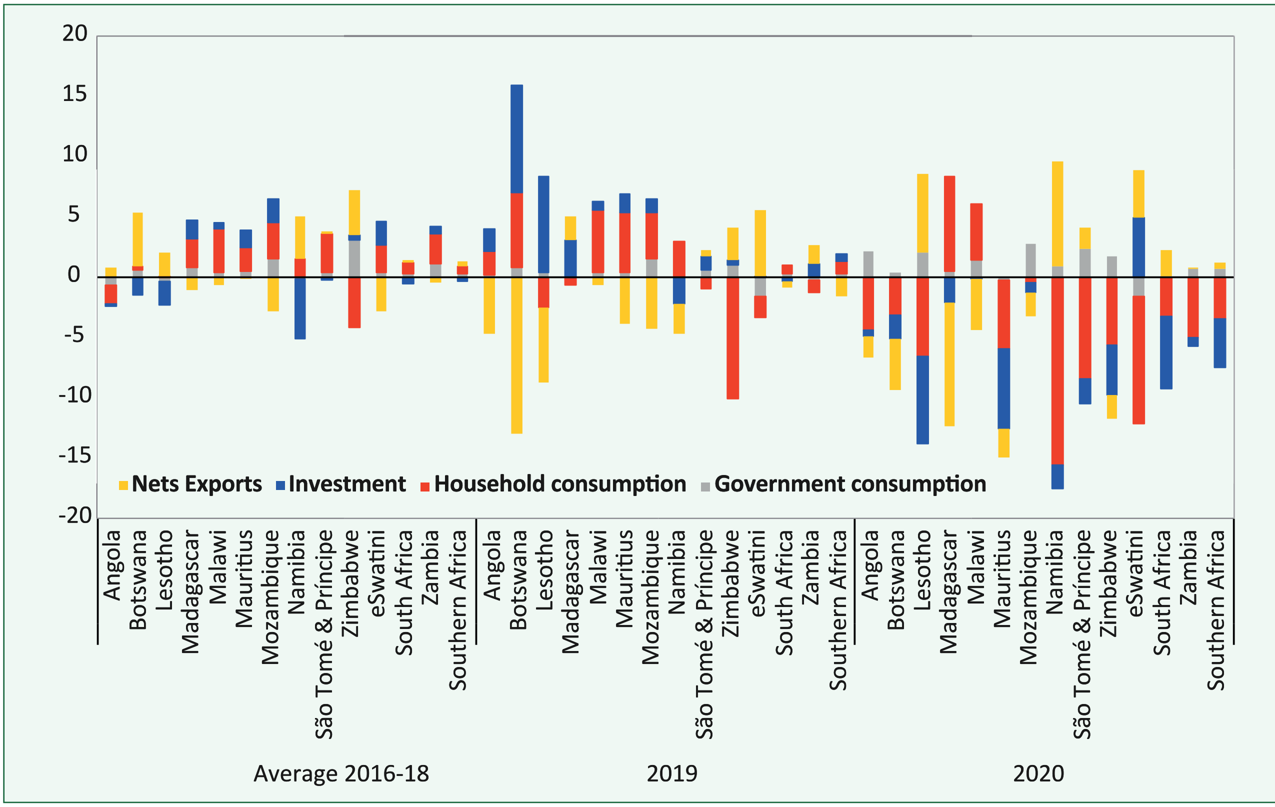
COVID-19's effects have been uneven across countries in the region. Malawi was the only Southern African economy estimated to have expanded in 2020, with real GDP growth of 1.7 percent. The pandemic caused considerable damage to countries whose economies heavily depend on tourism, especially Mauritius (–15.0 percent GDP growth), Zimbabwe (–10.0 percent), Botswana (–8.9 percent), and Namibia (–7.9 percent). Tourism, particularly international travel, was adversely affected by lockdowns and travel restrictions. Though restrictions on movement have been eased, tourism has not recovered much, perhaps reflecting risk aversion by prospective patrons. Industry also declined sharply in 2020 because of lockdowns and movement restrictions as well as reduced domestic and global demand. Closure of businesses and loss of jobs meant reduced disposable income for some consumers. In addition, pandemic-induced disruptions in global trade affected the region, particularly in the mining and manufacturing value chains.

After the successful containment of the first wave of COVID-19—and on the back of optimism about vaccine development—the global economy largely reopened in the second half of 2020. Global demand picked up sharply, particularly for primary commodities,[6] driving prices to record highs for copper, iron ore, oil, platinum, and others. But the logistical bottlenecks created by the closure of the global economy in response to the pandemic began to bind as global demand increased. Such bottlenecks were especially apparent in shortages of shipping containers and ships, significantly hampering international trade. Dampened trade activity undermined growth in Southern Africa and in Africa as a whole.

Industry's contribution to growth in Southern Africa fell from –0.5 percent in 2019 to an estimated –2.8 percent in 2020. The decline was across the board, with only Malawi and eSwatini registering positive industrial growth. Angola, whose exports are dominated by oil, was also hurt as oil prices collapsed in the first half of 2020. Yet oil prices benefited from strong demand in the second half of 2020 as the world economy recovered from the first wave of the pandemic. By March 2021 oil prices had returned to pre-COVID levels. Though industrial commodities rallied in 2020, precious metals other than gold did not do as well. Botswana was hit by the lackluster performance of diamonds, its main export.

[6] The sharp rise in demand for commodities has partly been driven by a shift in consumption to goods and away from services in developed countries and Asia, due to the continued restrictions—such as on restaurants and international travel—associated with consumption of services.

Figure 1.5: Demand-side contributions to GDP growth (at market prices) in Southern Africa by country, 2016-20 (Percent)



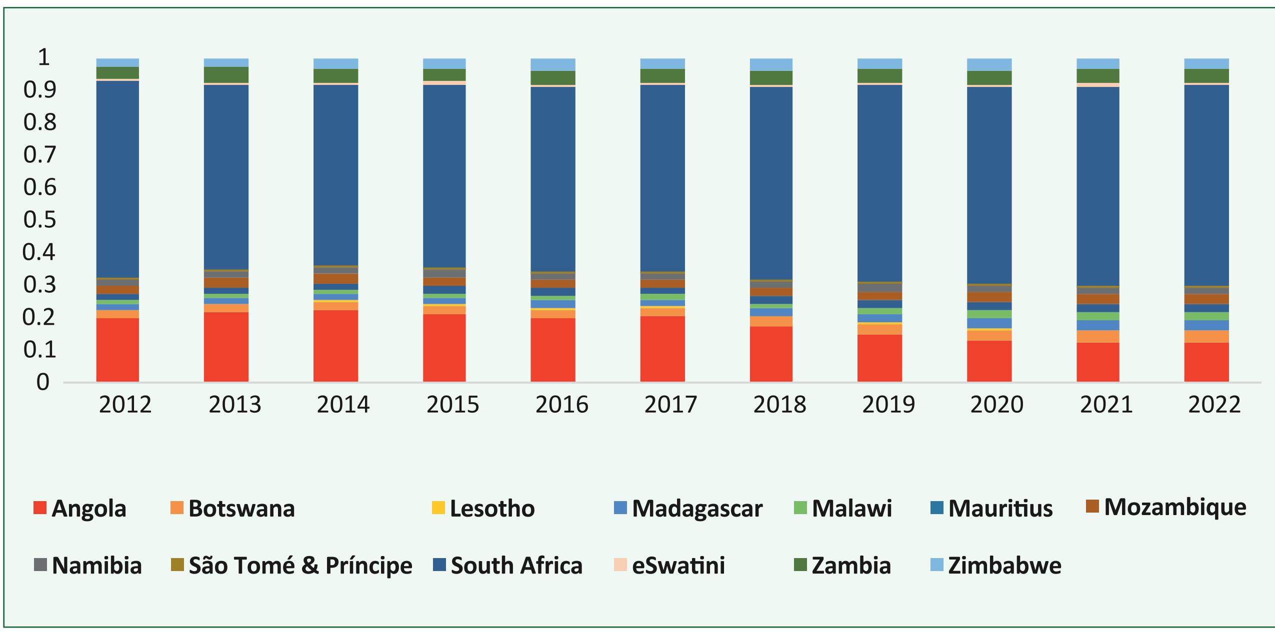
Source: African Development Bank statistics.
Note: Data for 2020 are estimates.

Turning to the demand side of the economy, performance in Southern Africa has varied by period (figure 1.5). In 2016–18 household consumption drove GDP growth, contributing 0.6 percentage point to regional growth. Net exports contributed 0.4 percentage point while government consumption contributed 0.3. On average, investment contributed 0.3 percent to regional growth during this period. This outcome was driven by poor investment growth performance in Namibia (–5.0 percent), Lesotho (–2.0 percent), Botswana (–1.4 percent), and South Africa (–0.6 percent). Household consumption remained the biggest contributor in 2019, at 1 percentage point, followed by investment at 0.6 percentage point and government consumption at 0.3. Net exports contributed –1.6 percentage points to growth in 2019.

In 2020 the situation changed dramatically. Government consumption, at 0.7 percentage point, became the largest contributor to growth as governments responded to COVID-19 by raising spending to cushion their economies, beef up their health sectors, and provide social safety nets. Net exports contributed 0.5 percentage point, supported by the commodities rally and the collapse in oil prices, which allowed for better trade balances and, for South Africa, a rare surplus on its current account. Angola, a major oil exporter, was hit hard by the collapse in commodity prices in 2020. Current account balances were also aided by import compression due to trade restrictions associated with COVID-19. Investment contributed –4.0 percentage points to regional growth and household consumption –3.5 percentage points, because lockdowns reduced employment, incomes, and hence consumption. Investment detracted from growth in all Southern African countries except eSwatini, where it contributed 4.9 percentage points. Household consumption contributed positively to growth only in Madagascar (7.8 percentage points) and Malawi (4.7 percentage points).

These data indicate a decline in Southern Africa's economic performance that has led to worsening welfare outcomes for citizens. Per capita GDP registered an average annual growth rate of –0.2 percent during 2012–18, fell to –2.0 percent in 2019, and is estimated to have further worsened to –8.6 percent in 2020. Per capita GDP growth for the region is expected to improve to 0.9 percent in 2021 and 0.1 percent in 2022, reflecting generally better economic growth as countries recover from COVID-19 as well as the region's low population growth, estimated at 1.87 percent in 2015–20 (UNDESA 2019). But such economic growth rates are too low to reverse the declines of the past few years—implying that citizens of the region are staying poorer. All countries in the region had negative per capita GDP growth rates in 2020, with Malawi (at –1.0 percent) having the best performance. Zimbabwe, at –11.5 percent, and Mauritius, at –15.1 percent, had the worst. Zimbabwe's economy is suffering from structural challenges that have bedeviled the country since the early 2000s, while Mauritius experienced the worst GDP growth in the region because the pandemic hit its services sector hard (particularly tourism and hospitality).

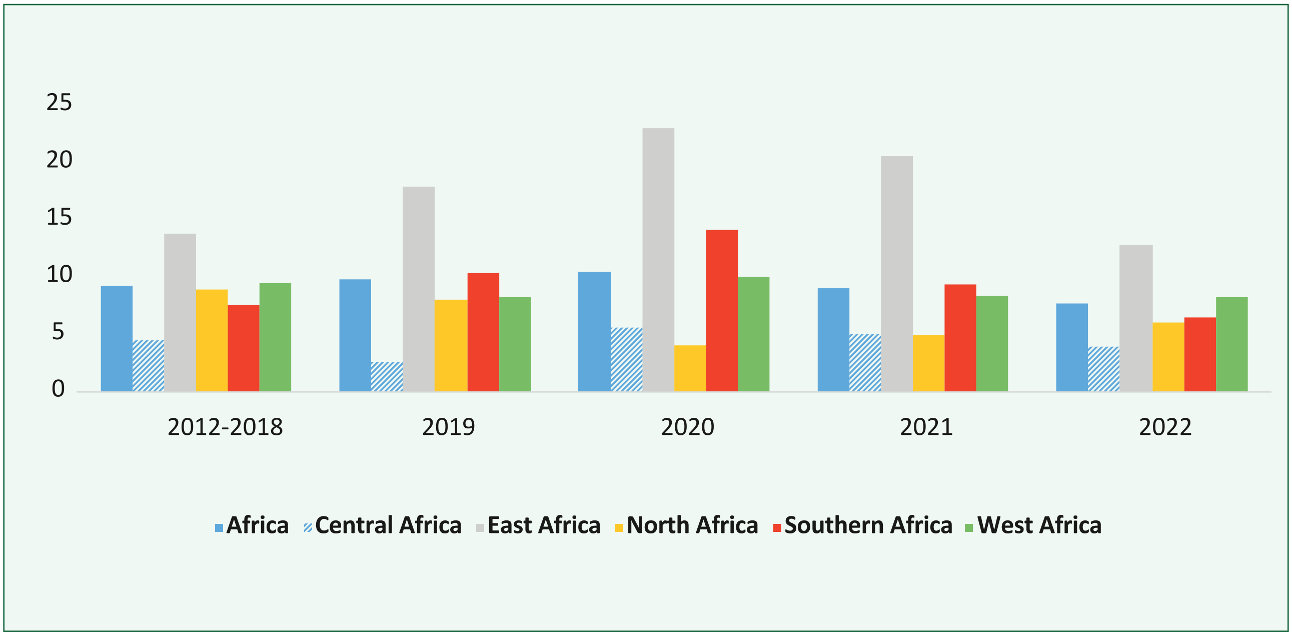
Figure 1.6: Contributions to Southern Africa's GDP by country, 2012-22 (Percent)



Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

As noted, South Africa dominates Southern Africa's economy. The country's share of regional GDP averaged 58 percent during 2012–18, followed by Angola with 20 percent (figure 1.6). (In 2019 South Africa's share increased slightly to 61 percent.) The rest of the countries are fairly small in relative terms. South Africa's large share of regional GDP means that growth dynamics there dictate growth dynamics for the rest of the region. Since the global financial crisis in 2009, South Africa has experienced very weak growth and the region has fared badly relative to the other regions of the continent. For example, Southern Africa's share of Africa's GDP shrunk from about 27 percent in 2012 to about 24 percent in 2020. In the medium term, South Africa's share of regional GDP is expected to increase to about 62 percent, cementing the country's dominance of the region.

Figure 1.7: Inflation in Africa and its regions, 2012--22 (Percent)



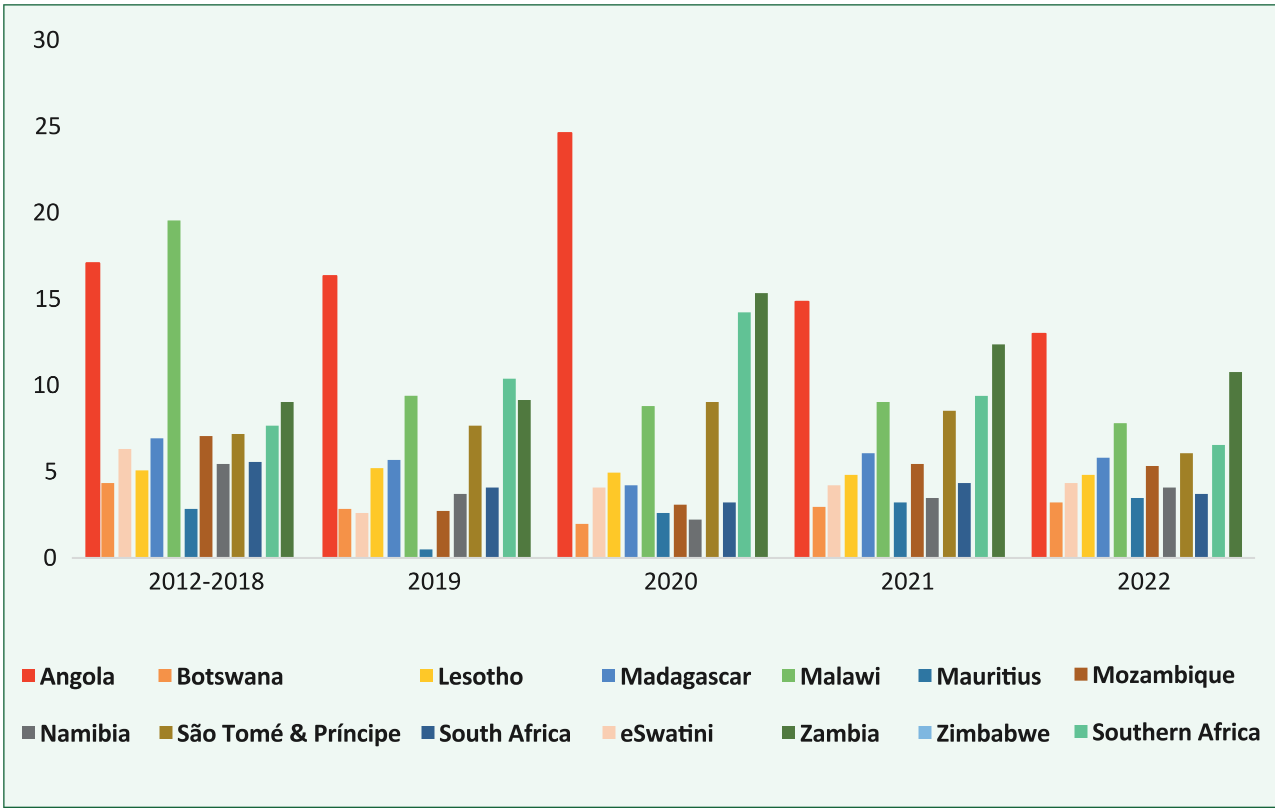
Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

1.2 INFLATION

Low and stable inflation—one of the key indicators of macroeconomic stability—is key to investment, and thus to sustainable growth and development (Barro 1996). Low and stable inflation also supports higher living standards, particularly for people living on fixed incomes. For these reasons and others, Southern African countries (like their African and global counterparts) have implemented policies to keep inflation in check, including more sound monetary and fiscal policies.

Inflation has been high in Africa, averaging about 10 percent a year since 2012. Inflation in the region is largely a supply-side phenomenon rather than an expression of economic overheating (Economist Intelligence Unit 2021). In most countries inflation is driven by global developments in food and oil prices, on which monetary policy can have little effect. Put differently, Africa's inflation is largely "imported." Among the continent's five regions, East Africa had the highest inflation during the period under study, averaging 13.8 percent in 2012–18 and rising to about 18.0 percent in 2019 and 23.0 percent in 2020 (figure 1.7). East Africa is paradoxically also Africa's fastest-growing region, and the only one estimated to have expanded in 2020 in the face of COVID-19. Southern Africa had Africa's second-highest inflation during these periods—at 7.6 percent, 10.4 percent, and 14.2 percent—though it is expected to fall to 6.5 percent by 2022. North Africa and Central Africa had the lowest inflation rates during that time.

Figure 1.8: Inflation in Southern Africa by country, 2012-22 (Percent)



Source: African Development Bank statistics.

Note: Data are estimates for 2020 and projections for 2021 and 2022. Data for Zimbabwe are excluded because of hyperinflation in 2019 (227 percent) and 2020 (623 percent).

Average inflation in Southern Africa has exhibited episodes of disinflation punctuated by occasional sharp rises. Regional inflation fell from 6.5 percent in 2012 to 5.7 percent in 2015 before jumping to 11.2 percent in 2016. This was followed by disinflation to 7.6 percent in 2018 before rising again to 10.4 percent in 2019 and 14.2 percent in 2020. The sharp reflation in 2016 was driven by rising inflation in Angola, Mozambique, and Zambia while the resurgence of double-digit inflation in 2019 and 2020 was driven by hyperinflation in Zimbabwe as well as high inflation in Angola and Zambia (figure 1.8).

There is a lot of variation in inflation across Southern Africa; in 2019 it ranged from 0.5 percent in Mauritius to 227 percent in Zimbabwe. Most countries had single-digit inflation in 2019 and are estimated to have maintained these low rates in 2020. Botswana, Namibia, and Mauritius had much lower inflation, bringing down the regional average. Botswana's inflation was 2.8 percent in 2019 and is estimated to have been 1.9 percent in 2020, before rising to 3.0 percent in 2021 and 3.3 percent in 2022. In Namibia the consumer price index basket is dominated by housing and utilities, so the country is less exposed to the volatility of food and oil prices. Angola, Zambia, and Zimbabwe are the only countries where inflation is estimated to have hit double digits (or more) in 2020.

The sharp rise in inflation in Zimbabwe since 2018 reflected myriad factors, chief among them the abandonment of a multicurrency regime, opaque system of foreign currency allocation, lack of public confidence in the economy, and weak productive sector. As a result, the local currency has slid sharply against the U.S. dollar because currency trades have moved to the parallel market. Among other steps to combat inflation, the government has implemented a more credible fiscal framework, introduced a more transparent auction system to allocate scarce foreign currency, and partially walked back the banning of transactions in foreign currencies. These measures have helped raise confidence and stabilize the exchange rate of the Zimbabwe dollar against major currencies. The consequence has been sharp disinflation, with inflation expected to fall from an estimated 623 percent in 2020 to 135 percent in 2021.

Recent inflation developments in Angola can be seen as part of the country's macroeconomic adjustment process. Under the government's macroeconomic stabilization program, the country has abandoned the peg of the kwanza to the dollar, allowing for a more market-determined exchange rate. As a result, the kwanza depreciated 54 percent against the U.S. dollar during the first six months of 2018.[7] Though inflation started falling as the effects of the reforms began to manifest, the COVID-19 shock drove oil prices—the country's main export commodity—to record lows in 2020, causing a sharp depreciation of the kwanza. Inflation shot from about 16 percent in 2019 to nearly 25 percent in 2020 but is projected to decline in the medium term, reaching 13 percent in 2022. This will be due to expected economic diversification, stronger growth, and better fiscal metrics flowing from reforms.

Zambia has generally had modest inflation since 2012 but has experienced bouts of accelerations. For example, inflation rose from 7.8 percent in 2014 to 10.1 percent in 2015, then hit about 18 percent in 2016. Similarly, inflation jumped from about 9 percent in 2019 to an estimated 15 percent in 2020. Inflation in Zambia is "mainly driven by the pass-through effects of the depreciation of the kwacha and elevated food and transport prices" (AfDB 2021, p. 147). Part of the kwacha's weakness in 2020 reflected loss of confidence in it following a sovereign default by the Zambian government (Africa Report 2021). Inflation in Zambia is negatively correlated with copper prices, with inflation higher when copper prices are lower and vice versa, reflecting the role of copper prices for the kwacha exchange rate (Roger, Smith, and Morrissey 2017). High fiscal deficits are also expected to keep inflation elevated (Bank of Zambia 2021). Inflation is projected to decelerate to about 11 percent by 2022 as the economy recovers.

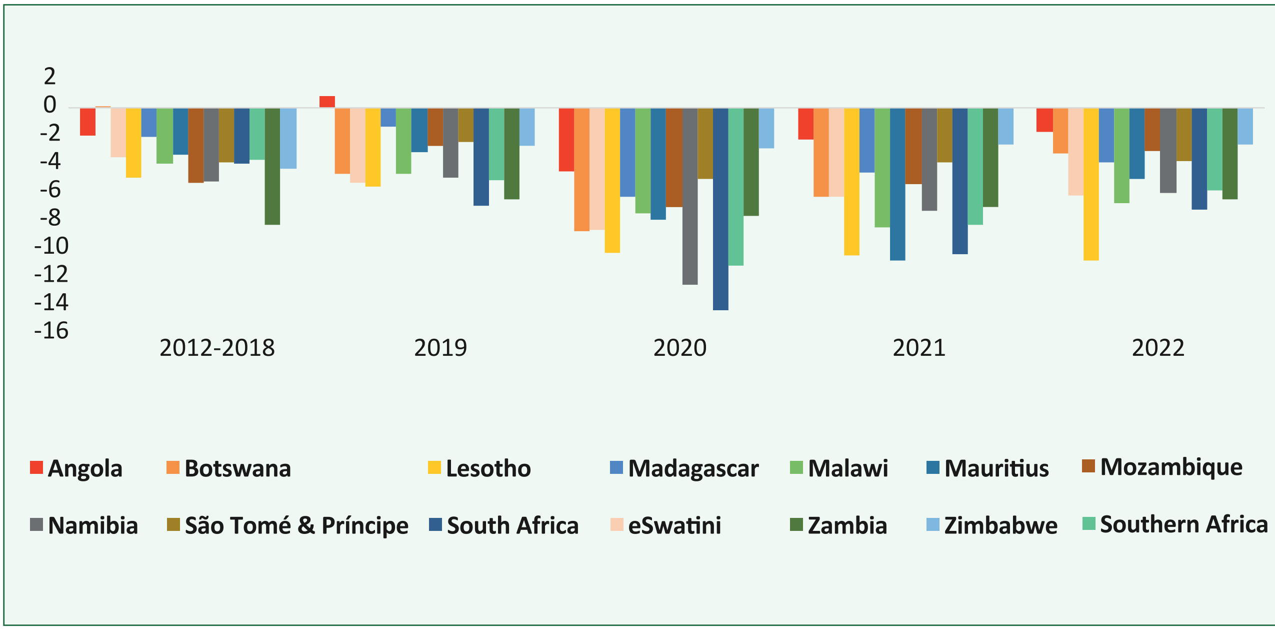
1.3 FISCAL BALANCES

When government spending exceeds government revenue, the shortfall is financed through borrowing and reflects as a budget deficit for the period in question. Though deficits are common in most economies, they pose a major constraint for developing countries—where governments typically must invest in infrastructure and other social services while collecting limited taxes. Southern Africa generally ran budget deficits during 2012–20, and this trend is expected to continue in 2021–22. The region's deficit rose from –3.7 percent of GDP in 2012–18 to about –5.0 percent in 2019, then more than doubled to over –11.0 percent in 2020 (figure 1.9). Governments raised spending in response to COVID-19 while revenue plummeted as a result of economic lockdowns. The regional deficit is projected to recover to about –6.0 percent of GDP in 2022.

[7] https://www.axiomatic.co.za/human-resources-what-is-happening-in-angola/

The increase in government spending in Southern Africa has not translated into higher economic growth, reflecting poor-quality government spending or structural constraints that predated COVID-19. As discussed below, the large fiscal deficits have pushed debt levels higher, raising sustainability concerns for some countries.

Figure 1.9: Fiscal balances in Southern Africa by country, 2012-22 (Percentage of GDP)

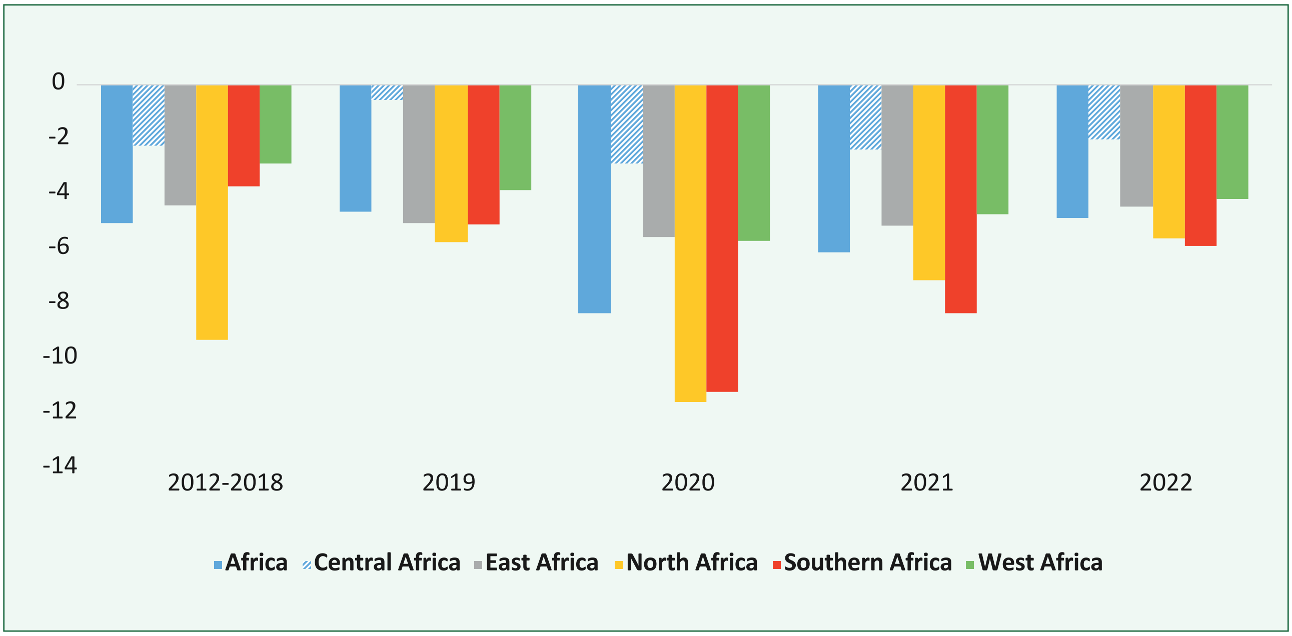


Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

Botswana is the only country in Southern Africa to have recorded a fiscal surplus in 2012–18, averaging 0.1 percent of GDP. During the same period, Zambia recorded a deficit of –8.3 percent of GDP, the largest in the region. Angola posted a budget surplus in 2019 (0.8 percent) but swung into a deficit in 2020 as oil revenues plummeted. Zimbabwe is estimated to have had the smallest deficit in 2020 (–2.9 percent), followed by Angola (–4.5 percent). South Africa and Namibia are estimated to have had the largest deficits in 2020, reaching –14.3 percent and –12.5 percent. South Africa's fiscal response to COVID-19 was quite large, at 10 percent of GDP. Deficits are expected to slowly shrink across the region through 2022—except in Lesotho, where the deficit is projected to worsen over the medium term.

There are several reasons for the elevated fiscal deficits in the region in 2020 and over the medium term. The high fiscal deficits in 2020 partly reflected countries' efforts to buffer the socioeconomic impacts of the pandemic through expansionary fiscal policy measures. In addition, the closure of economies during parts of the year and the resulting declines in GDP growth meant revenue collections were lower in 2020. Declining revenues from the Southern African Customs Union (SACU) also increased fiscal deficits in Botswana, Lesotho, Namibia, and eSwatini. Because the distribution of SACU revenues is lagged by at least one year, the larger effect from COVID-19 should be felt in 2021. Similarly, revenues underperformed for tourism-dependent economies such as Botswana, Madagascar, and Mauritius, further elevating fiscal deficits. Though most commodities saw higher prices in 2020, some—particularly oil and diamonds—experienced depressed demand and thus lower prices. As a result, countries such as Angola and Botswana were adversely affected.

Figure 1.10: Fiscal balances in Africa and its regions, 2012-22 (Percentage of GDP)



Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

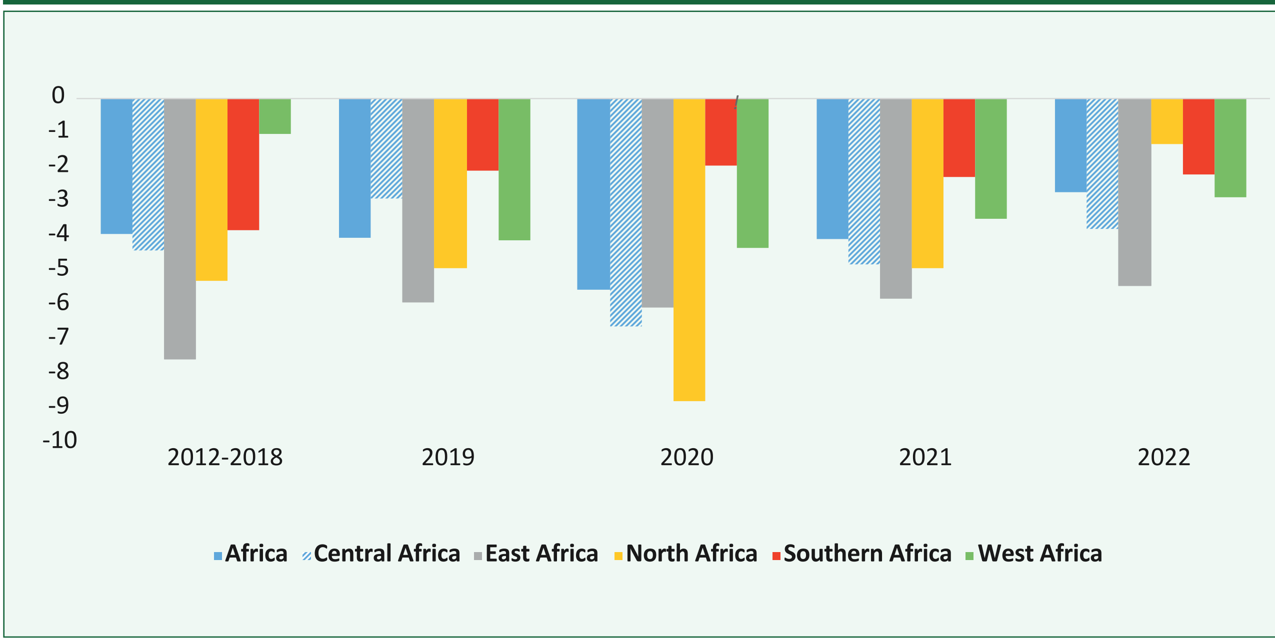
Though all African regions experienced deficits during 2012–20, they were highest in North Africa and Southern Africa, especially in 2019 and 2020. As noted, Southern African economies' high dependence on commodities exposes them to commodity price shocks and thus volatile revenue receipts. Because government spending tends to be sticky, revenue underperformance results in wider fiscal deficits as governments borrow to meet spending commitments.[8] Africa's fiscal deficit averaged –2.5 percent of GDP in 2012 but rose to an estimated –8.3 percent in 2020. The deficit is projected to shrink to –4.8 percent by 2022. Between 2020 and 2022, Southern Africa and North Africa are the two regions expected to have the largest deficits; Central Africa, the smallest.

[8] South Africa provides an interesting example. As revenues plummeted during the global financial crisis, expenditures continued to increase sharply, exceeding revenues. The expectation, it would seem, was that increased government spending would quickly revive the economy, with higher growth spurring better revenue performance. But that did not happen, as growth has remained uninspiring since the global financial crisis. The gap between spending and revenues has continued to widen, resulting in the country now considering stricter fiscal consolidation (National Treasury 2021, p. 29).

1.4 CURRENT ACCOUNTS

Southern Africa has been running a current account deficit since 2012 (figure 1.11), reflecting a shortfall of savings relative to investment for the region. From –2.9 percent of GDP in 2012, the current account deficit ballooned to –6.4 percent in 2015 (with an average of 3.8 percent in 2012–18) before declining to an estimated –1.9 percent in 2020. The recovery in 2020 reflects the decline in imports due to lockdowns across the region as well as the collapse in oil prices—a major import for all countries in the region except Angola. Still, Southern Africa had the smallest real, estimated, and projected current account deficits of all African regions in 2019–22. East Africa generally runs high current account deficits—except in 2020, when those in North and Central Africa were higher.

Figure 1.11: Current account balances in Africa and its regions, 2012-22 (Percentage of GDP)

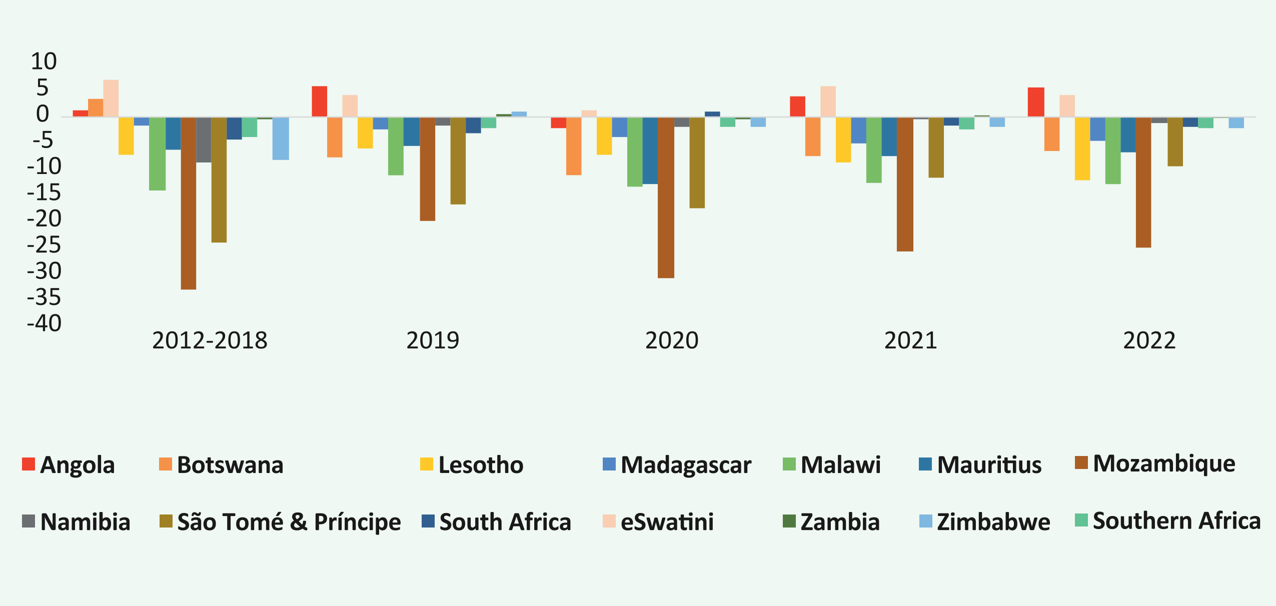


Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

Current account deficits mean that governments are running larger fiscal deficits relative to domestic savings (from households and corporations) and thus require external financing to close the gap. In Sub-Saharan Africa the main drivers of current account deficits are net income payments and trade deficits (Moussa 2016). In general, current account deficits should not be a major concern for developing economies because they should be temporary (Osakwe and Verick 2007). Ideally, current account deficits can be justified by the need to invest in productive infrastructure—human development, capital goods imports, and the like—to raise a country's productive capacity, and thus both potential and actual GDP growth. But inefficient spending and poor prioritization often mean that spending supported by external borrowing fails to deliver desired economic outcomes, resulting in perpetual current account deficits (that is, perennial dependence on foreign funding). Dependence on commodities, deindustrialization, relatively weak growth, revenue underperformance, and relatively high and sticky government spending largely explain current account deficits in Southern Africa.

Though most countries in the region have persistently turned out current account deficits, some have occasionally enjoyed surpluses (figure 1.12). eSwatini has consistently run a current account surplus over the study period. The same is true of Angola except in 2020, when the country experienced a current account deficit due the collapse in oil prices. Zambia has also done well with its current account, with a deficit of –0.5 percent of GDP during 2012–18, a surplus of 0.6 percent in 2019, and small estimated and projected deficits in 2020–22, reflecting the strong rally in commodity prices. Malawi, Mozambique, and São Tomé & Príncipe have had the largest current account deficits. Mozambique's averaged –33 percent of GDP over 2012–18, about –20 percent in 2019, and about –31 percent in 2020. The current account deficit is projected to remain elevated in 2021 and 2022, at nearly –25 percent of GDP, implying that the country must borrow about a quarter of its GDP in international markets to finance its consumption.

Figure 1.12: Current account balances in Africa and its regions, 2012--22 (Percentage of GDP)



Source: African Development Bank statistics.
Note: Data are estimates for 2020 and projections for 2021 and 2022.

1.5 POVERTY, INEQUALITY, AND UNEMPLOYMENT

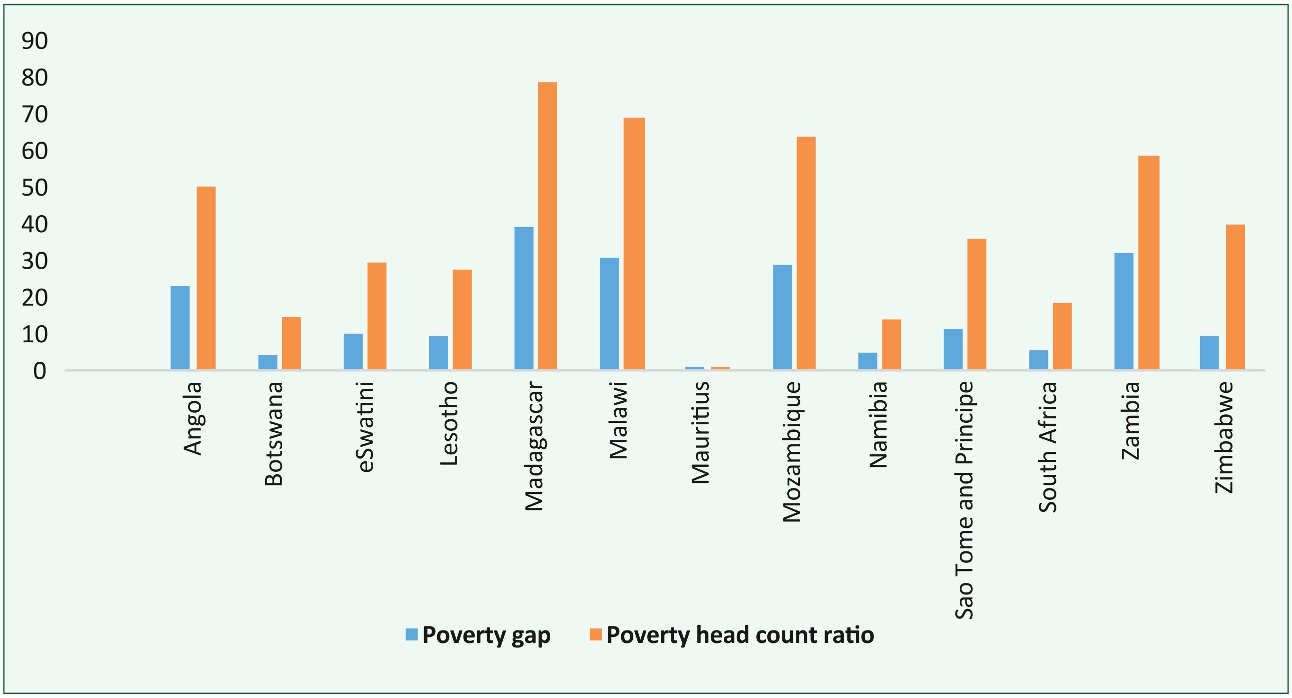
As discussed, COVID-19 has slowed economic growth in Southern Africa (and Africa generally) and expanded fiscal deficits as governments have responded to it. Another policy concern is that the pandemic might reverse the development gains made in the region since the turn of the millennium. Exogenous and endogenous factors affect poverty and inequality through many production and consumption channels (for example, through labor markets, assets, livelihoods, consumption, health, and productivity; Stewart 2002). By affecting countries, sectors, and individuals unevenly, COVID-19 could exacerbate poverty and inequality in the region.

This is a particular concern because young people in Southern Africa already faced high unemployment and underemployment before the pandemic, and hence are more vulnerable to declines in labor demand. Similarly, women—particularly poor women—are overrepresented in the sectors hit hardest (such as hospitality, tourism, restaurants, and smallholder farming), and so face greater risk of increased unemployment and poverty. Emerging evidence from Africa shows that poverty increases more in female-headed households than in male-headed ones because of harsher income effects on women workers and because poverty in female-headed households was already higher before the pandemic (Chitiga and others 2020; Maisonnave and Cabral 2020). These risks are compounded by the limited fiscal capacity of African countries to provide comprehensive, sustainable income support to those adversely affected by COVID-19.

Monetary poverty is a measure of households' capacity to meet their basic needs for food, housing, clothing, and other goods and services (Lakner and others 2018). Thus, tackling monetary poverty will most likely positively affect other dimensions of poverty, such as education, safe drinking water, and health. Two other measures of poverty are the poverty headcount and poverty gap indexes. The headcount index measures the prevalence of poverty—that is, how many households are poor relative to all households. The poverty gap index measures the depth of poverty, indicating how far below the poverty line poor households are.

Between 2011 and 2018 Madagascar, Malawi, Mozambique, and Zambia exhibited the highest poverty rates in Southern Africa as measured using 2011 purchasing power parity (PPP; figure 1.13). The rates ranged from 58.7 percent in Zambia to 78.8 percent in Madagascar. By contrast, Mauritius had no extreme poverty, with the poverty headcount ratio (measured at $1.90 a day) declining from 0.6 in 2012 to just 0.2 in 2017. Namibia had the second lowest ratio, at 13.8, followed by Botswana at 14.5 and South Africa at 18.7. Extreme poverty generally fell in Southern Africa between 2000 and 2019. The poverty headcount ratio generally fell as well, though some countries experienced a reversal after the global financial crisis. Using this measure, poverty dropped consistently since 2000 in Botswana, Lesotho, Malawi, Mozambique, Namibia, and eSwatini. But it rose in Madagascar, São Tomé & Príncipe, and Zimbabwe, and showed a U shaped pattern in Mauritius, South Africa, and Zambia.

Figure 1.13: Poverty in Southern Africa by country using the international poverty line, various years (Percent)



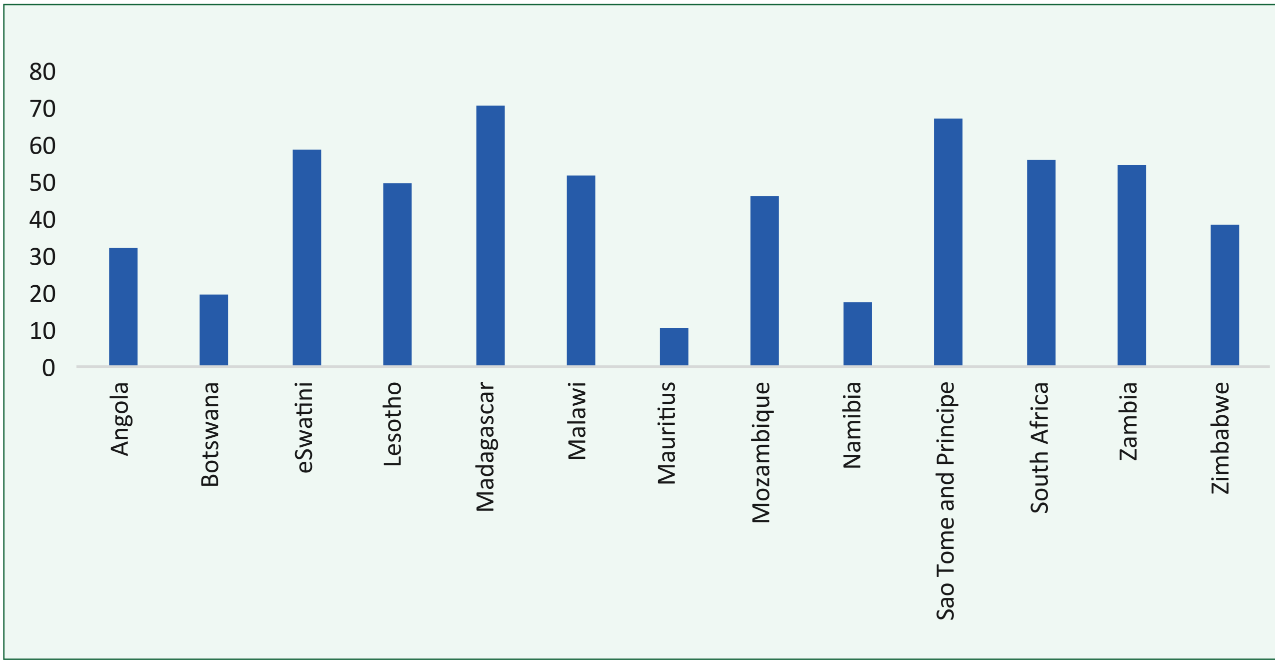
Source: World Bank 2021c.
Note: The international poverty line is $1.90 a day based on purchasing power parity (PPP) in 2011. The most recent available data are presented because annual data are not available for each country.

Since the early 2000s the poverty headcount fell by about 58 percentage points in Namibia, 56 in Lesotho, 50 in Mauritius, 49 in Botswana, 46 in South Africa, and 40 in eSwatini (World Bank 2021c). Marginal reductions in poverty occurred in Mozambique (20 percentage points) and Malawi (5 points). The remaining Southern African countries saw poverty expand, with Zimbabwe showing the largest increase, at 85 percentage points between 2011 and 2019, followed by Angola at 37 percentage points. (The increase in Zimbabwe was largely due to natural disasters and macroeconomic challenges; in Angola it was largely due to the decline in world oil prices.)

While every country in the region implements social protection programs, different outcomes on poverty reflect differences in the scale of the programs—both the population covered and size of support. Countries like Mauritius and South Africa, with more fiscal space, have far-reaching programs that have substantially reduced poverty. Other countries, such as Malawi, Mozambique, and Zimbabwe, are fiscally constrained. Hence their social protection programs are modest. Moreover, some programs are driven by donor support, and so not sustainable.

Poverty headcounts measured at national poverty lines reflect the cost of living actually experienced by poor people. Poverty appears quite high in Southern Africa when measured against national poverty lines (figure 1.14). Mauritius has the smallest share of the population below the poverty line, at 10.3 percent in 2017; followed by Namibia (17.4 percent in 2015) and Botswana (19.3 percent in 2009). South Africa is perhaps most surprising, with more than 56 percent of the population falling below the national poverty line in 2014, ranking below countries such as Angola, Mozambique, and Zimbabwe.

Figure 1.14: Poverty in Southern Africa by country using national poverty lines, 2011 (Percent)

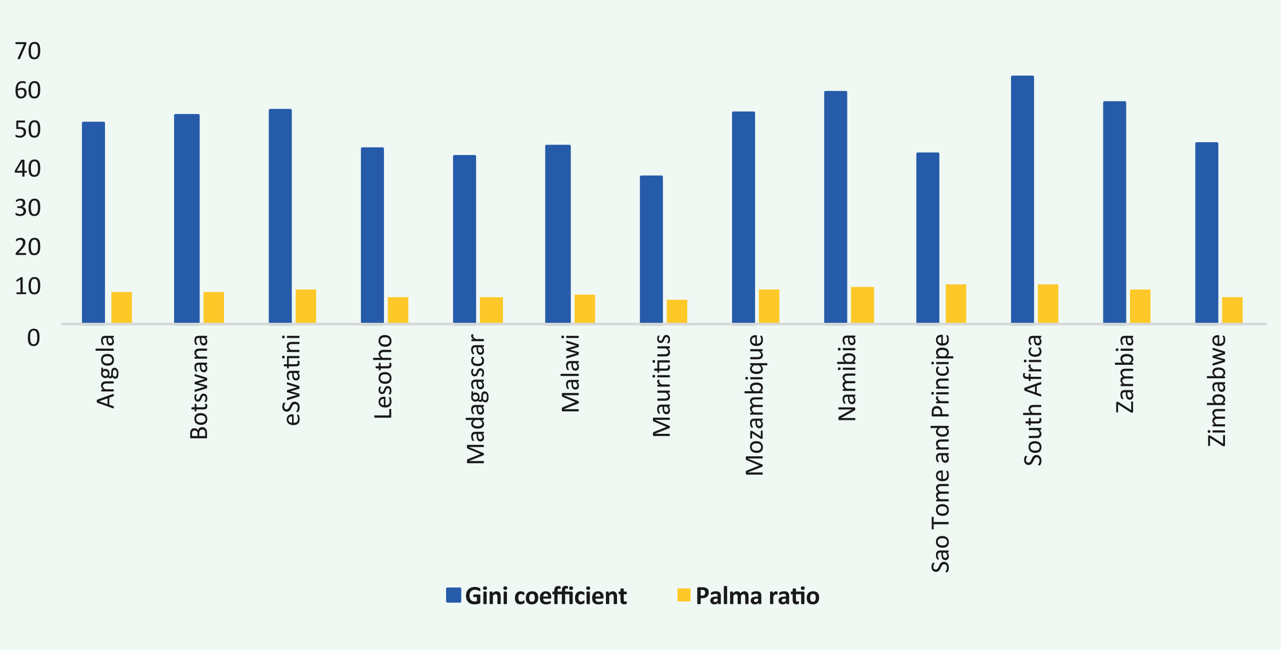


Source: World Bank 2021c.

Inequality is also high in the region, whether in terms of outcomes or opportunities. For inequality of outcomes, measures such as the Gini coefficient and Palma ratio show that Southern Africa suffers from high income inequality (figure 1.15). South Africa has the highest Gini coefficient in the region (and globally), at 63 percent, while Mauritius has the most egalitarian society, with a Gini coefficient of 38 percent. The Palma ratio shows similar outcomes. The challenge for the region is to create opportunities for its citizens to raise earnings and thus incomes, as well as to strengthen redistribution policies that reduce inequality. High inequality is a drag on economic growth (Cingano 2014) and can foster social instability.

A sustainable approach to reducing poverty and inequality is to create decent jobs across the spectrum of skills in an economy. In many Southern African countries, most jobs available to the poorest people are low paying and vulnerable. Formal unemployment is not the best indicator of vulnerability in most of the region's countries because informal sectors are large and social protection systems are small. Many people are underemployed or work multiple jobs, so such data may better capture labor market patterns and differences. In other words, poor people—men or women—cannot afford to be unemployed. But in the absence of such data, the analysis here uses formal unemployment.

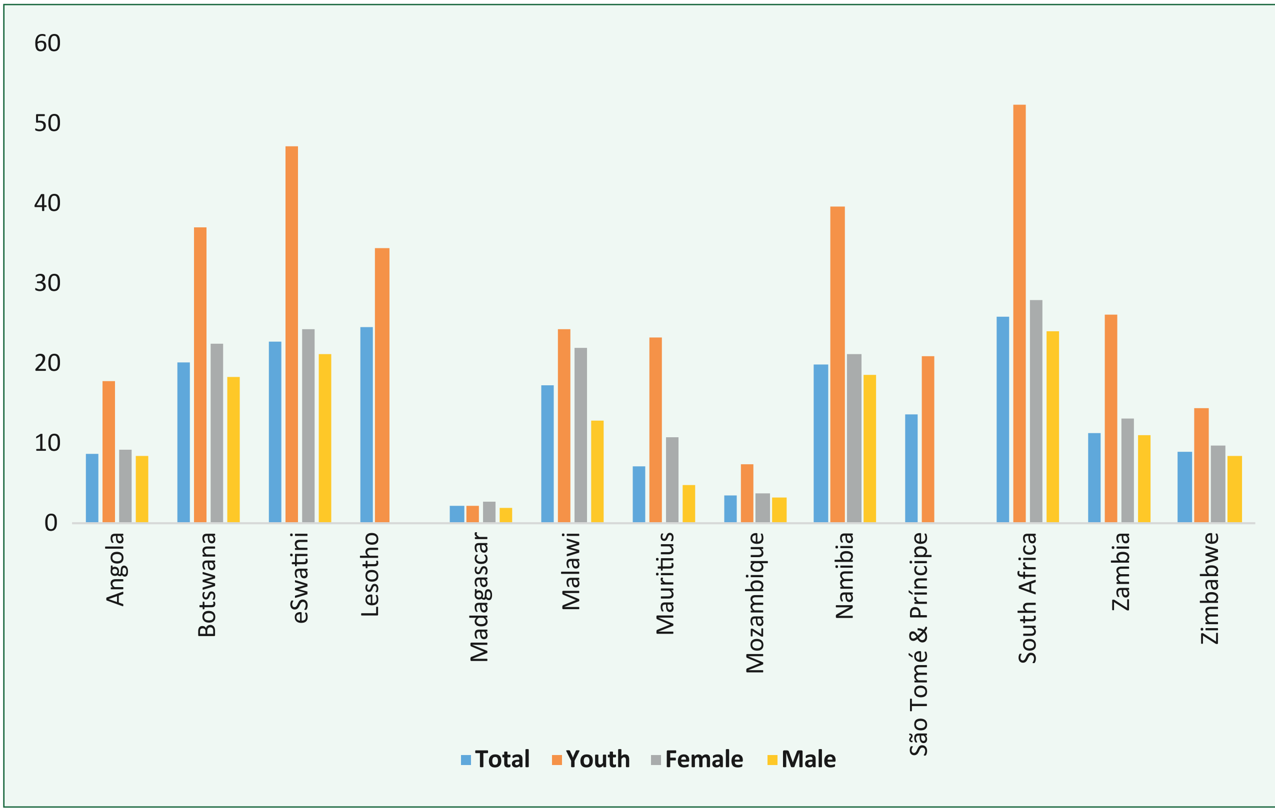
Figure 1.15: Inequality in Southern Africa by country, 2010-18 (Percent)



Source: World Bank 2021c; UNDP 2021.

In 2010–19 unemployment was lowest in Madagascar (2 percent), followed by Mozambique (3 percent), Mauritius (7 percent), and Angola (9 percent; figure 1.16). Except for Mauritius, these low unemployment rates reflect high informality. In most low-income and lower-middle-income countries in the region, people must work to eke out a living—though most are engaged in vulnerable employment. But given the formal definition of unemployment, they qualify as employed; hence the artificially low unemployment rates. Upper-middle-income countries (Botswana, Namibia, South Africa), with larger formal labor markets and stronger social protection systems, show higher unemployment. These countries entered the COVID-19 era with high unemployment rates, which have since been made worse by the pandemic.

Figure 1.16: Unemployment in Southern Africa by country, 2010--19 average (Percent)



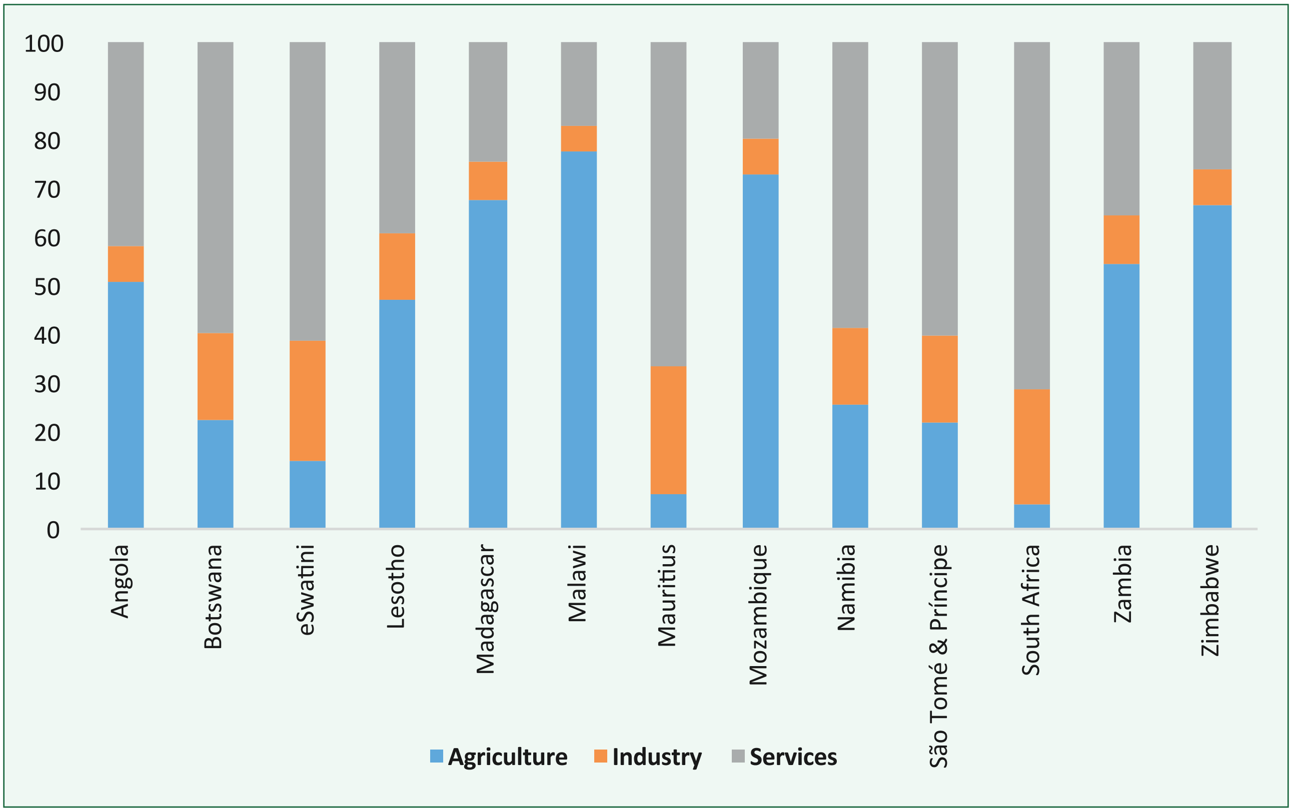
Source: World Bank 2021c.

Even more concerning are the region's rates of youth unemployment. Except in highly informal economies, youth unemployment is extremely high: above 50 percent in South Africa, 47 percent in eSwatini, 40 percent in Namibia, and 37 percent in Botswana. Across all countries, female unemployment is higher than male unemployment. But these data mask the real challenges facing female workers. Specifically, women are overrepresented in vulnerable employment, particularly household enterprises (ILO 2018). Such jobs typically involve personal services requiring face-to-face interactions. For these reasons, young people and women have been disproportionately impacted by COVID-19, with many thrust into poverty.

What can policymakers do to mitigate these effects? Where fiscal space allows, social transfers should be provided to those hit hardest by the pandemic. But given the limited fiscal space in most countries, governments should strive to keep activities open through better-designed lockdowns and public campaigns on COVID-19 safety protocols. Such efforts should allow people to remain employed while minimizing risks of transmission. Governments in the region should also ramp up vaccination efforts.

Most jobs in Southern Africa involve agriculture or services (figure 1.17). Industry is generally not a major employer, mainly because industry is fairly small in most countries, with many countries having experienced deindustrialization. Moreover, industry is generally capital intensive, so a unit of GDP requires much less labor to produce than a unit of GDP in agriculture or services. Aggravating the situation is that, in most Southern African countries, services are low value added (such as trading or selling merchandise, beauty services, and hospitality).

Figure 1.17: Sectoral contributions to employment in Southern Africa, 2010-20 average (Percent)



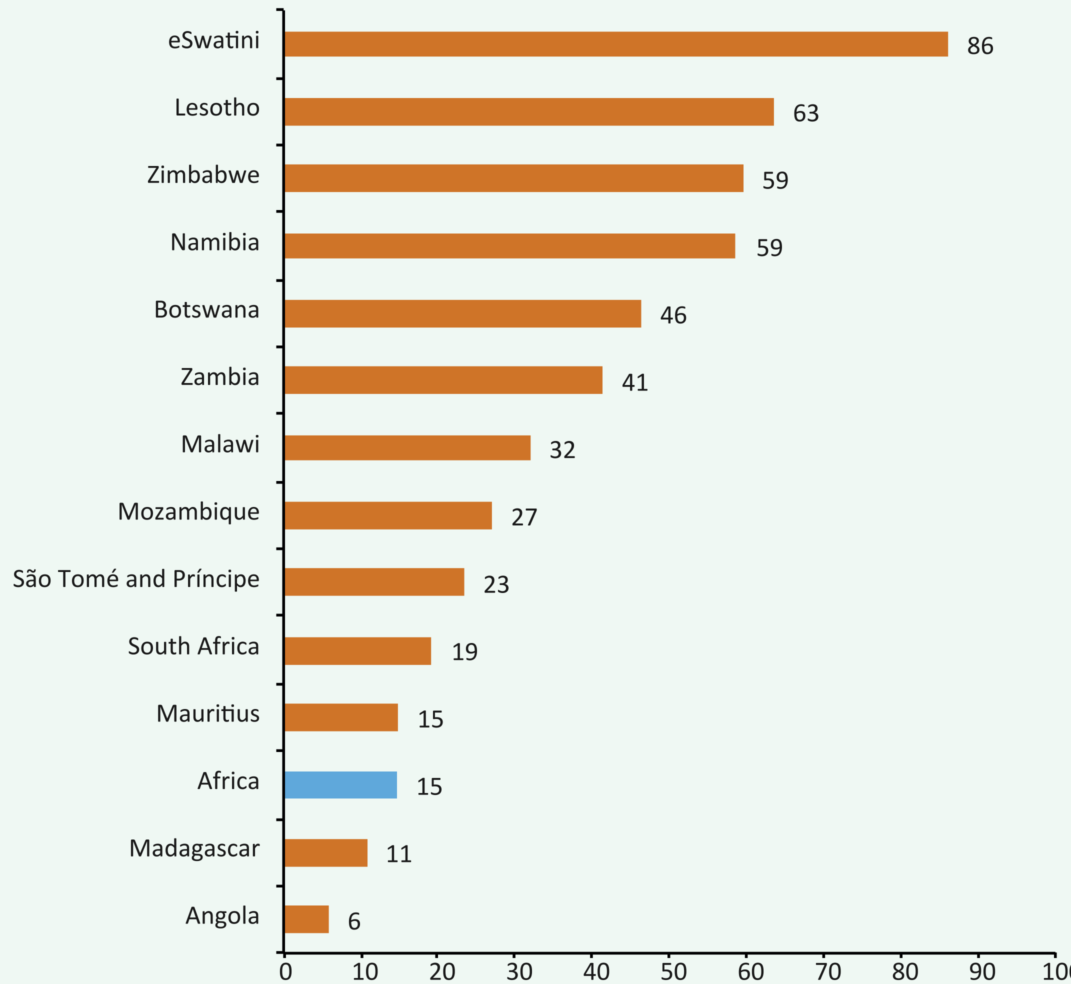
Source: World Bank 2021c.

Agriculture is the most important source of employment for countries with extensive informality or low official unemployment, affirming the vulnerability of such jobs (earnings subject to the vagaries of weather). Except in São Tomé & Príncipe, there is a strong correlation between industrial and services employment and per capita GDP. Specifically, upper-middle-income countries have larger shares of employment in industry, and even larger shares in services. This is suggestive of the traditional evolution of economies where they structurally transform, with employment moving from agriculture to industry and then services. Though this seems encouraging, industry's contribution to growth is quite small and services are fairly low skilled (except in Mauritius and South Africa, which have high-end and globally competitive financial service sectors). Thus there are merits to an agriculture-driven development strategy that aims to raise the low capital-labor ratios in the sector, particularly smallholder farms.

1.6 INTRA-AFRICAN TRADE

Trade within Africa remains extremely low. Between 2015 and 2017 intra-African trade, defined as trade in goods and services between African economies, accounted for 15 percent of total trade in Africa. This compares poorly to other major economic regions such as Asia (61 percent), Europe (67 percent), and the United States (47 percent). Those trends have hardly changed since then (figure 1.18). Intra-African trade, unlike Africa's trade with the rest of the world (which is dominated by commodities), is dominated by manufactured goods, foodstuffs, and services (Songwe 2019), and typically involves small and medium-size enterprises (SMEs) and small shipments. So, intra-African trade supports increased value addition within Africa, and thus growth.

Figure 1.18: Intra-African trade in Africa and Southern Africa by country, 2019 (Percentage of total trade)



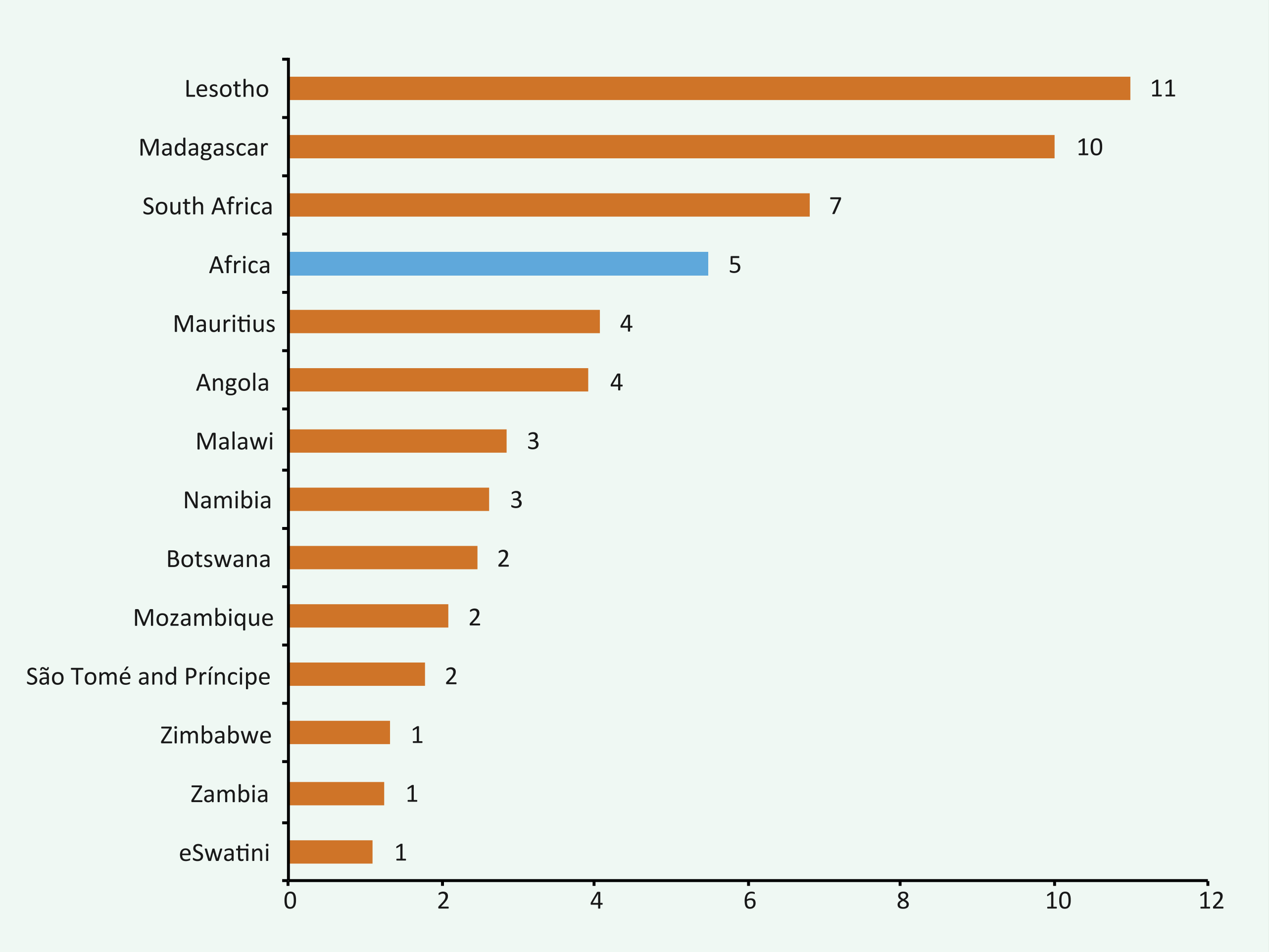
Source: African Development Bank statistics.

Some countries in Southern Africa show significant trade openness, at least from a regional perspective. About 86 percent of eSwatini's total trade is within Africa, followed by Lesotho (63 percent), and Namibia and Zimbabwe (59 percent). Intra-African trade by Southern African countries is largely an intraregional trade story, possibly reflecting the constraints imposed by interregional trade restrictions and trade logistics. With South Africa as the gateway to the Southern African Customs Union (SACU) region, trade between SACU countries and South Africa is substantial. Except for São Tomé & Príncipe (and to a lesser extent Zambia), the rest of Southern African countries' intra-African trade is mostly with South Africa.

South Africa is also the key export and import route for most landlocked countries in the region. Any logistics inefficiencies in South Africa would adversely affect most regional economies. Indeed, the recent riots in South Africa—which resulted in temporary closures of major routes to and from the Durban harbor, as well as port operations—highlighted the risks posed to the region as a result of the concentration of export and import activity through the harbor. As recovery from COVID-19 takes hold, countries in the region should pursue structural reforms to engineer faster and more robust broadly based economic growth and to enhance the resilience of their economies to shocks. Reforms could include cutting the costs of doing business, reducing product market regulation, fostering competition, and improving the quality of education.

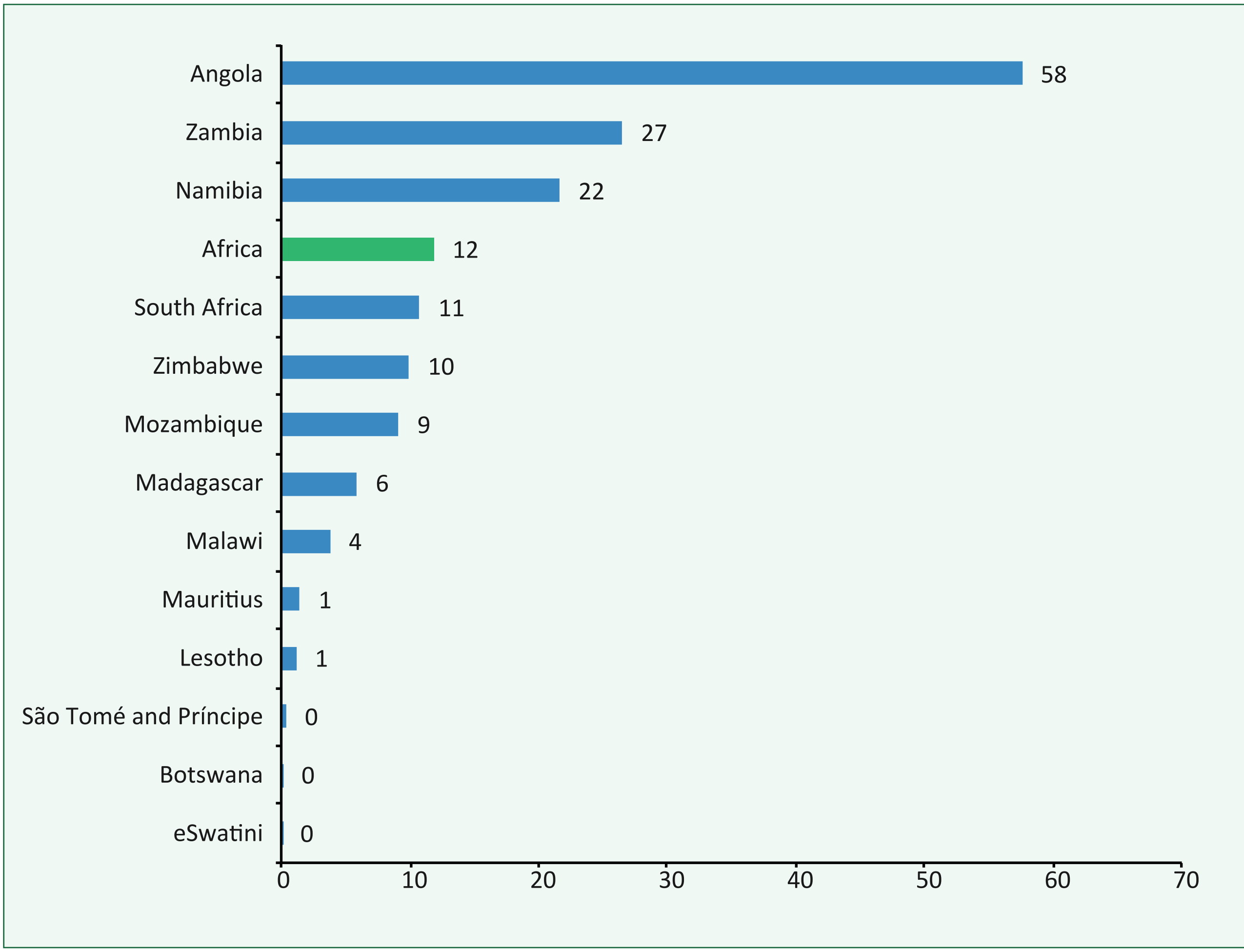
Infrastructure development should also be prioritized to reduce the concentration risk associated with channeling most regional trade through the Durban harbor. Countries should also eliminate unfair business practices and promote competition within the regional bloc. Part of the slow growth in the region could also be attributed to fragility. Angola, Lesotho, Mozambique, and Zimbabwe exhibit elements of fragility or have a history of political instability, undermining economic development. Measures to address the causes of fragility, particularly inclusion, should be pursued as part of structural reforms. Efforts should be enhanced to create opportunities for women and young people, the two groups disproportionately affected by COVID-19 (ILO 2020; UN Women 2020).

Figure 1.19: Exports to the United States from Africa and Southern Africa by country, 2019 (Percentage of total)



Source: African Development Bank statistics.

Figure 1.20: Exports to China from Africa and Southern Africa by country, 2019 (Percentage of total)



Source: African Development Bank statistics.

Overall, 11 of the 13 Southern African countries have intra-African trade higher than the African average. Only in Angola and Madagascar is intra-African trade lower than the African average. Angola's intra-African trade is lower because the country's exports are dominated by oil, most of which goes outside Africa. Lesotho, Madagascar, South Africa, and Mauritius are the region's largest exporters to the United States (figure 1.19), leveraging on the African Growth and Opportunity Act (AGOA). But AGOA will end in 2025. Angola, Zambia, and Namibia have the largest concentration of exports to China (figure 1.20), with Angola exporting mostly oil and Zambia mostly copper.

1.7 MEDIUM-TERM MACROECONOMIC OUTLOOK

The future of Southern Africa, and indeed the continent, hinges on how the COVID-19 pandemic evolves and the policy measures adopted to help the recovery. Though vaccination is considered the surest way to reach herd immunity at minimal economic and human cost, the region and continent are lagging other parts of the developing world. Mauritius is the region's leader on vaccination, but in early June 2021 only 13 percent of the population was fully vaccinated. São Tomé & Príncipe is second with 3.0 percent of the population fully vaccinated, followed by Zimbabwe with 2.5 percent. In most Southern African countries less than 1 percent of the population was fully vaccinated as of early June 2021. Until herd immunity is achieved, economic recovery in the region will depend on effective social distancing and hygienic protocols to contain the spread of the virus, and on adapting economic activities to minimize contact. Still, vaccinations are the only viable route out of the pandemic.

Southern Africa is projected to grow at 3.2 percent in 2021 and 2.4 percent in 2022. But this recovery is quite weak given the base effects from the estimated –6.3 percent contraction in 2020. In 2021 only Botswana and Mauritius are projected to grow by more than 5 percent, suggesting weak growth dynamics in the region. Inflation is expected to moderate in the medium term, from an estimated 14.2 percent in 2020 to a projected 9.4 percent in 2021 and 6.5 percent in 2022. This shift will mostly be driven by the expected moderation of inflation in Angola and Zimbabwe, but also reflects weak demand in the region's economies given the weak growth projected for 2021 and 2022.

The outlook for government finances appears mixed, with deficits in some countries—Angola, Madagascar, Mozambique, São Tomé & Príncipe, and Zimbabwe—recovering closer to pre-pandemic levels by 2021. These countries appear to be benefitting from buoyant commodity prices and thus tax revenues. All the region's countries except Lesotho are expected to see an improvement in fiscal deficits in 2021 and 2022. Deficits for Lesotho are projected to remain at or above –10 percent of GDP in both years. Current account balances are projected to deteriorate marginally in the outer period, perhaps reflecting the recovery in imports (especially investment goods, consumer goods, and oil) in line with the recovery in the region's economies. Mozambique's current account deficit is expected to remain elevated, at –26 percent in 2021 and –25 percent in 2022, presenting financing challenges for the government. Lesotho and Malawi also show elevated current account deficits in the projected horizon.

Poor growth outcomes for the region can partly be explained by lackluster growth in South Africa, the nerve center of the regional economy. Low growth in South Africa means reduced positive externalities for the region's economies, which are the country's main trade partners, supplying inputs and demanding manufactured and processed goods from South Africa in return.

There are several moderate risks to this outlook, mostly to the downside for growth. First, uncertainty remains around the trajectory of COVID-19, particularly given the region's low vaccination rates. Lockdowns may continue to be implemented unless vaccinations are accelerated, impacting the region's economies. On the other hand, faster vaccination could see a return of tourists, supporting faster growth. Second, buoyant commodity prices are supporting recovery in the region. A collapse in commodity prices (as in 2014) could undermine recovery—and ultimately increase poverty in the region. Third, recovery in the region will benefit from continued improvement in global logistics and supply bottlenecks. But should global logistics and supply bottlenecks persist, growth in the region would be adversely impacted, with an upside risk to inflation.

Another risk is higher global food inflation, raising the specter of imported food inflation for the region. But good harvests across the region should mitigate that risk. There is also a risk that countries may fail to consolidate their fiscal positions or that exports may underperform while imports recover, widening current account deficits. Large current account deficits present upside risks for currency depreciations and, through pass-through effects, inflation. Finally, socio-political instability is a growth risk for the region. For instance, there is currently some uneasiness in Mozambique, South Africa, eSwatini, and Zimbabwe. These tensions need to be resolved to minimize disruptions to economic activity.

CHAPTER 2

DEBT DYNAMICS AND FINANCING ISSUES

This chapter explores Southern Africa's debt and financing landscape, the changing structure and drivers of the region's debt, emerging vulnerabilities and the outlook for debt, and the medium-term outlook for debt.

2.1 DEBT AND FINANCING LANDSCAPE

COVID-19 and the associated lockdowns imposed by many governments have left a trail of economic destruction in many countries in Southern Africa. To protect lives and livelihoods as well as minimize the negative economic impacts of the shock, governments in the region have introduced fiscal and monetary measures. The fiscal interventions were generally the same across all the countries in the region and included various forms of tax relief and increases in government spending. Data from the IMF Policy Tracker and country reports show that Angola, Botswana, Lesotho, Madagascar, South Africa, and eSwatini used tax exemptions to mitigate effects on households and corporations. Monetary policy and macroprudential measures included lowering central bank lending rates, temporarily suspending debt service payments, requiring banks to provide moratoriums on guaranteed credit repayments, extending loan maturities for the private sector (including small and medium-size enterprises), and introducing Special Purpose Vehicles to support the financing of private investments.

Governments' COVID-19 recovery programs also varied in magnitude and coverage. South Africa announced a $26 billion stimulus package—equivalent to 10 percent of the country's GDP and larger than those in several high-income countries including Canada and the Republic of Korea (Bhorat and others 2020). To counter the worst immediate impacts of COVID-19, in September 2020 Botswana introduced the Economic Recovery and Transformation Plan, costing $1.2 billion—7 percent of GDP—and to be implemented over two and a half years (Botswana SONA 2020).

eSwatini introduced the Post–COVID-19 Economic Recovery Plan to resuscitate the economy and reignite economic growth through high-impact private projects. The government proposed investing about $400 million, or 10 percent of GDP (IMF 2020g). In Lesotho the pandemic hit at a time when growth had already been subdued for several years due to structural bottlenecks and a weak regional environment, while government finances struggled to cope with the volatility of transfers from the Southern African Customs Union (SACU), which account for about half of revenue. Moreover, the shutdown in South Africa, by far the largest source of remittances on which many households in Lesotho depend, and which had accounted for nearly one-fifth of GDP, resulted in about 60,000 workers returning to Lesotho before the border was closed. Lesotho responded to COVID-19 by setting aside about $140 million, or 9.5 percent of GDP, for the National COVID-19 Response Integrated Plan 2020, with $40 million covering health care personnel and logistics (among other things) and $100 million supporting different parts of the economy including small and medium-size enterprises. The government also made a provision to repay about $50 million in domestic arrears, providing much-needed liquidity for the private sector (IMF 2020f).

Zimbabwe's government unveiled a $350 million Economic Recovery and Stimulus Package, equivalent to 9 percent of GDP, aimed at revitalizing the economy and providing relief to individuals, households, small businesses, and industries affected by the COVID-induced economic slowdown (Government of Zimbabwe 2020). Although the funding budgeted by Malawi to respond to the pandemic is not known, the IMF Policy Tracker shows that the government's fiscal policy response included $20 million (0.25 percent of GDP) for health care and targeted social assistance programs and about $50 million (0.6 percent of GDP) for an emergency cash transfer program, mostly financed by development partners (IMF 2020d). In Madagascar several social, fiscal, and financial measures—including cash transfers, in-kind donations, tax relief, subsidies, and credit easing—were adopted to support vulnerable households and the private sector at an estimated cost close to 2.8 percent of GDP (IMF 2020h).

In Mozambique COVID-19 exacerbated the country's economic challenges, interrupting a nascent recovery following the powerful tropical cyclones Idai and Kenneth, which struck in 2019. To mitigate the impact of the pandemic and preserve macroeconomic stability, the government increased health spending, allocating between $28 million (about 0.2 percent of GDP) and $47 million (0.3 percent of GDP). The IMF Policy Tracker shows that in Mauritius the government increased public health spending by $33 million (0.28 percent of GDP). Another $460 million (4.0 percent of GDP) was budgeted for the Government Wage Assistance Scheme (GWAS) and the Self-Employed Assistance Scheme (SEAS). The State Investment Corporation has raised about $100 million (0.8 percent of GDP) to make equity investments in troubled firms, including small and medium-size enterprises. The Development Bank of Mauritius also provided about $260 million (2.3 percent of GDP) in credit to distressed enterprises and cooperatives. As part of the COVID-19 response, the government also submitted a $435 million (3.6 percent of GDP) supplementary spending bill to parliament.

A halt in international tourism and sharp drop in foreign remittances have deepened the external financing needs of São Tomé & Príncipe, though no data are available on how much money the government has allocated for its COVID-19 response. Zambia responded to the pandemic by launching the Economic Recovery Program 2020–2023, which focuses on restoring macroeconomic stability, attaining fiscal and debt sustainability, dismantling the backlog of domestic arrears, restoring growth and diversifying the economy, and safeguarding social protection programs. As in São Tomé & Príncipe, Zambia's pandemic responses are expressed in terms of targets but say nothing about the expenditures that the government will incur to finance them. However, the IMF Policy Tracker states that the Zambian government issued a $450 million bond (2.3 percent of GDP) to finance expenses related to COVID-19.

Nine of the thirteen countries in Southern Africa requested emergency COVID-19 financial assistance from the IMF, in the form of balance of payments support. Some, like South Africa, obtained funds under the Rapid Financing Instrument (table 2.1). Angola got funding through the Extended Fund Facility and São Tomé & Príncipe through the and Extended Credit Facility. Others relied on the Rapid Credit Facility. An attractive feature of IMF financial support is that the institution's legal framework precludes it from providing assistance unless programs directly address fiscal and debt sustainability.

Table 2.1: IMF disbursements in Southern Africa related to COVID-19, 2020–21			
Country	Approval	Amount disbursed	Type of facility
Angola	September 2020	$1 billion	Extended Fund Facility
Botswana	No approval information		
Lesotho	July 2020	$49.1 million	Rapid Credit Facility and Rapid Financing Instrument
Madagascar	July 2020	$171.9 million	Rapid Credit Facility
Malawi	May 2020	$91 million	Rapid Credit Facility
Mauritius	No approval information		
Mozambique	April 2020	$309 million	Rapid Credit Facility
Namibia	March 2021	$270.8 million	Rapid Financing Instrument
São Tomé & Príncipe	February 2021	$19.5 million	Extended Credit Facility
South Africa	July 2020	$4.3 billion	Rapid Financing Instrument
eSwatini	July 2020	$110.4 million	Rapid Financing Instrument
Zambia	Talks ongoing		
Zimbabwe	No approval information		

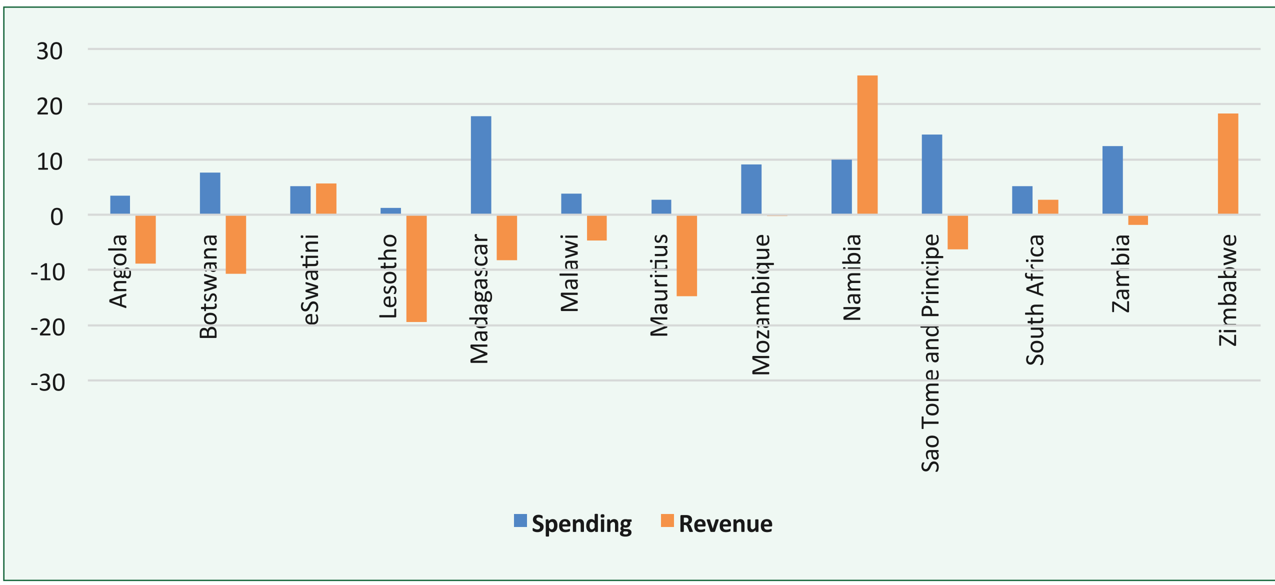
Source: IMF country reports, 2020–21.
Note: The Rapid Credit Facility provides fast concessional financial assistance with limited conditionality to low-income countries facing urgent balance of payments needs. It emphasizes poverty reduction and growth objectives. The Rapid Financing Instrument provides quick financial assistance that is available to all member countries facing urgent balance of payments needs. The instrument was created to make IMF support more flexible in addressing the diverse needs of member countries. When countries face serious medium-term balance of payments problems because of structural weaknesses that take time to address, the IMF can assist with the adjustment process through an Extended Fund Facility. The Extended Credit Facility also provides financial assistance to countries with protracted balance of payments problems.

Some Southern African countries also received COVID-19 support from other development partners and multilateral organizations. The African Development Bank provided assistance to Madagascar, Malawi, Mozambique, and São Tomé & Príncipe through the Multi-Country COVID-19 Response Support Program (MCRSP). Through the program, these countries received $138 million in loans and grants from the African Development Fund and Transition Support Facility. This one-year facility, which ended in July 2021, was designed to support labor force productivity, safeguard incomes and livelihoods, and strengthen economic resilience (AfDB 2021). The African Development Bank also provided a one-year, $225 million loan to Mauritius under the COVID-19 Crisis Response Budget Support Program (AfDB 2021).

To help bridge Mozambique's $700 million budget gap (4.7 percent of GDP), the country's development partners have provided financial support that includes $22 million for the Pro-Health Project, $40 million from the Islamic Bank to support health care, $170 million from the World Bank for health spending and social protection, and $54 million from the European Union for budget support (IMF 2020c). Even though talks with the IMF are ongoing regarding Zambia'srequest for support under the Extended Credit Facility, the country received support under the G20 Debt Service Standstill Initiative. But with debt already unsustainable before COVID-19, the government has sought comprehensive debt treatment under the G20 Common Framework.

The various COVID-19 recovery programs implemented in Southern African ballooned government spending. And because some were in the form of tax relief, they depressed government revenue—leading to huge gaps between revenue and spending that required other forms of financing. Unless properly managed, monitored, and gradually phased out after the pandemic, these necessary but costly interventions could have far-reaching implications for debt sustainability (AfDB 2021). In Malawi government spending as a percentage of GDP jumped 18 percent between 2019 and 2020, followed by South Africa (15 percent), Zambia (12 percent), and São Tomé & Príncipe (10 percent). Zimbabwe had the smallest increase in government spending (0.1 percent), followed by Madagascar (1.2 percent) and Mozambique (2.7 percent).

Figure 2.1: Changes in government spending and revenue in Southern Africa by country, 2019-20 (Percentage of GDP)



Source: IMF 2021c.

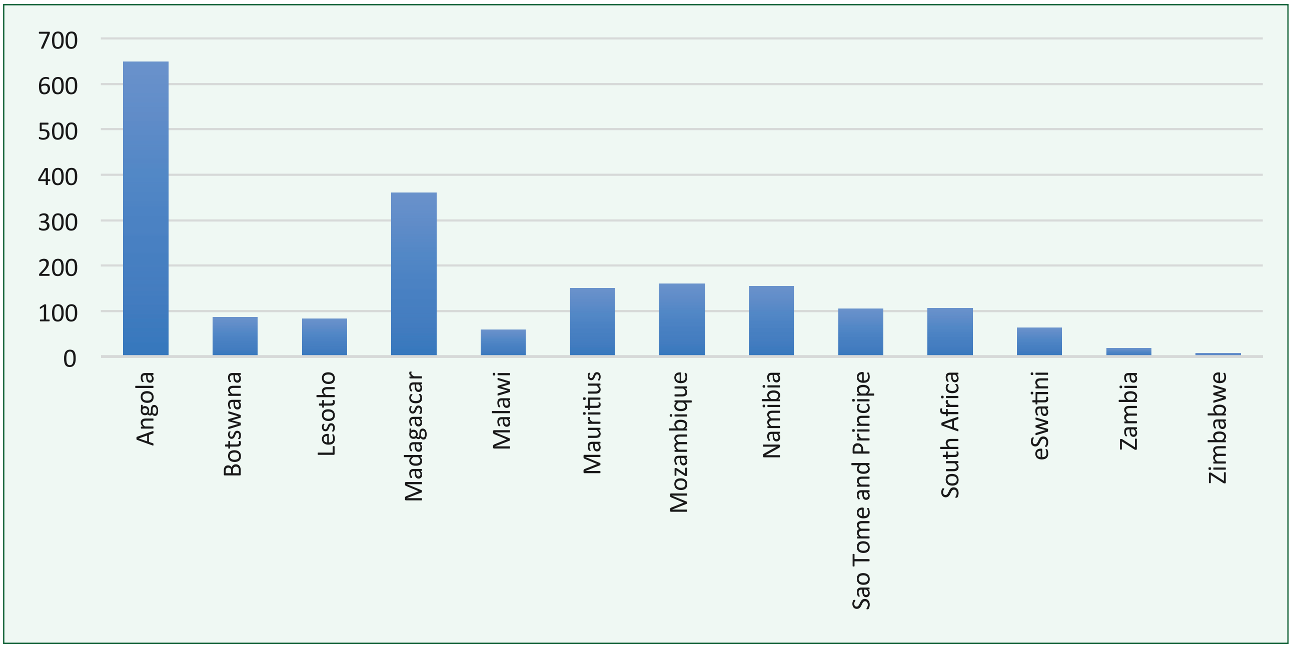
Few countries in Southern Africa saw revenue increase between 2019 and 2020. Government revenue as a percentage of GDP fell in 8 of the region's 13 countries, with the biggest drops in Madagascar (19 percent), Mozambique (15 percent), and Botswana (11 percent). Revenue rose in São Tomé & Príncipe (25 percent), Zimbabwe (18 percent), and Lesotho (6 percent), likely thanks to grants and social contributions that are included in revenue. GDP and trade contractions due to COVID-19 affected countries heavily dependent on tax revenues. In Malawi, for example, nearly 94 percent of government revenue comes from taxes (World Bank 2021c).

Among the 11 countries for which tax and revenue data are available, 9 (except Angola and Botswana) generate at least 80 percent of their revenue from direct and indirect taxes (World Bank 2021c).

In 2019 annual growth in imports of most Southern African countries (excluding Madagascar and Mauritius) was lower than in 2018 (World Bank 2021c). If this trend continued in 2020, countries heavily dependent on customs revenue—like that from the Southern African Customs Union (SACU)—were also affected. Using 2010–19 averages, countries where customs taxes formed a significant share of revenue were Botswana (39 percent), Namibia (34 percent), Lesotho (19 percent), Zimbabwe (18 percent), and Madagascar (14 percent). Dipping commodity prices had a huge effect on revenue in Angola, where oil rents account for 28 percent of GDP.

Changes in government spending and revenue due to COVID-19 increased fiscal deficits across Southern Africa (figure 2.2). Angola saw its deficit skyrocket nearly 650 percent, from 0.8 percent of GDP in 2019 to –4.5 percent in 2020, the largest change in the region (AfDB 2021). Madagascar and Mozambique followed at 360 percent and 160 percent respectively. Zimbabwe had the smallest change in its fiscal deficit (7 percent), followed by Zambia (18 percent) and Malawi (59 percent). The fiscal deficits in 2020 were far greater than the recommended 5 percent of GDP and outside the Southern African Development Community (SADC) macroeconomic convergence target of less than 3 percent.

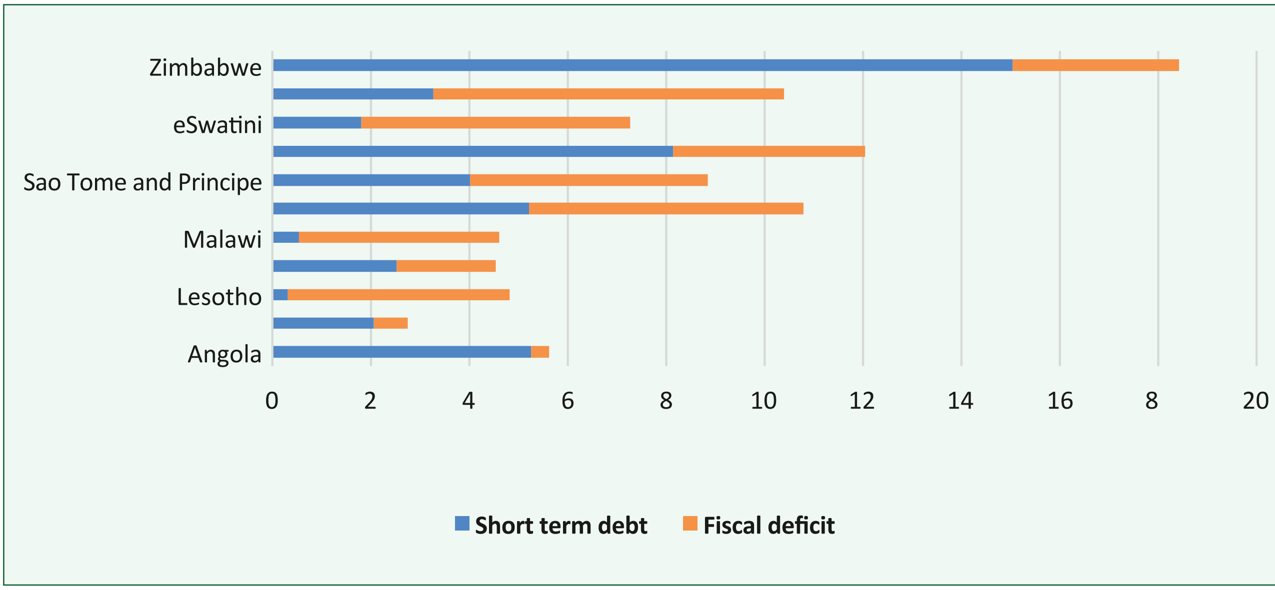
Figure 2.2 Changes in fiscal deficits in Southern Africa by country, 2019-20 (Percentage of GDP)



Source: African Development Bank statistics.

Wider gaps between spending and revenue have not only raised fiscal deficits, they also may have affected governments' gross financing needs. In 2010–19 Zimbabwe was the only country in Southern Africa where gross financing needs exceeded the critical threshold of 15 percent of GDP (AfDB 2021; figure 2.3). If the situation deteriorated in 2020 due to COVID-19, Mozambique and South Africa might also have exceeded this threshold. Gross financing needs in Angola, South Africa, and Zimbabwe are driven by short-term debt as opposed to those in Lesotho, Malawi, eSwatini, and Zambia, which are largely due to fiscal deficits.

Figure 2.3: Gross financing needs in Southern Africa by country, 2019-20 (Percentage of GDP)



Source: African Development Bank statistics; World Bank 2021c.

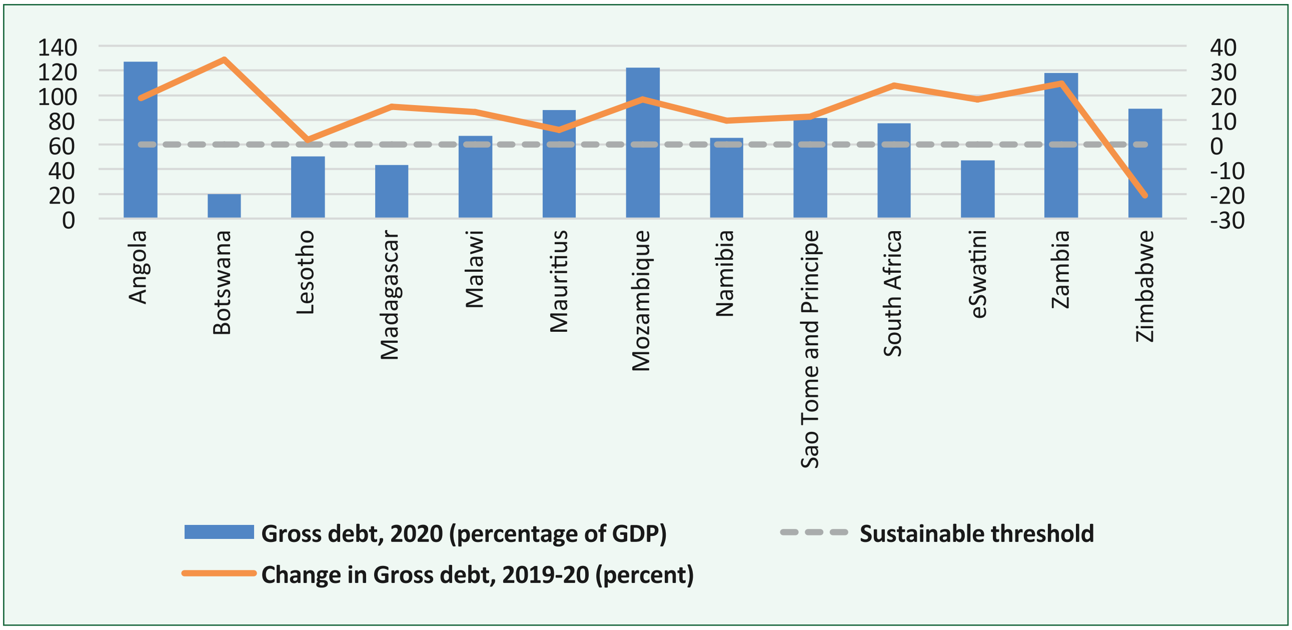
2.2 CHANGING STRUCTURE AND DRIVERS OF DEBT

The large increases in fiscal deficits in Southern Africa in 2020 translated into higher debt. Between 2019 and 2020 government debt as a percentage of GDP rose an average of 13 percent in the region, with the sharpest increases in Botswana (34 percent), Zambia (25 percent) and South Africa (24 percent; figure 2.4). As discussed, South Africa launched a massive $26 billion COVID-19 recovery program and at the same time experienced a decline in government revenue, while Botswana and Zambia are among the three countries that have not secured any IMF funding and also experienced revenue declines in 2020.

Zimbabwe was the only country where gross debt declined between 2019 and 2020—from 112 percent of GDP to 79 percent—partly because the country is in debt overhang and distress, and thus struggling to find creditors in tightening markets. Lesotho's debt rose less than 1 percentage point in 2020. Only Botswana, Lesotho, Madagascar, and eSwatini had gross debt to GDP levels below the 60 percent SADC macroeconomic convergence threshold. Angola and Mozambique had the highest ratios of debt to GDP, exceeding 120 percent, while Zambia's was 117 percent.

During 2010–20 general government gross debt in Southern Africa averaged 50 percent of GDP (IMF 2021c). Growth in such debt was driven by countries such as Mozambique and Zambia, where debt's share of GDP rose more than 25 percentage points in 2015 alone. Debt also spiked in 2019, led by Zimbabwe—where it jumped 78 percentage points of GDP.

Figure 2.4:Government gross debt profiles in Southern Africa by country, 2020

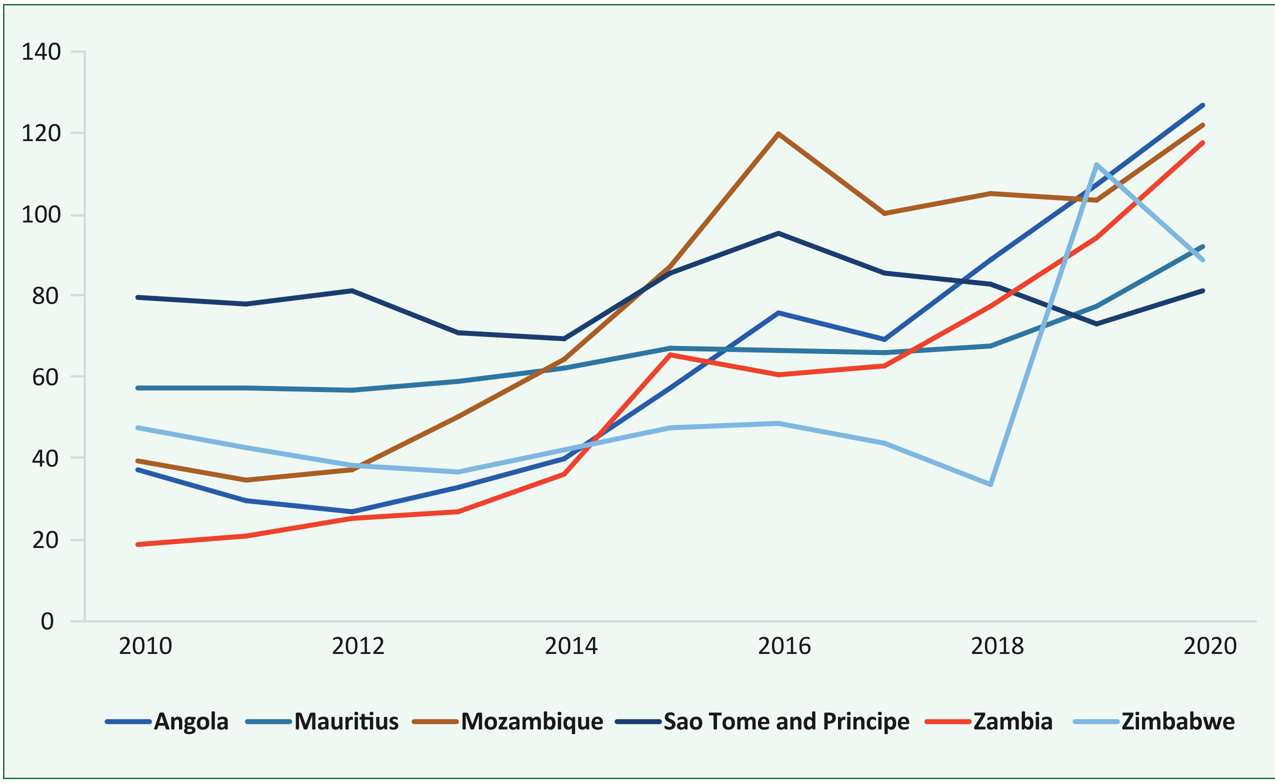


Source: IMF 2021c.

Most Southern African countries had stable debt dynamics immediately after the global financial crisis. Madagascar, Malawi, Mozambique, São Tomé and Príncipe, and Zambia had benefited from the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), which substantially reduced their ratios of debt to GDP. But debt as a share of GDP started rising for nearly all Southern African countries in about 2014, in line with the waning of the commodity super-cycle that began in the early 2000s. Less diversified, commodity-dependent economies like Angola, Mozambique, and Zambia saw debt worsen, resulting in them entering the COVID-19 pandemic with elevated debt.

Southern African countries can be split into three groups: those with significant debt, those with sharply rising debt, and those with relatively low and stable debt. Countries of concern— Angola, Mauritius, Mozambique, São Tomé & Príncipe, Zambia, and Zimbabwe—had debt above 80 percent of GDP in 2018–20 (figure 2.5). Angola, Mozambique, and Zambia have seen debt explode in recent years as commodities have underperformed. São Tomé & Príncipe's debt, while high, has been rather stable, suggesting that its debt dynamics are well contained. By contrast, Zimbabwe's debt has risen sharply, partly in response to the 2018 depreciation of the Zimbabwean dollar.

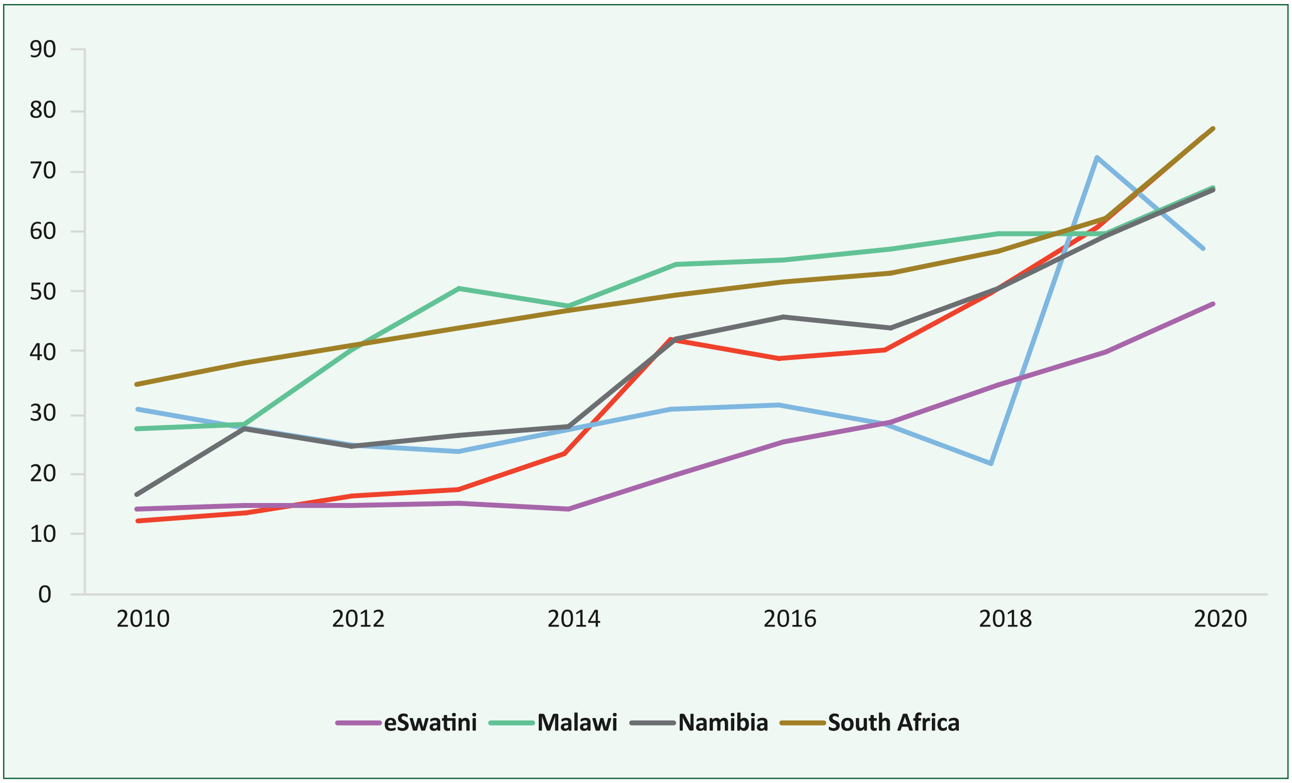
Figure 2.5: Southern African countries with significant debt, 2010-20 (Percentage of GDP)



Source: IMF 2021c.

Malawi, Namibia, South Africa, and eSwatini experienced rapid increase in debt between 2010 and 2020 (figure 2.6). Though the debt may not yet be unsustainable, policymakers should be concerned by the uptick. eSwatini's ratio of debt to GDP is still below 50 percent—and thus within the realm of sustainable debt—but has grown at a steep pace. COVID-19 could further affect eSwatini's debt dynamics, particularly if the pandemic leaves scarring effects that slow growth and thus revenue. eSwatini's debt could also rise if South Africa, the country's main trade partner, continues to experience slow growth. The National Treasury's budget for 2021 projects that South Africa's debt will peak at 89 percent of GDP in 2022/23 before slowly easing (National Treasury 2021).

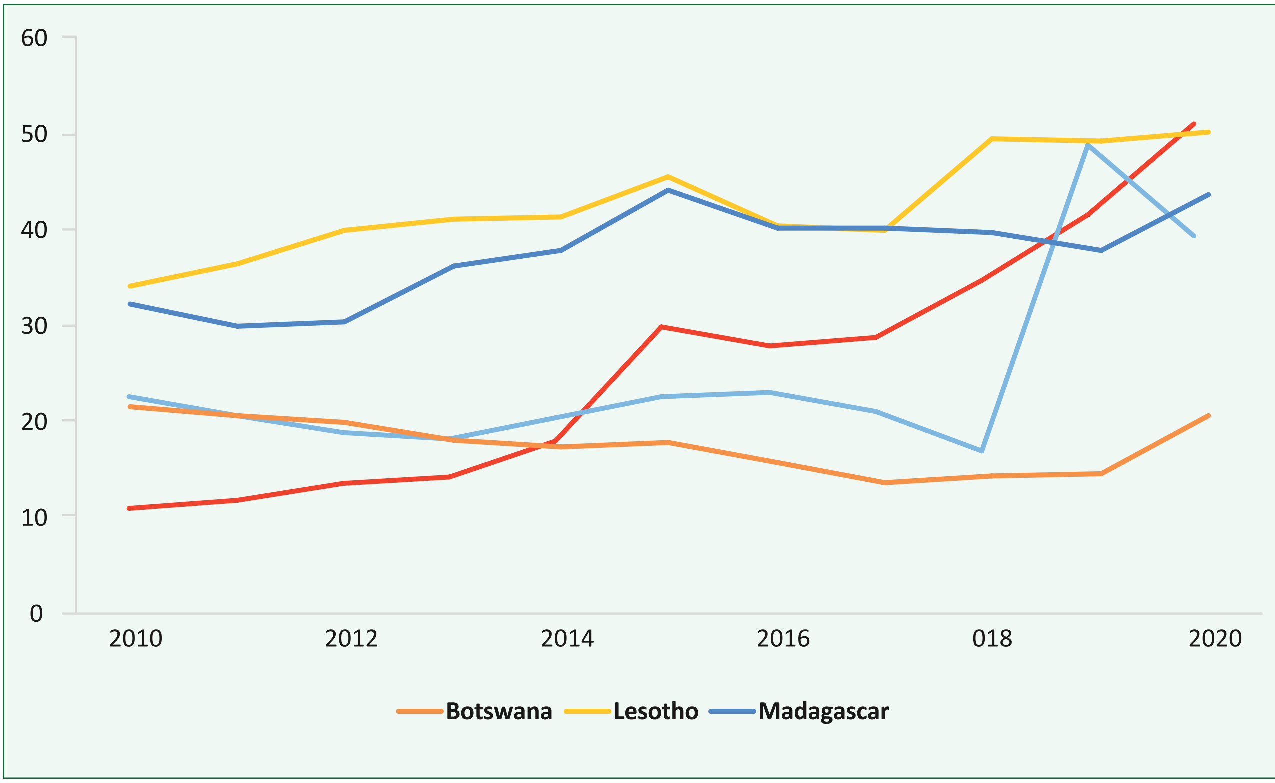
Figure 2.6: Southern African countries with sharply rising debt, 2010-20 (Percentage of GDP)



Source: IMF 2021c.

Botswana, Lesotho, and Madagascar exhibit low and stable debt dynamics (figure 2.7). Botswana's ratio of debt to GDP, which had been falling since the global financial crisis, rose to an estimated 21 percent in 2020 as revenues underperformed and the government responded to COVID-19. Lesotho's debt-to-GDP ratio has also remained largely stable, remaining virtually unchanged at about 50 percent between 2018 and 2020. Madagascar projects a similar picture, with debt-to-GDP just over 40 percent despite COVID-19's economic shocks. Low debt provides countries with fiscal space, enabling them to respond to and buffer the impact of economic shocks.

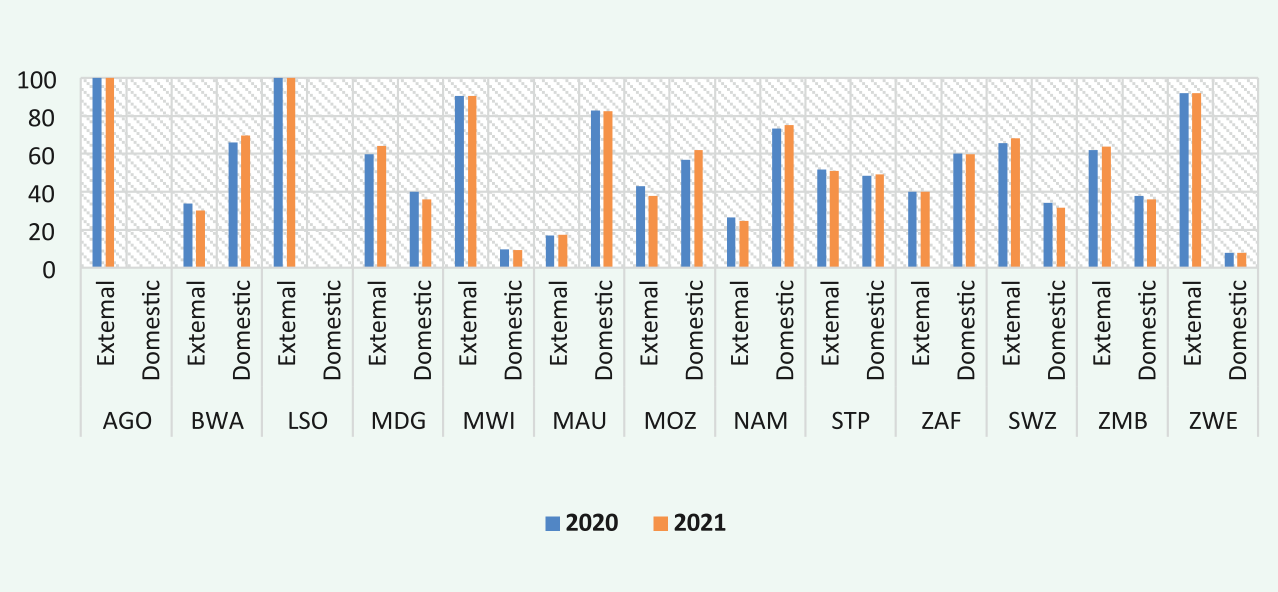
Figure 2.7: Southern African countries with low and stable debt, 2010-20 (Percentage of GDP)



Source: IMF 2021c.

External debt is driving the regional increase in government debt. In 2010 external debt accounted for 43 percent of outstanding debt in the region; by 2021 it accounted for an estimated 51 percent. For countries with underdeveloped financial markets, external debt will continue to be the only option for funding. Angola and Lesotho do not use domestic debt to finance their shortfalls between spending and revenue (figure 2.8). During 2010–21 Malawi and eSwatini had low domestic debt, averaging about 13 percent and 7 percent. But between 2019 and 2020 eSwatini's use of domestic debt increased from 6 percent to 34 percent. Botswana's use of domestic debt has been rising, from 53 percent in 2012 to a projected 70 percent in 2021. These trends in domestic debt use reflect the deepening of some countries' bond markets, enabling them to mobilize domestic resources and tap into idle domestic savings (AfDB 2021).

Figure 2.8: External and domestic debt distribution in Southern Africa by country, 2020-21 (Percent)



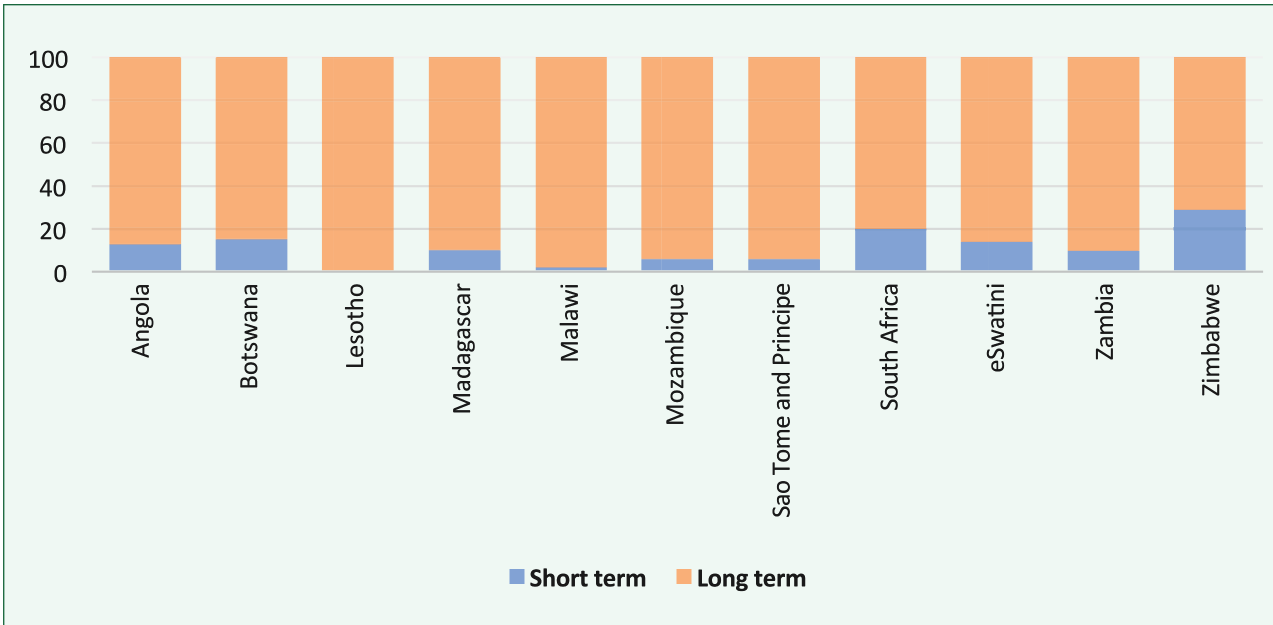
Source: African Development Bank statistics.

Note: Data for 2021 are projections. AGO is Angola, BWA is Botswana, LSO is Lesotho, MDG is Madagascar, MWI is Malawi, MAU is Mauritius, MOZ is Mozambique, NAM is Namibia, STP is São Tomé & Príncipe , ZAF is South Africa, SWZ is eSwatini, ZMB is Zambia, and ZWE is Zimbabwe.

Mauritius is the only country in the region that used domestic debt to finance its total debt between 2010 and 2021, maintaining a consistent 84 percent over the period. This is probably due to the country's highly developed financial market, which enables it to raise funding locally.

External debt in the region tends to be long term rather than short term. During 2010–19 Zimbabwe had the highest share of short-term external debt, at 29 percent of the total, followed by South Africa at 20 percent (figure 2.9). Zimbabwe probably has the greatest worries about debt refinancing given its liquidity and debt overhang challenges. In Lesotho and Malawi short-term foreign debt accounted for less than 2 percent of outstanding external debt, while Mozambique had the highest share of long-term foreign debt stock at 91 percent.

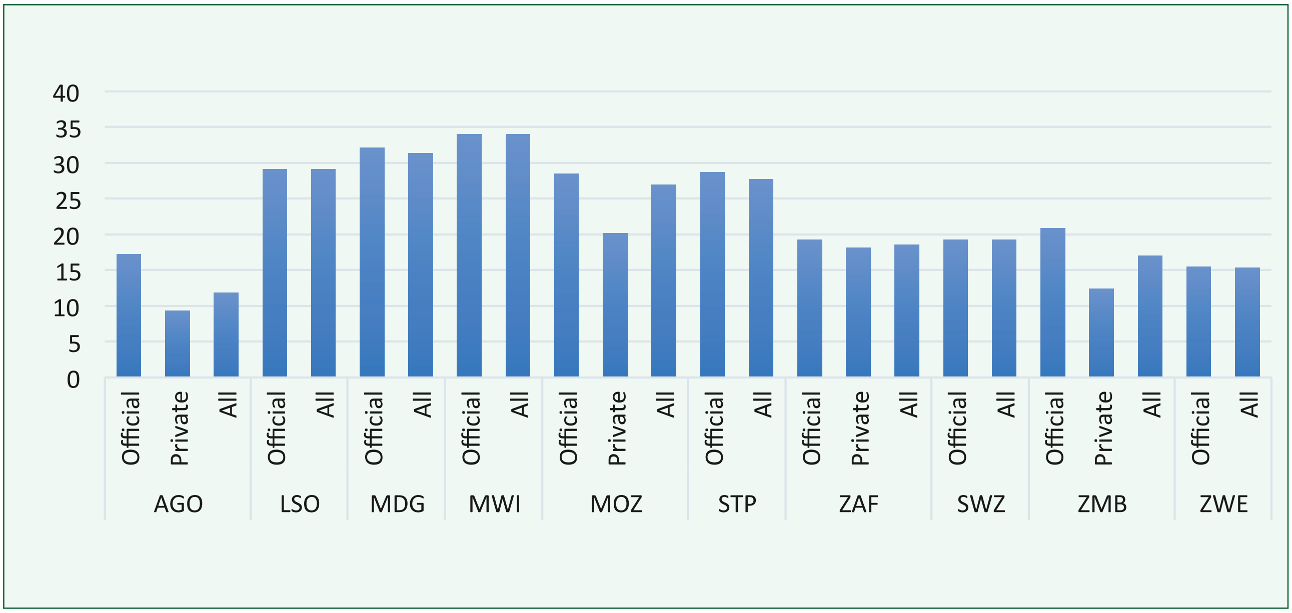
Figure 2.9: Short- and long-term external debt shares in Southern Africa by country, 2010-19 (Percentage of total)



Source: World Bank 2021c.
Note: Short-term debt is defined as that with an original maturity of one year or less; long-term debt has a maturity of more than one year (World Bank 2021b). Data are not available for Mauritius and Namibia.

The average maturity on new external debt commitments also varies by country—and in some, it has been declining. Madagascar and Malawi are the only countries with total external debts maturing after 30 years, while in Angola and Zimbabwe external debts mature in 12 and 15 years respectively (figure 2.10). In all the region's countries, debt from official creditors appears to have longer maturities than debt from private creditors. The maturity periods of external debt affect debt burdens because countries with short maturities have to raise more funds every year to honor their interest and principal payments. That may lead some countries to default on their debt obligations.

Figure 2.10: Average maturities of external debt in Southern Africa by country, 2010-19 (Years)

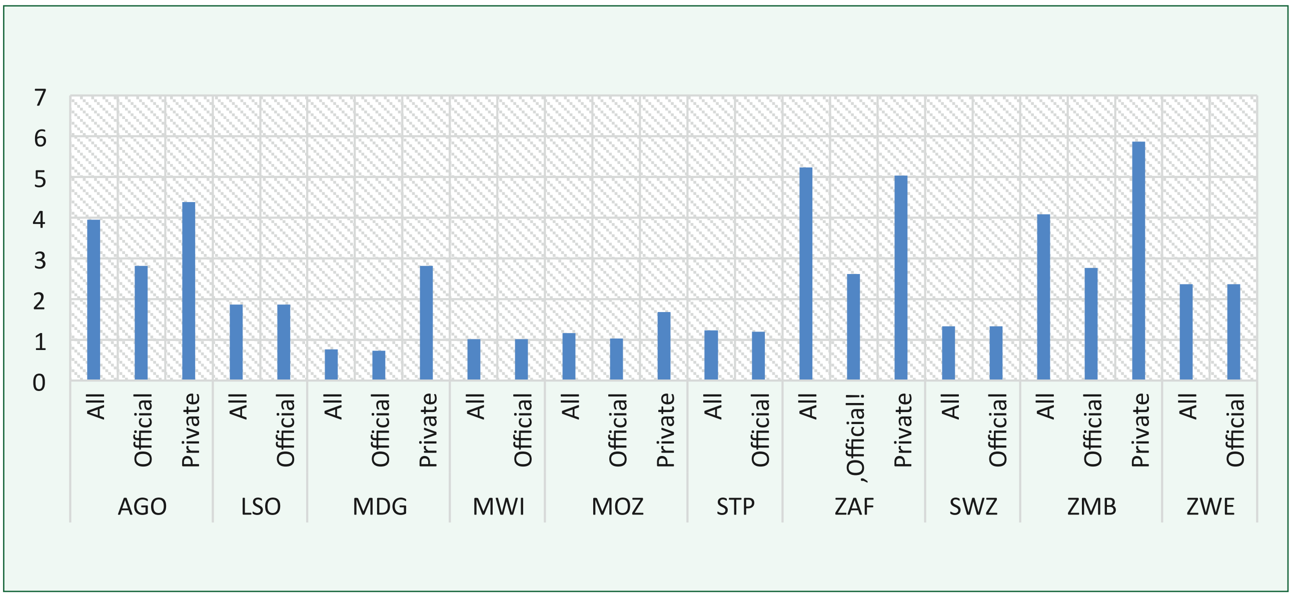


Source: World Bank 2021b.

Note: AGO is Angola, LSO is Lesotho, MDG is Madagascar, MWI is Malawi, MOZ is Mozambique, STP is São Tomé & Príncipe, ZAF is South Africa, SWZ is eSwatini], ZMB is Zambia, and ZWE is Zimbabwe. Data are not available for Botswana, Mauritius, and Namibia.

Another debt characteristic closely related to maturity is the average interest rate charged on external debt. Interest rates charged by private creditors are generally higher than those charged by official creditors (figure 2.11). Average interest rates are less than 6 percent a year. So, if that is the case even with domestic debt, then to improve debt sustainability the annual growth rate should exceed 6 percent in countries like Angola, South Africa, and Zambia.

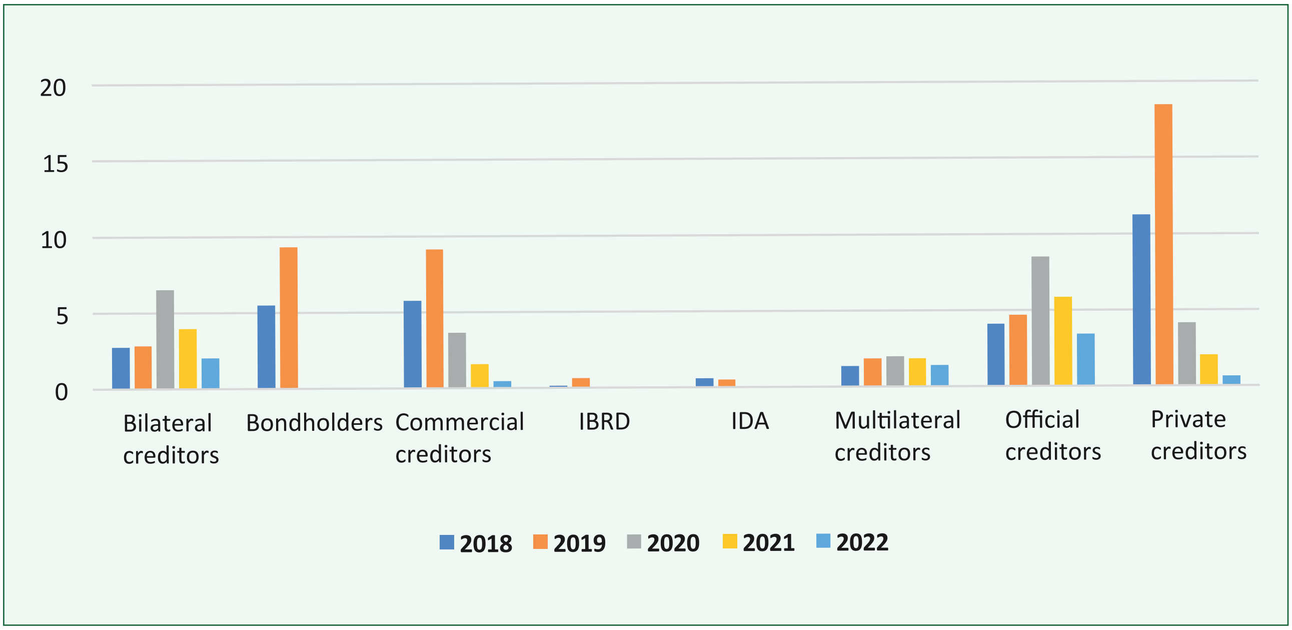
Figure 2.11: Average interest rates on external debt in Southern Africa by country, 2010-19 (Percent)



Source: World Bank 2021b.
Note: AGO is Angola, LSO is Lesotho, MDG is Madagascar, MWI is Malawi, MOZ is Mozambique, STP is São Tomé & Príncipe, ZAF is South Africa, SWZ is eSwatini, ZMB is Zambia, and ZWE is Zimbabwe. Data are not available for Botswana, Mauritius, and Namibia.

Official and bilateral creditors accounted for a large share of the external debt obtained in the region in 2020, followed by private creditors and commercial banks (figure 2.12). Though no data are available on the use of Eurobonds in the region from 2020 onward, Angola, Mozambique, South Africa, Zambia, and Zimbabwe used them to raise funds in 2019. Between 2010 and 2019 Angola, Lesotho, São Tomé & Príncipe, eSwatini, and Zambia increased their reliance on bilateral creditors, while Botswana, Madagascar, and Zimbabwe reduced theirs (see annex). Angola, South Africa, and Zambia are increasingly using bondholders for debt finance, and South Africa and Zambia have significantly increased their use of commercial banks. Between 2010 and 2019 debt from the World Bank Group—the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA)—fell in most countries in the region except Malawi, while use of multilateral creditors grew significantly only in Botswana and Malawi. The expected fall in the use of debt from these lenders in 2022 could be due to expected recoveries in the region's economies and increased vaccinations to minimize COVID-19's economic disruptions.

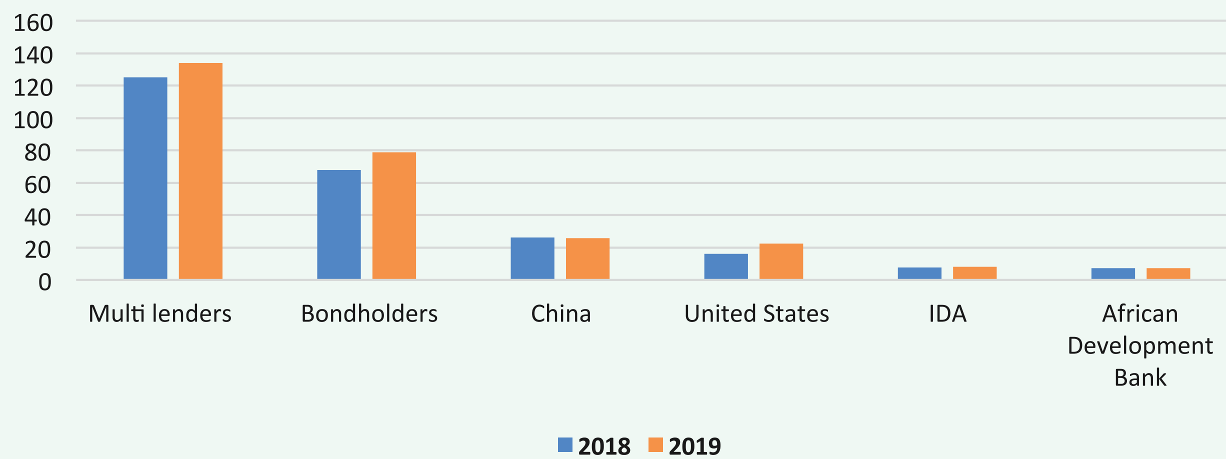
Figure 2.12: Sources of external debt for Southern Africa, 2018-22 (Billions of U.S. dollars)



Source: World Bank 2021b.
Note: Data for 2021–22 are projections.

In 2019 the largest sources of credit to the region were multiple lenders ($134 billion), bondholders ($79 billion), and bilateral creditors like China ($26 billion) and the United States ($23 billion; figure 2.13). The largest recipients of Chinese loans in the region were Angola ($15 billion), Zambia ($3 billion), and South Africa ($2.3 billion). The United States only provided credit to five countries, with the most going to South Africa. Most Chinese loans are collateralized, which could make it difficult for countries to negotiate and restructure their debts because of debt seniority problems associated with such loans.

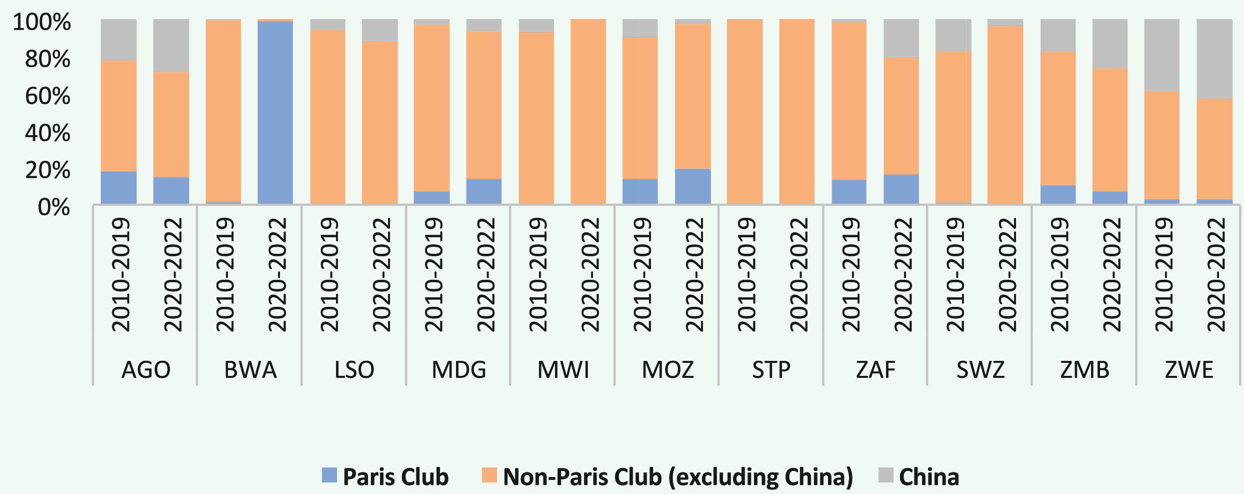
Figure 2.13: Top creditors to Southern Africa, 2019 (Billions of U.S. dollars)



Source: World Bank 2021b.

The profile of external creditors varies for most countries in the region. Both before and after COVID-19, most countries continued to use non–Paris club debt, with only Botswana borrowing a lot from the 22-member Paris Club of official creditors after COVID-19 (figure 2.14). In some countries part of the non–Paris Club debt is from China. Data for 2020–22 indicate that Angola, South Africa, Zambia, and Zimbabwe are increasing their borrowing from China. For lack of transparency, the magnitudes of non–Paris Club borrowing are unclear. Hgher borrowing from non–Paris Club and commercial creditors may mean shorter maturities relative to typical long-term multilateral concessional loans, raising refinancing risks (AfDB 2021).

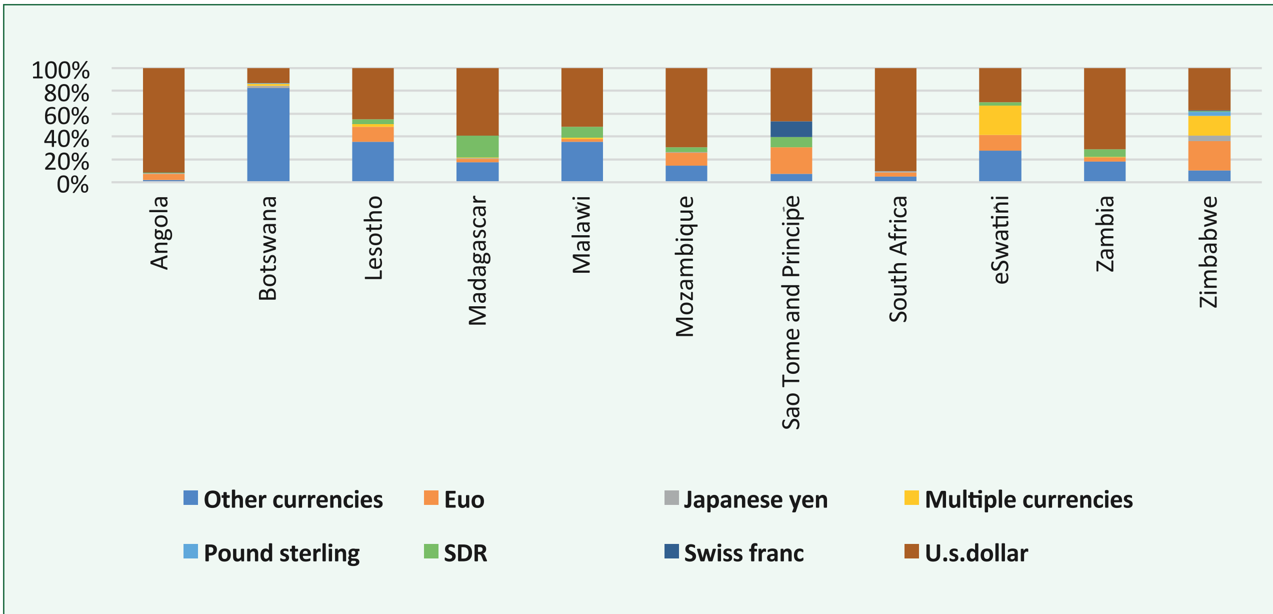
Figure 2.14: Debt from the Paris Club, non-Paris Club, and China in Southern Africa by country, 2010-19 and 2020-22



Source: World Bank 2021b.
Note: AGO is Angola, BWA is Botswana, LSO is Lesotho, MDG is Madagascar, MWI is Malawi, MOZ is Mozambique, STP is São Tomé & Príncipe, ZAF is South Africa, SWZ is eSwatini, ZMB is Zambia, and ZWE is Zimbabwe.

The use of debt from different creditors means that the borrowed funds are denominated in different currencies, though a large portion is in U.S. dollars. In 2010–19 in Angola and South Africa, more than 90 percent of external debt was denominated in U.S. dollars (figure 2.15). More than a quarter of external debt transactions in São Tomé & Príncipe and Zimbabwe was in euros, while Botswana had a lot of debt in unspecified other currencies. Multiple currency debt has also been widely used in eSwatini and Zimbabwe, while Madagascar had made more use of IMF Special Drawing Rights (SDRs). In Angola, Botswana, Madagascar, and Zimbabwe external debt is denominated in at least seven currencies.

Figure 2.15: Currency composition of external debt in Southern Africa by country 2010-19 (Percent)



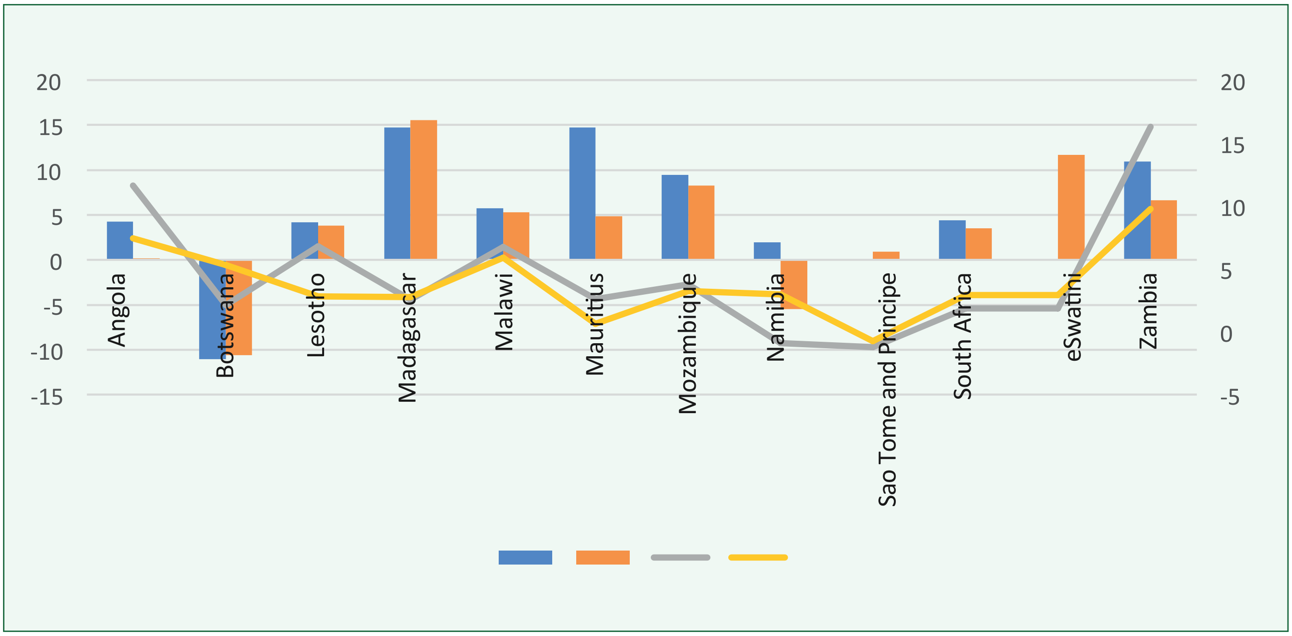
Source: World Bank 2021b.

Given that the composition of external debt by creditor type also varied in 2020–22 (see figure 2.12), borrowing in different currencies exposes countries to exchange rate risks. Between 2010 and 2019 the Botswana pula, Mauritian rupee, and South African rand all depreciated against the U.S. dollar (AfDB 2021), suggesting that these countries' external debts have been increasing in local currency terms. During 2019–20 the euro and pound depreciated by 9 percent and 3 percent against the U.S. dollar while the Japanese yen appreciated by 5 percent and the Swiss franc by 9 percent—suggesting that the local currency cost of debt denominated in euros and pounds probably fell while that of debt denominated in yen and francs rose.

In 2019–20 and 2020–21 the exchange rates of most countries in the region depreciated against the U.S. dollar (except in São Tomé & Príncipe, where the local currency is pegged to the euro; figure 2.16). In Zimbabwe there was no change in the value of the currency in the two periods, suggesting that the local currency value of external debt remained the same. In Zambia local currency depreciations were above 10 percent, which has negative effects on the country's ability to service its external debt, especially if foreign currency reserves are scarce. Thus exchange rate depreciation was the main contributor to changes in the region's public debt—particularly in Angola, Lesotho, and Malawi, where external debt accounts for a large portion of total debt (AfDB 2021).

In 2019 import cover was less than the recommended three months in Malawi, eSwatini, Zambia, and Zimbabwe (World Bank 2021c). Only in Angola, Botswana, and Mauritius did import cover exceed the SADC macroeconomic convergence target of six months. Low reserves due to projected current account deficits may continue to aggravate currency depreciations and inflate the local currency value of foreign debt. Such countries must find ways to improve foreign currency inflows.

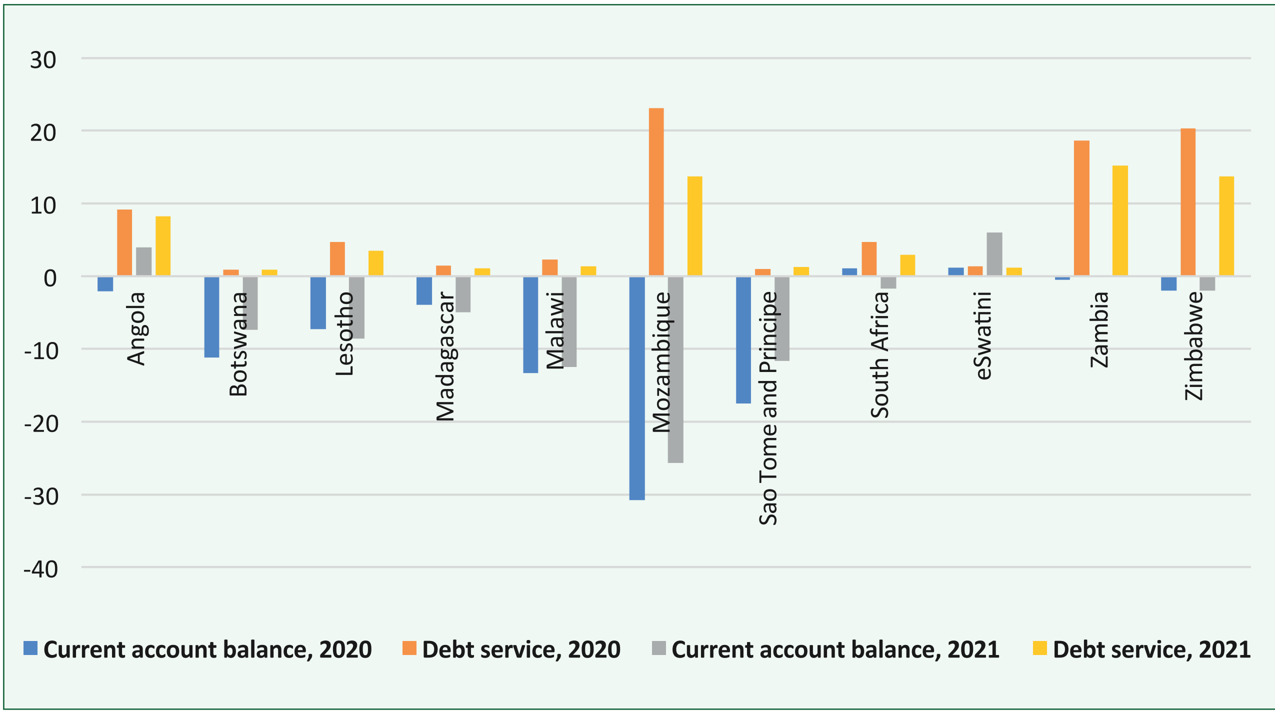
Figure 2.16: External debt and Exchange rate changes in Southern Africa by country, 2019-20 and 2020-21 (Percent)



Source: African Development Bank statistics.
Note: Exchange rate changes are shown on the right vertical axis.

Poor trade performance is another factor compounding the depreciation of exchange rates and levels of import cover, thus worsening foreign debt obligations in the region. In 2020 South Africa and eSwatini were the only countries in Southern Africa that ran positive current account balances, while Malawi, São Tomé & Príncipe, and Mozambique were the only countries with current account deficits above the SADC convergence target of –9 percent of GDP (at –13 percent, –17 percent, and –31 percent respectively; figure 2.17). Mozambique may face serious debt service challenges as a result. In 2019 the country's arrears on long-term debt were well above $700 million, the third highest after Zimbabwe and Zambia (World Bank 2021b). Balance of payments support from the IMF Rapid Credit Facility and Rapid Financing Facility must have helped some of these countries even though such relief is short term. Improving export competitiveness is crucial, and hopefully the recently launched African Continental Free Trade Area (AfCFTA) will help boost export diversification and growth as well as improve current account positions. Deteriorating current account balances and high debt service levels in the region are concerning because they are predictive of debt defaults. In 2021 debt service levels will be lower than in 2020 in most of the region's countries, possibly due to estimated increases in GDP.

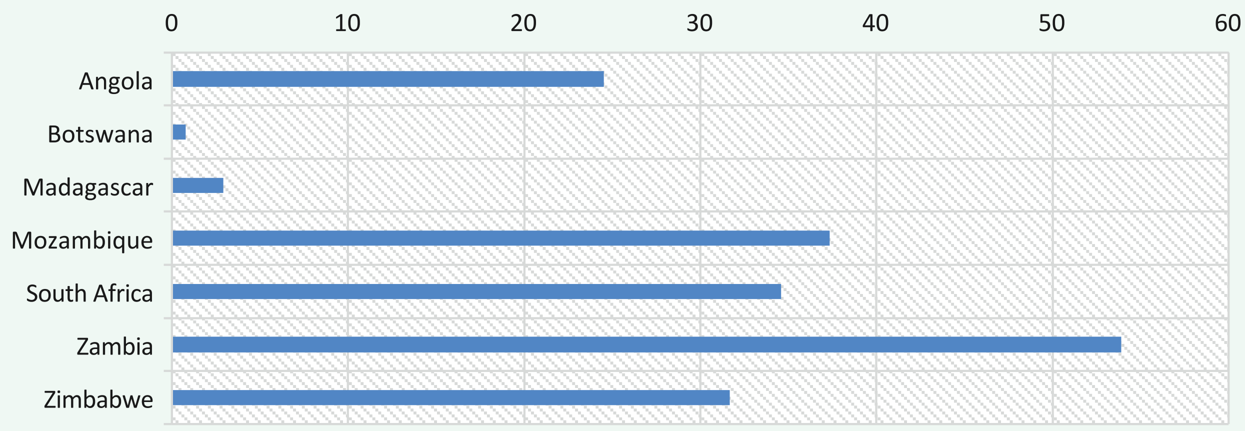
Figure 2.17: Current Account balances and Debt Service in Southern Africa by country, 2020-21 (Percentage of GDP)



Source: African Development Bank statistics; World Bank 2021b.
Note: Data are not available for Mauritius and Namibia.

Current account deficits not only affect governments' ability to service debts but also have implications for the private sector, which also borrows from the debt market. In 2019 private nonguaranteed external debt totaled $104 million in the region (World Bank 2021b). Such debt accounted for 54 percent of Zambia's total external debt, 37 percent of Mozambique's, and 35 percent of South Africa's (figure 2.18). All this private debt was owed to commercial banks and private creditors (except in South Africa, were part of it was owed to bondholders). Servicing this debt forces private debtors to compete with governments for scarce foreign currency, putting pressure on foreign exchange markets. Although private debt is beneficial and essential in any economy, runaway private debt can result in economic crisis—as was the case with the 2008–09 global financial crisis. High private sector debt also means that a large portion of companies' earnings are spent on debt interest and principal, diverting resources from investment and thus creating a drag on economic growth. In the future, that may compromise the private sector's ability to honor its debt obligations.

Figure 2.18: Private sector debt in seven Southern African countries, 2019
(Percentage of total external debt(



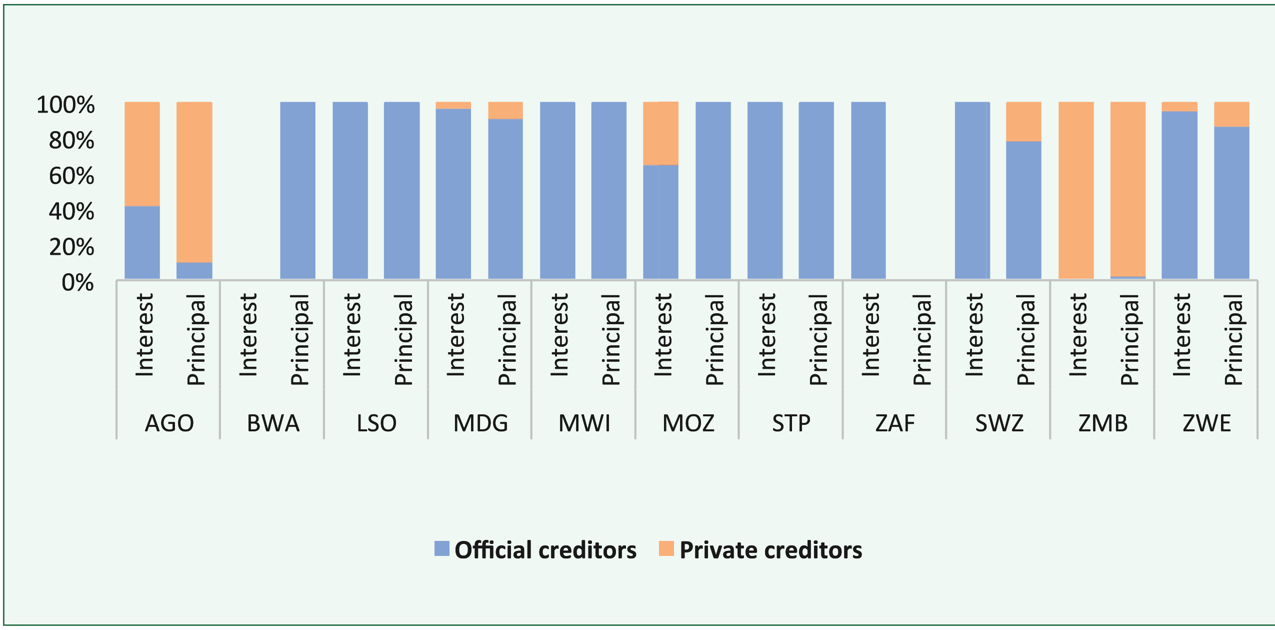
Source: World Bank 2021b.

In 2019 the 11 Southern African countries with available data owed interest and principal installments on their external debt (figure 2.19). Most of the arrears in Angola and Zambia were owed to private creditors, while in Botswana,[9] Lesotho, Malawi, and São Tomé & Príncipe all accumulated arrears were owed to official creditors. These differences in defaulting structures create complications during debt restructuring because of the pecking order of sovereign debt repayments. Debts to multilateral government lenders such as the IMF and World Bank are senior to debts to all other government creditors, which are in turn are senior to bonds and bank loans owed to private creditors (Schlegl, Trebesch, and Wright 2019).

This seniority structure is in place because a default on an IMF or World Bank loan is considered most consequential, because governments will be cut off from crisis lending when it is most needed, and countries risk losing their voting rights in these institutions (Reinhart and Trebesch 2016). Defaulting on bondholders is highly visible in the international press and will result in downgrades by the major credit rating agencies as well as potential legal disputes with specialized hedge funds. But a sovereign default on commercial bank loans or bilateral official loans may be less consequential as these defaults often occur "silently," without much media coverage, and may trigger less collateral damage. Most governments know that the consequences of default depend on who the defaulted creditors are and what bargaining power each creditor group has, so they prioritize repayments accordingly (Schlegl, Trebesch, and Wright 2019). This partly explains the move by some African countries from multilateral and Paris Club debt to bilateral non–Paris club debt, mostly from China (see figure 2.14).

[9] In 2019 Botswana's principal arrears were extremely small ($1,382), as were South Africa's ($4,149)—making them the only countries in the region with less than $300,000 in arrears.

Figure 2.19: External debt arrears by type in Southern Africa, 2019 (Percent)

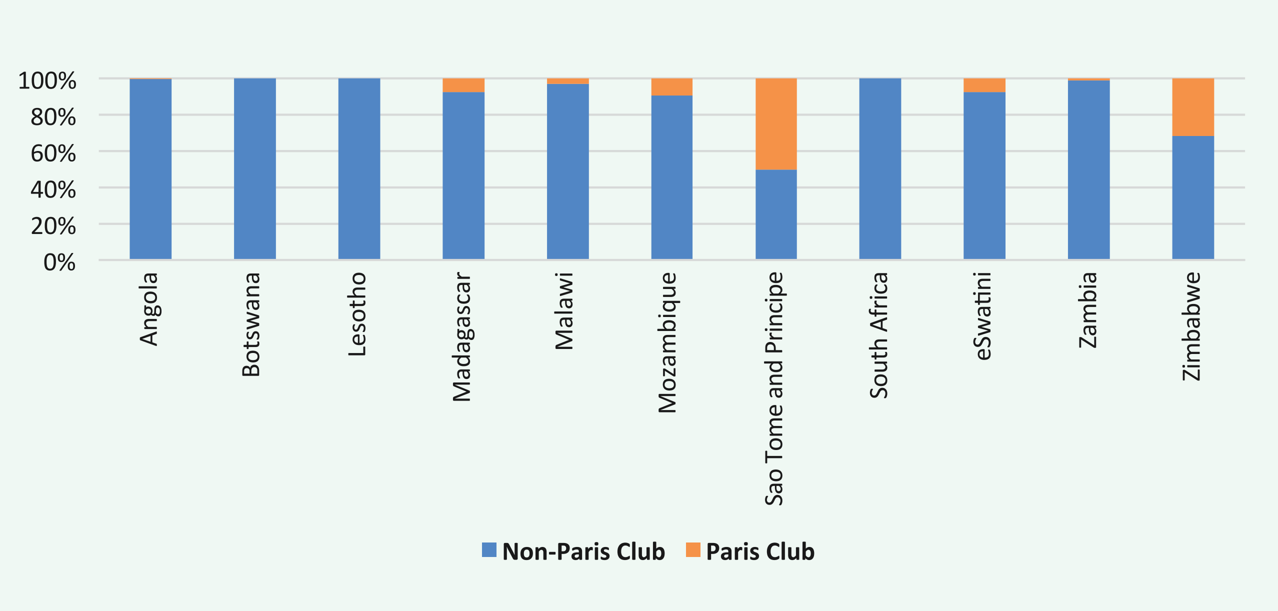


Source: World Bank 2021b.
Note: AGO is Angola, BWA is Botswana, LSO is Lesotho, MDG is Madagascar, MWI is Malawi, MOZ is Mozambique, STP is São Tomé & Príncipe, ZAF is South Africa, SWZ is eSwatini, ZMB is Zambia, and ZWE is Zimbabwe. Data are not available for Mauritius and Namibia.

In 2019 a large share of accumulated arrears were on debts obtained from non–Paris Club members (figure 2.20). São Tomé & Príncipe and Zimbabwe had the largest shares of Paris Club debt arrears. In São Tomé & Príncipe a large portion of these arrears (about $25 million) were on Italian debts and the rest was owed to Brazil. In Zambia all the debt arrears (nearly $50 million) were owed to the United Kingdom. In 2019 the accumulated principal and interest arrears owed by Zimbabwe to Paris Club members totaled $1.3 billion. The country's debt arrears exceed $100 million to five countries (France, Italy, Japan, the United Kingdom, and the United States; World Bank 2021b).

Mozambique, Zambia, and Zimbabwe have not been servicing their debts to non–Paris Club members. In 2019 the accumulated interest and principal arrears owed by Zambia totaled $4.3 billion, by Zimbabwe $2.7 billion, and by Mozambique $637 million (World Bank 2021b). Mozambique also had debt arrears owed largely to bondholders ($120 million), Libya ($242 million), and other bilateral creditors ($227 million), while Zambia had $4.2 billion in arrears owed to other multiple lenders. Most of Zimbabwe's arrears are owed to the African Development Bank ($730 million), China ($406 million), multilateral creditors ($269 million), the IBRD ($1 billion), and the IDA ($327 million). Thus debt restructuring in Zimbabwe will have to involve and appease more players than in Mozambique and Zambia.

Figure 2.20: Distribution of Paris and non-Paris Club debt arrears in Southern Africa by country, 2019 (Percent)



Source: World Bank 2021b
Note: Data are not available for Mauritius and Namibia.

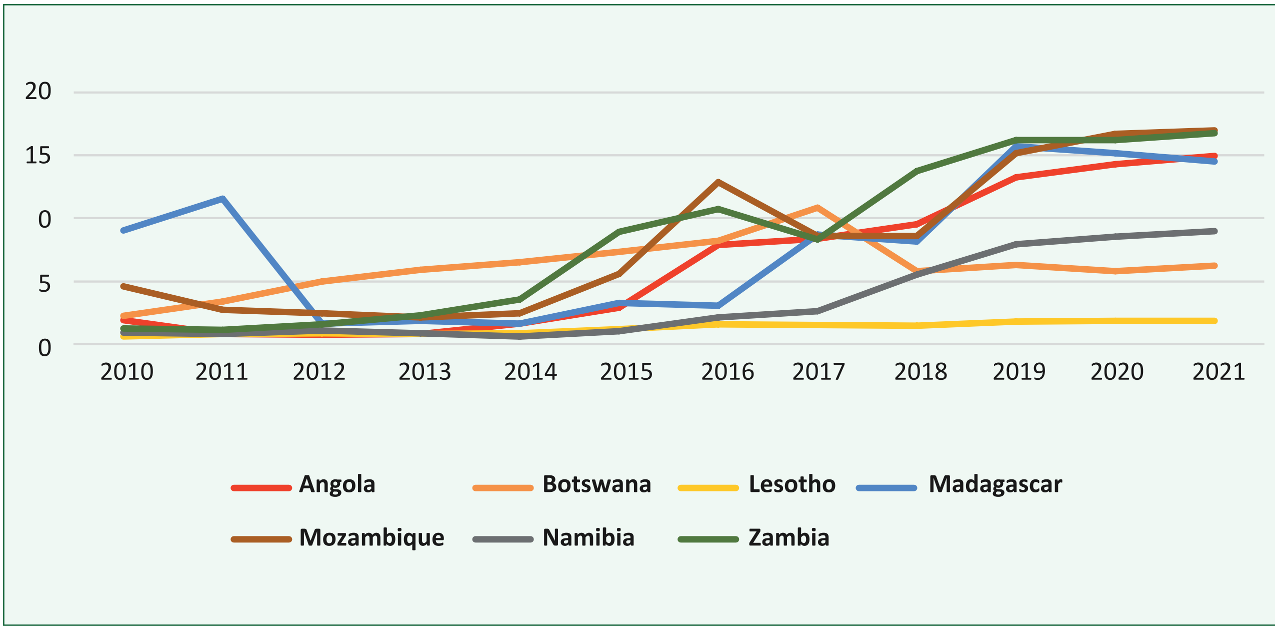
In 2019 the net change in interest arears, which measures the variation in the amount of interest in arrears between two consecutive years, was positive for Madagascar, South Africa, eSwatini, Zambia, and Zimbabwe—suggesting that they accumulated more interest arrears that year (World Bank 2021b). Other countries in the region are trying to reduce their interest arrears because the net change was negative.

2.3 EMERGING VULNERABILITIES AND THE OUTLOOK FOR DEBT

Rising debt and continuous defaults by some of the region's countries on their interest and principal payments, coupled with poor foreign exchange inflows due to persistent current account deficits, are signals of debt vulnerability. Angola, Mozambique, and Zambia have ratios of debt to GDP that exceed 100 percent—far above the recommended 60 percent ceiling. Budget deficits are higher than 5 percent of GDP except in Angola and Zimbabwe, which is also concerning.

Another indicator used to gauge governments' ability to sustainably manage their debts is the percentage of revenue accounted for by interest payments. For several years, interest as a percentage of revenue has been rising in Angola, Madagascar, Mozambique, and Zambia (figure 2.22). In all four countries this share is estimated to exceed 14 percent in 2021. It is lowest in Lesotho, where it has hovered below 2 percent.

Figure 2.22: Interest expenses relative to revenue in seven Southern African countries, 2010-21 (Percent)

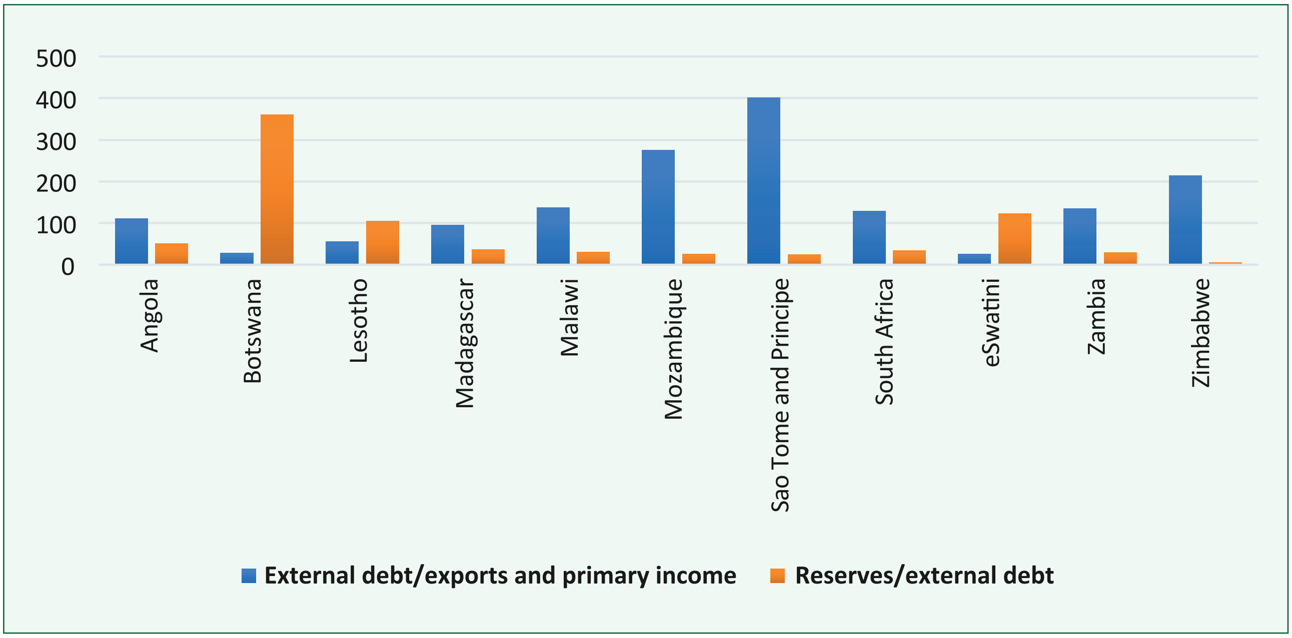


Source: African Development Bank statistics.

There has been no significant change in the share of interest expenses paid before and after the onset of COVID-19. Increasing interest expenses on public debt may expose countries to higher refinancing and rollover risks, undermining their ability to service maturing debt obligations.

External debt as a percentage of export revenue and primary income is another debt sustainability indicator. This ratio has been rising in Angola and reached nearly 200 percent in 2016; for 2010–19 it averaged 110 percent (figure 2.23). In São Tomé & Príncipe this share averaged 401 percent over that period, in Mozambique it was 276 percent, and in Zimbabwe it was 214 percent. Given COVID-19's effects on borrowing levels and export revenues, these figures are likely to have worsened from 2020 onward. Though this ratio does not raise immediate alarm because not all debt is paid from export revenues, it signals impending risk for countries using mostly short-term debt and having large amounts of private debt as a share of total debt. Reserves as a percentage of external debt are above 100 percent in Botswana, Lesotho, and eSwatini but very low in the rest of Southern Africa (see figure 2.23). A high ratio suggests that a country has the capacity to liquidate its external debt without difficulties and is thus a promising sign of debt sustainability.

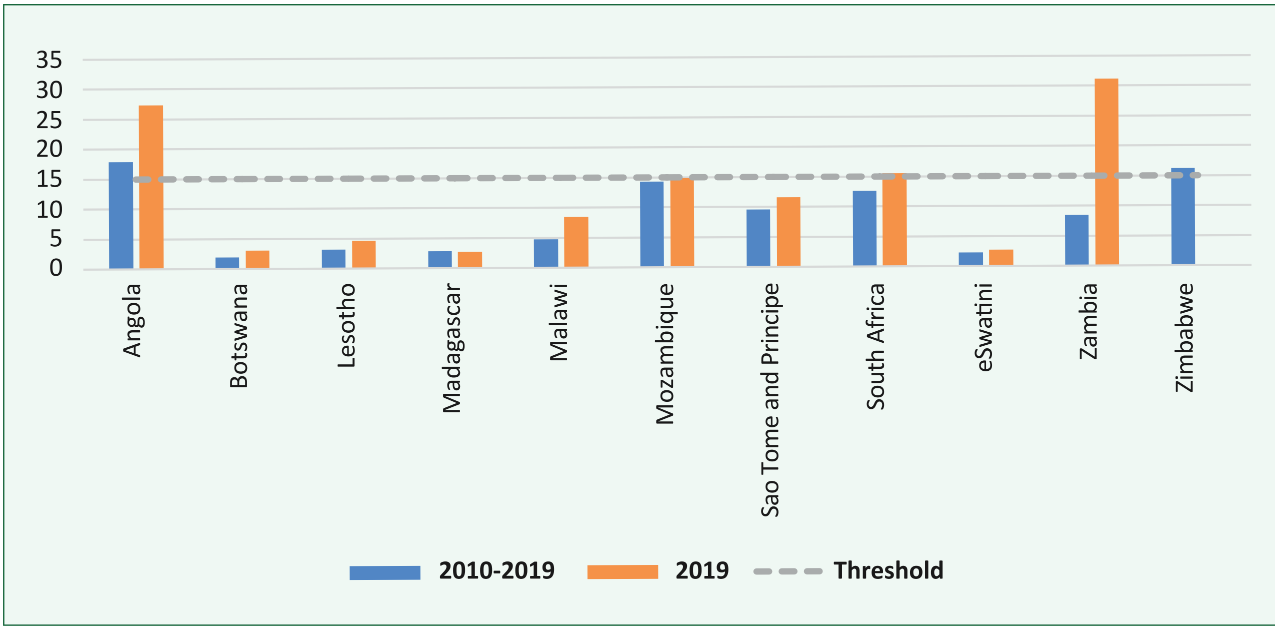
Figure 2.23: Debt sustainability indicators for Southern Africa by country, 2010-19 (Percent)



Source: World Bank 2021b.

The ratio of debt service to exports is another common debt sustainability indicator. The IMF recommends that this ratio be around 15 percent, while that of debt service to revenue should not exceed 18 percent. But in 2019 Angola, South Africa, and Zambia exceeded the first threshold (figure 2.24). Moreover, most countries in the region are not servicing their debts and are running arrears, so this ratio may be underestimated.

Figure 2.24: Debt service relative to exports in Southern Africa by country, 2010-19 and 2019 (Percent)



Source: World Bank 2021b.

The Southern African countries in debt distress are Mozambique, São Tomé & Príncipe, and Zimbabwe (IMF 2021a). The risk of debt distress is moderate in Lesotho, Madagascar, and Malawi and high in Zambia (table 2.2). Because it is harder for countries to move from lower to stronger credit ratings, creditworthy countries must do all they can to maintain their ratings. In 2018 Madagascar, Malawi, Mozambique, São Tomé & Príncipe, and Zambia were classified as Heavily Indebted Poor Countries (HIPCs) and thus qualified for irrevocable debt relief under the HIPC initiative (UN 2020). Being in debt distress can undermine political and popular support for policy reforms in debtor countries if the benefits from reforms are perceived to be directed to paying off debt rather than delivering needed public services to poor people (Kraay and Nehru 2004). Pressure to meet external debt service payments may also tempt debtor country governments to seek short-term solutions at the expense of fundamental, longer-term reforms.

Table 2.2: Credit ratings of some Southern African countries, 2021				
Country	Standard and Poor's	Moody's	Fitch	Debt distress level
Angola	CCC+	Caa1	CCC	
Botswana	BBB+	A3		
Lesotho			B	Moderate
Madagascar	B-			
Malawi			B-	Moderate
Mauritius		Baa2		
Mozambique	CCC+	Caa2	CCC	In debt distress
Namibia		Ba3	BB	
South Africa	BB-	Ba2	BB-	
Zambia	SD	Ca	RD	In debt distress

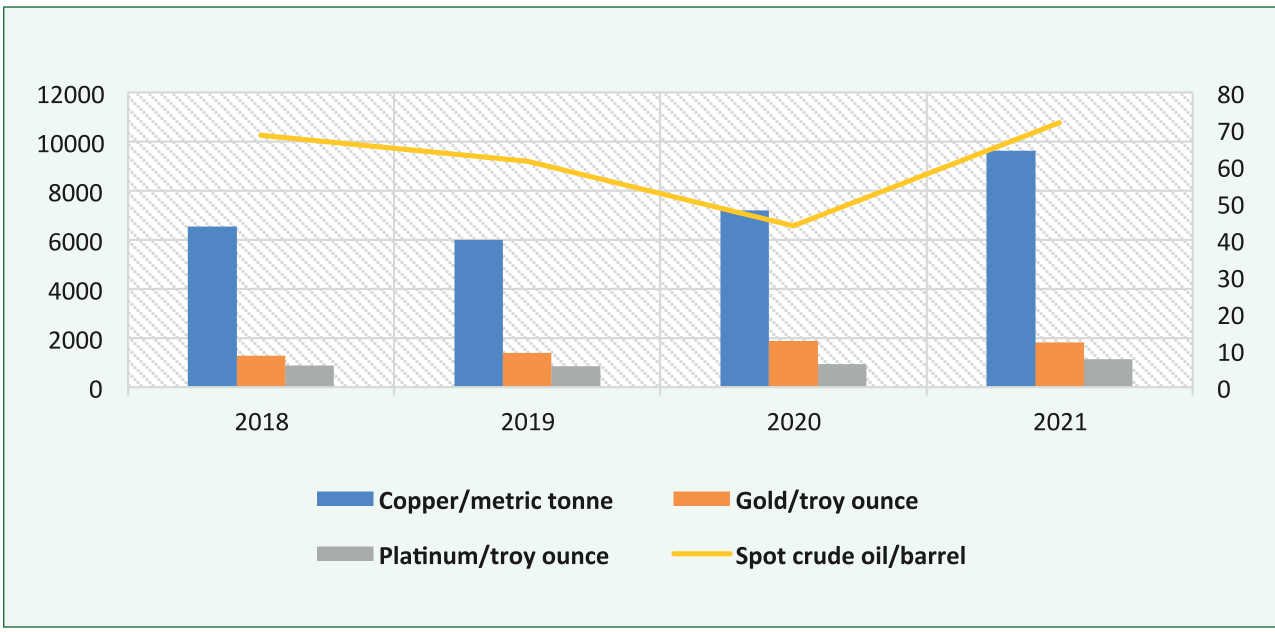
Source: Trading Economics 2021; IMF 2021a.

Some Southern African countries in debt distress had their debt forgiven in 2010–19, including Mozambique ($696 million), Madagascar ($111 million), and Zimbabwe ($68 million; World Bank 2021b). Debt distress makes it more costly for countries to borrow because of high default risk. Zimbabwe and possibly Zambia have accumulated massive debts and huge arrears, funding from official and private sources is drying up, and domestic resources are inadequate to meet the countries' financing needs—pushed both countries into serious debt overhang. Zimbabwe also has a large contingent liability to farmers who had their assets expropriated under the land reform program. Measures such as government guarantees to firms, equity injections, and loans that some countries in the region have used in response to COVID-19 will also expose governments to contingent liabilities in the medium to long term. In 2019 private debt guaranteed by public debt totaled $602 million for South Africa and $9 million for São Tomé & Príncipe, exposing them to contingent liabilities in the event of bankruptcies of the private partners (World Bank 2021b).

The option of using collateralized debts by some countries in the region increases the risk of mortgaging strategic state assets (unless commodities are used) and compromises economic sovereignty. Some countries in Africa grant China resource concessions, allow it to take an ownership stake in infrastructure projects, or secure loans using their natural resources as collateral (ISS 2019). Angola, Madagascar, Mozambique, and Zambia are among them. But this approach does not address the root causes of external imbalances and creates an uneven hierarchy of creditors that could complicate negotiations on debt resolution. Collateralized borrowing affects the seniority of official cred¬itors and multilateral creditors because debts backed by collateral are treated better than other debts. The seniority position of sovereign debt defines the bargain¬ing power of lenders during debt resolution negotiations and makes the negotiations more complicated (AfDB 2021). Collateralized loans can also reduce incentives for borrowers to use and manage their debt wisely, leading to overborrowing (Bolton 2003).

One promising development is that commodity prices have been picking up and oil prices have surpassed pre-COVID levels. Platinum, copper, and gold prices appear to be on an upward trend (figure 2.25). Between the start of 2020 and June 2021 the commodities index for crude oil rose 69 percent, followed by copper at 56 percent, platinum at 27 percent, and gold at 4 percent. These changes may improve the export revenues and reserves of countries endowed with these resources, such as Angola, South Africa, Zambia, and Zimbabwe.

Figure 2.25: Prices of various commodities, 2018-21 (U.S.dollars)



Source: IMF data.
Note: The price of crude oil is shown on the right vertical axis and 2021 prices are for June.

2.4 MEDIUM-TERM DEBT OUTLOOK

During 2021–22 government revenue and spending as a percentage of GDP are expected to fall in many Southern African countries, which may reduce fiscal deficits and borrowing needs (IMF 2021c). But in Malawi, Mauritius, Mozambique, São Tomé & Príncipe, South Africa, and Zimbabwe revenue is expected to increase while spending falls, which is encouraging—particularly for Mozambique and Zimbabwe, with their high debt levels. This trend also explains why fiscal deficits are expected to fall in all the countries in the region, with the largest drop being in Mauritius (AfDB 2021). Still, the outlook for debt is not yet promising because in most countries in the region, government gross debt as a percentage of GDP is expected to increase. Though most of the increases are projected to be mild, they are relatively high in Zambia (where debt as a percentage of GDP will increase by 11 percentage points between 2021 and 2022) followed by Botswana and eSwatini (5 percentage points). The largest drop is expected in Angola (where debt is projected to fall 11 percentage points), followed by São Tomé & Príncipe (5 percentage points).

Though external debt is expected to fall in 2021 for the region as a whole, that is not the case for Madagascar, eSwatini, and Zambia. It also appears that in 2021–22 the 11 countries in the region with data on external debt are projected to reduce their use of debt from various sources, including bilateral and multilateral creditors and Paris and non–Paris Club lenders (World Bank 2021b). Given that exchange rates will likely continue to depreciate in many countries, higher external debt in Madagascar, eSwatini, and Zambia will continue to raise the debt burden. The expected depreciation of exchange rates is due to projected changes in current account balances, which will likely deteriorate in 7 of the region's 13 countries. This deterioration might put more pressure on exchange rates and neutralize the benefits of the expected drops in external debt in some countries. But the expected increase in spot crude oil, platinum, and copper prices in 2021 may improve export revenues in countries well-endowed with these resources.

In terms of debt sustainability, the interest growth differential is expected to improve in all the countries of the region and even move into the ideal negative territory in Lesotho, Mauritius, South Africa, and Mozambique. However, interest expenses as a percentage of revenue will increase in all countries except Madagascar and São Tomé & Príncipe, which hopefully will result in lower arrears on interest. Debt restructuring is crucial for countries overburdened with debt to minimize the possibility of countries being forced to cut spending on essential services like education, health, and social security.

CHAPTER 3

POLICY PRIORITIES TO RECOVER FROM COVID-19

In Southern Africa the length of recovery from COVID-19 will vary by country and will mainly depend on the magnitude of devastation left behind. Policy responses of different duration should be pursued to tackle the macroeconomic and debt challenges created by the pandemic.

3.1 SHORT-TERM POLICIES

- Targeted support may be needed for sectors—such as tourism—hit hardest by the pandemic. The COVID-19 recovery plans introduced by countries in the region could be tweaked to pay specific attention to the unevenness of the recovery, with support increasingly directed to sectors for which conditions remain most challenging. For instance, support for tourism could include wage support for firms that retain workers. Other possible policies to preserve capital and investments in tourism include concessional loans, extended debt restructuring, and extended tax deferments, with means testing where needed to minimize wasteful spending. In addition, policies that use tax codes to foster domestic tourism (as have been used in Malaysia) should reduce capital destruction in the sector and support speedier recovery. These policies could also be used in other sectors.
- Agriculture plays a key role in the region's economies, especially in Madagascar, Malawi, Mozambique, São Tomé & Príncipe, Zambia, and Zimbabwe. Given the impacts of cyclones and droughts, further investments to stabilize production and enhance value chains will be vital to recovery efforts across the region.
- The quality and efficiency of government spending should be enhanced to increase value for money. Not all government projects are national priorities. To enhance transparency, governments in Southern Africa should be open to conducting spending reviews of existing programs, either on their own or with the assistance of international organizations. Indeed, more efficient spending is a way of mobilizing domestic revenue because it releases resources for use elsewhere without compromising on project delivery.
- Countries need to perform due diligence when entering into loan agreements. Project feasibility should be thoroughly assessed, and the best possible loan terms negotiated.
- Governments must ensure that funds are used efficiently and for the projects for which they were intended. More effective public financial management systems should be introduced, and misappropriation of funds and wasteful spending should not be tolerated.
- Fast-tracking COVID-19 vaccination programs may help countries ease tourism restrictions and boost visitors, increasing tourism revenues. This is important for countries where in 2019 tourism accounted for more than 10 percent of export revenue: Mauritius (39 percent), Madagascar (23 percent), Namibia (10 percent), and Zambia (10 percent). According to the Bloomberg COVID-19 Vaccination Tracker, as of June 2021 Mauritius had the region's highest vaccination levels, having administered doses to about 16 percent of the population, followed by São Tomé & Príncipe (4 percent) and Botswana and

Zimbabwe (3 percent). Unless vaccination levels are ramped up and herd immunity achieved, the revival of tourism will continue to limp.

- Encouraging foreign direct investment is also key to improving growth and foreign currency reserves. In 2019 most countries in the region (except Angola, South Africa, and Zambia) recorded positive foreign direct investment and portfolio investment net inflows. If this trend continues, it will help boost foreign currency reserves and even GDP (World Bank 2021b).

3.2 MEDIUM-TERM POLICIES

- Policies should try to remove bottlenecks on trade among Southern African countries. This cross-border trade usually involves small companies and small shipments, and is sensitive to trade frictions (World Bank 2015). Policies such as one-stop border posts and increased customs harmonization should help engender cross-border and thus intra-African trade.
- Deliberate policies are needed to enhance revenue mobilization.[10] This challenge predates COVID-19 but is more urgent than ever before. By increasing accountability, policies that foster transparency in government budget operations (such as tax receipts, spending, and tax concessions) tend to enhance domestic revenue mobilization. Governments should also make it a priority to address weaknesses in revenue administrations. Minimizing political interference in tax administrations and improving compliance with value-added tax (VAT) laws should raise tax revenues. Greater use of digital technologies should enhance the efficiency of tax collections by increasing compliance and cutting costs. Better training of tax officials—particularly in advanced areas such as audit and transfer pricing—should help reduce tax revenue losses. Finally, governments should consider introducing new forms of taxes where possible. For example, property taxes could help broaden the tax base.
- Innovative ways of mobilizing resources should be explored to boost revenue. Such efforts also involve tackling illicit financial flows. Improper invoicing led to high level of such flows for the mining sectors in Botswana, South Africa, Zambia, and Zimbabwe (Gumede and Fadiran 2019). At the start of 2021, Angola and Madagascar introduced VATs—a welcome development.
- In most Southern African countries, implementing the African Continental Free Trade Area (AfCFTA) agreement would boost trade growth and export revenues. The agreement is an engine for developing regional trade, so Southern African countries should start creating trade plans that tap into this potential. Effective exploitation of the agreement will reduce the region's vulnerability to global disruptions and boost regional competition and productivity—and thus promote growth.
- Restoring debt sustainability in some countries in the region will require coming up with comprehensive debt restructuring plans. Mutually beneficial refinancing arrangements should be negotiated with creditors. Given that some countries owe large amounts to Paris Club official creditors and non–Paris Club creditors and are not Heavily Indebted Poor Countries (HIPCs), they will have to satisfy Evian Approach conditions for debt restructuring. Eligibility or admittance to this debt rescheduling scheme requires that a country be in an IMF-monitored program and prove that it is unable to meet its external financial obligations. But lack of trans parency (especially on some non–Paris Club debt owed to China) and a race to seniority through collateralization may make debt restructuring difficult. Acceptance of Paris Club terms and IMF-monitored programs may boost international confidence, unlocking further financial assistance or bridging finance. As of December 2019, Angola, Mozambique, and Zimbabwe together owed more than $1 billion to Paris Club members (World Bank 2021b).
- Some debt-burdened countries in the region should consider debt swaps and conversions. For example, a

[10] Other possible interventions include policies aimed at increasing national saving rates such as tax exemptions on savings, generally lower income tax rates, and a stable macroeconomic environment.

traditional loan can be converted into an equity investment or an infrastructure investment. A foreign organization, such as Debt Advisory International, would acquire a country's debt at a discount and use the local currency equivalent to purchase domestic assets or invest in development projects. This approach extinguishes the external debt, and the debt swap can be permanent or for a specified period.

- For countries not in arrears, the use of debt buybacks could be explored to temporarily relieve debt servicing. Countries can sell their debt at a discount and repurchase when their finances have improved. This approach should be taken if a country's future economic performance appears bright.
- Authorities should investigate the benefits of digitalization. In São Tomé and Príncipe the introduction of electronic invoicing has allowed the authorities to expand the tax base into the country's informal sector, lifting revenues even during the COVID-19 crisis. Other Southern African countries should explore this route.
- Reforming governance systems to root out corruption and improve management of loss-making parastatals is also key to debt sustainability in the region. A World Bank study of governance indicators in the region found that all countries except Botswana, Mauritius, and (partly) Namibia had negative scores in 2019 (World Bank 2021d). Thus they scored poorly on control of corruption, rule of law, government effectiveness, regulatory quality, and voice and accountability. Making the African Union Africa Peer Review Mechanism more effective would improve governance in the region.

3.3 LONG-TERM POLICIES

- To reduce poverty, policies are needed to support economic recovery and growth. Southern African countries should use the opportunities presented by COVID-19 to reform their business and investment climates, cutting red tape and streamlining regulations—particularly for small and medium-size enterprises.[11] Most such policies do not necessarily entail fiscal costs.
- COVID-19 has also revived the need to establish well-functioning social protection programs. Within the region, Namibia and South Africa are the only countries with comprehensive grant programs that explicitly target the indigent.
- Industrial policies should foster the diversification of Southern Africa's economies and engender the regional economy's resilience to shocks. Such policies—including investment incentives, critical skills development, essential infrastructure, market access, and trade—can be deployed in the key sectors of the economy (agriculture, manufacturing, services) to enhance efficiency and productivity. COVID-19 has shown how lack of diversification exacerbates vulnerabilities. For example, countries that relied on tourism for growth were hit hard when international travel was suspended, while countries that depend on agriculture suffer greatly in the face of adverse weather events.
- Although fast debt accumulation in response to the pandemic is defensible, in most Southern African countries debt (domestic and external) is reaching unsustainable levels, which could reverse gains in macroeconomic stability. Rather than taking on new debt, governments should consider enhancing the quality of spending and, where revenues surprise on the upside, some fiscal consolidation to ensure continued sound macroeconomic policies.
- Domestic revenue mobilization is another avenue for boosting government revenue. Though each country's situation differs, the authorities should aggressively seek to minimize tax evasion and avoidance, eliminate distortionary corporate income tax exemptions and incentives, and explore the viability of introducing environmental taxes, among other efforts. Given the dependence of many Southern African countries on extractive industries, natural resource taxation may serve

[11] The opportunities brought about by COVID-19 include digitalization, contactless businesses and ecommerce, greater regional trade in light of the disruptions to global trade, and reduced pollution (which has brought climate discussions into sharper focus).

as another option for domestic revenue mobilization. The resources generated could be used to support the region's needed transition to a lower carbon economy.

- To deal with the recurrence of debt crises, it is time to reconsider whether state-contingent debt instruments that link debt service payments to a country's ability to pay can be used extensively as a tool to minimize the possibility of future unsustainable debt dynamics. Governments in the region should also consider developing fiscal rules and legislating debt-to-GDP thresholds to minimize moral hazard problems by those in power.

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ANNEX

Annex table 1: Types of creditors for external debt in Southern Africa by country, 2010 and 2019 (Percent)														
Country	Bilateral creditors		Bondholders		Commercial banks		IBRD and IDA		Multilateral creditors		Official creditors		Private creditors	
	2010	2019	2010	2019	2010	2019	2010	2019	2010	2019	2010	2019	2010	2019
Angola	19	32	-	15	33	12	1	3	2	5	21	37	41	31
Botswana	8	3	-	-	-	-	-	11	67	82	75	85	-	-
Lesotho	8	14	-	-	2	0.3	42	39	80	77	88	91	2	0.3
Madagascar	17	12	-	-	0	4	42	-	57	42	74	61	0	73
Malawi	14	17	-	-	1	-	24	40	57	65	71	83	1	-
Mozambique	20	24	-	4	2	3	25	15	36	22	56	46	2	7
São Tomé & Príncipe	60	67	-	-	-	4	8	4	21	18	80	85	-	4
South Africa	0	2	27	29	5	12	0	1	1	2	1	4	32	42
eSwatini	19	45	-	-	6	2	-	6	35	37	54	82	6	2
Zambia	6	13	-	11	-	8	10	4	22	8	28	21	0	20
Zimbabwe	26	22	0	0	5	2	15	7	24	10	50	32	9	4

Source: World Bank 2021b.