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Seeking Relief: China's Overseas Debt After COVID-19

Agatha Kratz
akratz@rhg.com

Matthew Mingey
mmingey@rhg.com

Drew D'Alelio (Summer Analyst)
drew.dalelio@yale.edu

In April 2019, Rhodium Group published a piece examining 40 cases in which China had renegotiated bilateral debts. Since then, the COVID-19 pandemic has plunged the global economy into recession. The downturn has reignited questions about the sustainability of China's overseas lending and how Beijing will respond to the many countries now struggling to manage their external debt obligations.

To better understand the outlook for renegotiations involving China, we have expanded our database to include over 130 cases from 2000 through September 2020. The updated dataset broadens our knowledge of past restructurings and offers insights into Beijing's current negotiating position and preferred outcomes. We find that:

Renegotiation requests are increasing: Even before the COVID-19 shock, China's borrowers were seeking restructurings as major repayment deadlines loomed in 2019-2020. COVID-19 has accelerated the trend. We find that at least 18 processes of debt renegotiation with China took place in 2020, and 12 countries are still in talks with Beijing as of end-September, covering USD 28 billion in Chinese loans.

For large loans, debt cancellation (write-offs) and asset seizures are unlikely: Our research shows that debt write-offs are almost always limited to small zero-interest loans, and we continue to find very limited evidence that China's policy banks have wiped away bilateral debt in exchange for control of strategic assets.

Instead, deferrals are most likely: Past and current cases suggest that deferrals remain Beijing's preferred solutions. Deferrals are aligned with the Debt Service Suspension Initiative (DSSI) framework, and will provide some breathing room for recipients. However, China's approach so far has been partial (focusing on principal repayment rescheduling, sometimes to the exclusion of interest payments), and talks are not standardized, open, or coordinated directly with other bilateral lenders.

As many as 1 in 4 dollars extended by China through overseas lending to date has come under renegotiation, amounting to USD 94 billion: Faced with the reality of unsustainable past lending, Beijing is recalibrating to limit and rationalize future flows, at least in the medium term. This will only be amplified by COVID-19.

Tel: +1.212.532.1157
Fax: +1.212.532.1162
Web: www.rhg.com

New York
5 Columbus Circle
New York, NY 10019

California
647 4th Street
Oakland, CA 94617

Hong Kong
135 Bonham Strand
Sheung Wan, HK

Paris
33 Avenue du Maine
75015 Paris

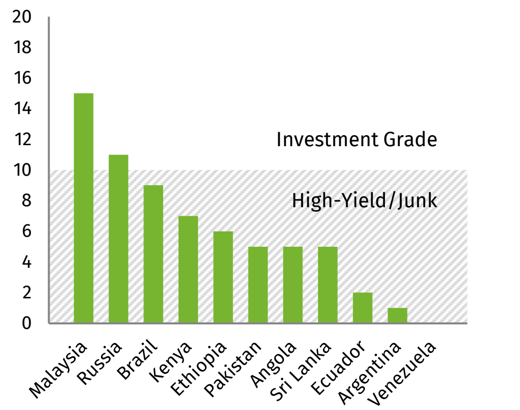
Renegotiation cases are increasing

In a note earlier this year, we explained that even before the COVID-19 shock, several of China's bilateral borrowers were likely to require external debt restructuring.[1] Since 2000, China's bilateral lending has become more commercial in nature, with more market-rate loans for large and complex infrastructure and energy projects. A substantial share of these loans has been extended to countries with weak macro fundamentals (Figure 1), or to unsustainable projects.[2] Many large loans are also coming due as grace periods (typically 5 to 7 years for Chinese loans) expire from 2019 to 2022. Data disclosed as part of (DSSI) talks revealed that as much as USD 53 billion in debt service is due to Chinese lenders from 2020 to 2024 from 68 developing countries (Figure 2).[3]

FIGURE 1

Sovereign Ratings of Top Recipients of Chinese Lending

Average Long-Term Sovereign Credit Rating (notches)

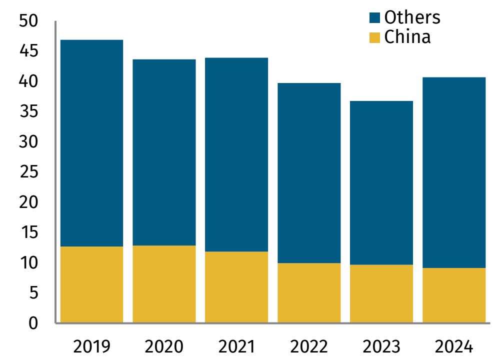


Source: Bloomberg, Rhodium Group calculations. Top recipients based on Horn, Reinhart, and Trebesch (2020) estimates of 2017 Chinese debt stocks. Ratings are long-term foreign currency sovereign default ratings. Where a sovereign is rated by multiple agencies, Individual ratings are translated to a unified numerical scale and averaged, where 20 = AAA (highest) and 0 Is unrated (or lowest possible score).

FIGURE 2

Debt Payments Due from DSSI Countries by Creditor

USD billion



Source: World Bank (IDS).

For heavy borrowers in emerging and frontier markets, Chinese loans have compounded stress that was building up before COVID-19. High international bond and private loan obligations are as pressing as Chinese loans and falling commodity prices have hurt revenues in large borrowers like Ecuador and Angola. Reflecting this mounting pressure, our dataset shows that at least 18 debt renegotiations took place in 2020 (Table 1), up from 10 for the whole of 2019.[4] As of October 2020,

[1] In this research note, we use the term "renegotiation" to refer to talks between China and borrower countries regarding changes to outstanding bilateral debt agreements. A renegotiation begins upon formal borrower request, as verified from government or media reports. "Renegotiations" can lead to a "write-off", to a loan "restructuring", or to "refinancing". In the case of a "write-off", an outstanding loan is forgiven, in whole or in part. In the case of a "restructuring", a loan's payment profile, terms or period is altered, including: extension of grace or maturity period; rescheduling of payments within existing maturity period; changes to interest rates; or other changes to lending terms. We also include under "restructuring" changes to commodity delivery contracts that used to service resource-backed loans.

[2] A timely example is Kenya's Standard-Gauge Railway, where actual freight traffic has come way short of projections, and the operator is registering large operating losses.

[3] The DSSI is a G-20-led initiative to suspend debt payments through the end of 2020 (at least)for up to 73 eligible developing countries. Creditor participants include the Paris Club (the member group of major bilateral creditors) and all other G20 creditors, including China. Under the DSSI, creditors are to suspend both principal and interest payments. DSSI relief is not automatic, and borrowers must both formally join the initiative and reach agreements with individual bilateral creditors, though the Paris Club is negotiating as a bloc.

[4] The 2019 figure besides includes 5 cases of small and relatively simple zero-interest loan write-offs (see later parts of the note for context), compared to none in 2020 so far. Xi Jinping pledged to write-off ZILs maturing in 2020, but specific agreements do not appear to have been finalized and this is separate from China's claims to have provided DSSI relief.

at least 12 renegotiations were still ongoing. This is a lower-bound estimate, as renegotiations are generally conducted in confidence and we do not have full visibility into talks with all countries. Chinese officials notably claim to have reached agreements with 10 DSSI-eligible countries but have not disclosed the full list.[5] More cases are likely to emerge in the coming months.

TABLE 1

Status of Recent Renegotiations

Renegotiations ongoing, requested or resolved in 2020

Country	Negotiation initiated***	Status	Estimated Amount under Renegotiation (USD mln)
Ukraine	2014	Ongoing	3,000
Zambia	2017	Ongoing	4,400
Djibouti	2019	Ongoing	460*
Maldives	2019	Completed (Deferral)	600
Maldives	2019	Ongoing	935
Ecuador	2020	Complete (Deferral)	417
Ecuador	2020	Complete (Deferral)	400
Kenya	2020	Ongoing	Unclear
Vanuatu	2020	Completed (Deferral)	Unclear
Venezuela	2020	Completed (Deferral)	19000
Laos	2020	Ongoing	Unclear
Mozambique	2020****	Ongoing	Unclear
Kyrgyzstan	2020****	Ongoing	1,800
Angola	2020****	Complete (Deferral)**	6,200
Pakistan	2020****	Ongoing	14,000
Pakistan	2020****	Ongoing	3,000
Tanzania	2020****	Ongoing	Unclear
Tonga	2020****	Ongoing	124 *

Source: Rhodium Group. *Estimates based on reported numbers or on a calculation of the reported percent of Chinese debt to GDP over total debt stock. **Based on tentative reports. ***Based on first public reports or official statements of a renegotiation request either made by borrower or received by China. ****Negotiations with DSSI participant countries. Sierra Leone is also rumored to be in talks with China, but we have not yet gathered enough evidence to include it in our database.

The 28-billion-dollar question

Given that almost USD 28 billion of China's overseas lending is still under renegotiation, with more cases likely to come, how Beijing handles renegotiations will be crucial to emerging and frontier markets recovery in 2020-2021. We make three observations:

Do not expect debt-for-equity swaps or large-scale write-offs

Our updated database confirms our previous finding that there are no cases where China has legally seized infrastructure assets due to borrower default (asset seizure), or retired debt in a direct and formal exchange for an equity stake (debt-equity swap). In two cases since 2018, Chinese firms have purchased equity stakes in troubled infrastructure projects funded by Chinese loans: the Hambantota Port in Sri Lanka (2018) and grid assets of Electricite du Laos (2020). But there is no concrete evidence of an accompanying "swap", as related Chinese debts appear to remain on recipients' books.[6] This is not to deny any link between strategic asset control and debt

[5] China's public statements on DSSI have shifted over time. On June 8, China's foreign ministry claimed China had "already announced the suspension of debt repayments from 77 developing countries". However, this appears inaccurate. Although 77 countries are *potentially* eligible for relief under DSSI, four (Syria, Eritrea, Sudan, and Zimbabwe) are currently ineligible, while only 41 countries had even applied for DSSI relief at the end of June. In late August, China instead claimed that it had received 20 requests from borrowers under DSSI, and struck agreements with 10 as of July 31.

[6] Deborah Brautigam of SAIS-CARI offers an in-depth analysis of the Hambantota case and refutation of asset seizure claims. The Electricite du Laos case has not yet been tied to an accompanying debt write-off.

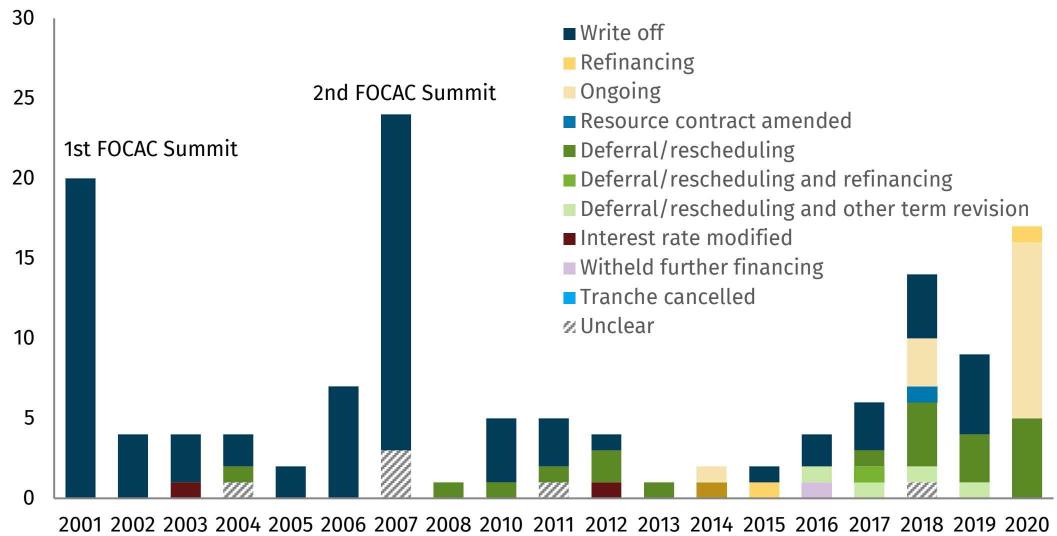
renegotiations. The prospect of preferential access to asset, resources or large-scale contracts certainly affects debt talks, and Iraq's oil fields and Zambia's copper resources could explain generous Chinese write-offs in our dataset.[7] Direct swaps, however, appear to be rare.

Moreover, is it highly unlikely that China will write off or forgive a large portion of outstanding debt. Despite COVID-19, China's policy remains that only its zero-interest loans (ZILs) are eligible for forgiveness.[8] Aside from two early exceptions (Iraq in 2007 and Cuba in 2011), all of the write-offs in our dataset involve ZILs.[9] Not only are these typically smaller than other loans (USD 35 million on average in our sample, excluding Iraq and Cuba), but they form only a small part of China's overseas lending – no more than 2% of China's overseas loans today.[10] This makes them less relevant to current COVID-19 debt pressures (Figure 3). Even if China unilaterally cancelled all outstanding zero-interest debt by the end of 2020, it would have only a marginal effect on overall debt service.

FIGURE 3

Restructurings by Outcome and Year

Count*



Source: Rhodium Group. *Does not include recent Chinese claims to have given 10 countries debt deferrals through DSSI.

In short, while Beijing is open to writing-off small debt amounts, such moves provide only limited debt relief. Interest-bearing loan renegotiations will be more critical. These cases are much larger on average (around USD 2 billion), ranging from USD 8 million to as much as USD 19 billion, including 18 cases worth over USD 10 billion. In these cases, China appears to insist on preserving net present value (NPV) as much as possible, and will typically agree only to deferral or rescheduling, with refinancing in rare cases.

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[7] Some discussions of China's negotiations with Angola also suggested that Angola's national oil company, Sonangol, might offer future equity stakes in oil fields as part of a deal. At present, this is unconfirmed.

[8] Write-offs typically cover ZIL maturing by the end of a given year. Cases may also include overdue or defaulted ZILs.

[9] Both Iraq and Cuba received write-offs during major multilateral debt reduction initiatives for both countries. China announced it would write off approximately USD 6.8 billion of Iraq's debt, while in Cuba, between USD 2 and 6 billion was ultimately written off. And although these debt stocks likely included several overdue zero-interest loans, they also included other loan types. For more information on Iraq, see: Acker, K., Brautigam, D. and Y. Huang (2020), "Debt Relief with Chinese Characteristics", Working Paper No. 2020/39, China Africa Research Initiative, School of Advanced International Studies, Johns Hopkins University, http://www.sais-cari.org/publications.

[10] Estimates differ on the proportion of ZILs in China's outstanding lending, from 0.2% (Horn, Reinhart, & Trebesch. 2020) to 5% (Acker, Brautigam, & Huang. 2020, though for Africa only).

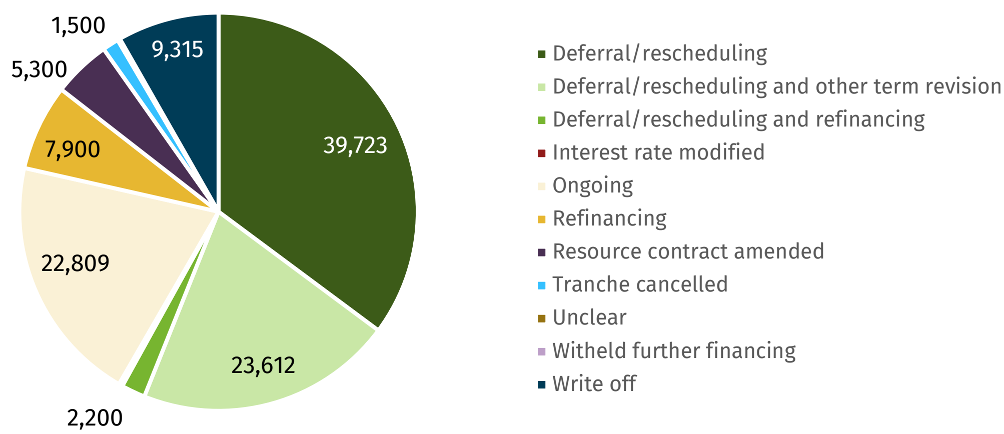
Expect deferrals and long, opaque, ad-hoc bilateral processes

Instead of large-scale forgiveness or debt-for-equity swaps, we expect most current renegotiations to end in deferrals via grace period extensions (for loans that have not yet entered principal repayment), maturity extensions, or rescheduling of payments within existing maturities. Deferrals have been China's historical preference (Figure 4), accounting for more than half of concluded cases (53%) and renegotiated amounts (58%).[11]

FIGURE 4

Renegotiations by Outcome

Amount renegotiated to date*



Source: Rhodium Group. *Does not include recent Chinese claims to have given 10 countries debt deferrals through DSSI.

Restructurings in 2020 show this preference persists. All four countries for which we have detailed outcomes in 2020 – the Maldives, Venezuela, Ecuador and Angola – have received some sort of deferral or rescheduling (Table 2).

TABLE 2

Outcomes in 2020

	Amount (USD mln)	Details
Angola	6,200 (CDB/Exim)	3-year deferral of principal payments, extended maturity*
Ecuador	417 (CDB)	12-month deferral in principal payments, within original maturity, oil offtake agreement updated
	474 (Exim)	16-month deferral in principal payments, within original maturity
Maldives	600 (Exim)	4-year deferral
Venezuela	19,000 (CDB)	Grace period extended until end of 2020

Source: Rhodium Group research. *The Angola renegotiations are not yet publicly finalized. The above regards two "smaller facilities", with some "further partial relief of principal" in 2024, per IMF reports. Angola is also pursuing restructuring with ICBC along similar lines.

On the face of it, this would make Chinese banks similar to other DSSI creditors in 2020. Although the DSSI allows for relief through either rescheduling or refinancing, most bilateral creditors to date have chosen to reschedule payments. However, China's approach remains different in practice. Unlike Paris Club lenders, which coordinate debt relief under standard terms, China's renegotiations are resolved on an ad-hoc, case-by-case basis. Processes (and outcomes) differ widely by borrower, loan type, and lender. One example is Ecuador, where China Exim and China Development Bank (CDB) delivered relief on oil-backed debts more than a month apart this year.

[11] Excluding ZIL write-offs.

Both delayed principal payments but did so over different periods. And an accompanying change in oil-offtake agreements was part of the CDB relief deal, but not (apparently) that of Exim. In the Maldives, repayment on Exim's USD 600 million in loans to the government have been deferred, but no progress has been made on USD 206 million in loans to the country's SOEs, and there is no public discussion of any talks regarding over USD 600 million in guaranteed debt from other lenders (ICBC and CDB). This is not to say that China's lenders never coordinate. Details coming out of the Angola restructuring suggest that China Exim and CDB have come to substantially similar terms. But Chinese banks do not display standard relief terms, whether talks occur in the DSSI framework or not, making it difficult to predict future outcomes. Finally, history suggests that some of these negotiations might take months, if not years, to complete.

Three additional factors

CDB or China Exim? China Development Bank (CDB) holds 43% of the debt currently (or recently) under negotiation in our dataset (Figure 5). CDB overseas loans are concentrated in a handful of countries, but these include some of the largest ongoing cases like Venezuela and Pakistan. Importantly, Beijing insists that CDB is not an official bilateral lender, treating it as a commercial bank for purposes of the DSSI. This means that CDB debt restructurings are open to a wider range of outcomes, with the potential for shorter deferrals and/or limited or no relief on interest payments.[12] Most of China's renegotiations in numbers will however involve China Exim (Figure 6), China's main lender to lower-income countries and, as China's export credit agency, an official bilateral creditor. We count 11 ongoing or recently concluded negotiations involving China Exim.

FIGURE 5
Main Actors in Current Renegotiations
Share of total *amounts* currently under renegotiation

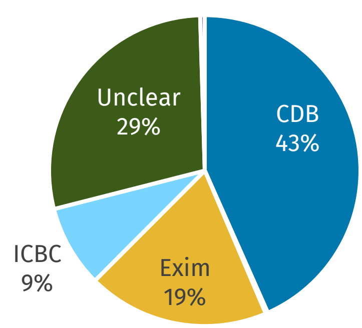
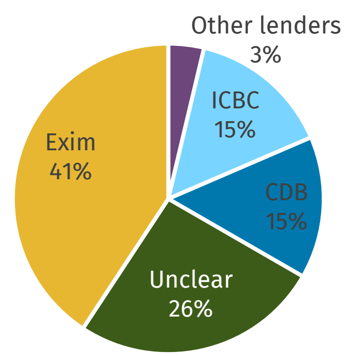


FIGURE 6
Main Actors in Current Renegotiations
Share of current renegotiation *cases*



Source: Rhodium Group research. For renegotiations involving multiple lenders where specific amounts for each lender are not known, debt is pro-rated.

IMF involvement matters. Renegotiations will also be shaped by multilateral institutions, especially the IMF. In past renegotiations, the IMF helped shape outcomes by insisting that borrowers restructure bilateral debt first in order to access IMF financing. This happened in the Republic of Congo in 2019, and indirectly in Pakistan the same year, when the IMF took steps to ensure its bailout funding would not be used to pay back Chinese and other bilateral creditors for three years. Although there have been exceptions, Beijing has often reached quicker outcomes when the IMF is negotiating in parallel. Beyond the IMF, the cases of Cuba and Iraq show China working

[12] This was a key sticking point in China's discussions with Angola: although China insisted that the deal be classified as DSSI relief, other G20 creditors were reluctant to agree to the label because the deal did not appear to include a suspension of interest payments. See Deborah Brautigam, "China, the World Bank, and African Debt: A War of Words" August 17, 2020, https://thediplomat.com/2020/08/china-the-world-bank-and-african-debt-a-war-of-words/

primarily under Paris Club terms (on borrower request), with ultimate relief packages similar to those offered by the Club and other bilateral creditors.[13]

Not just Chinese loans: Much of the attention has been on China's rise as a major bilateral creditor, but significant debt is also owed to international bond holders and private lenders. Bonds and private debt formed around one-third of debt service obligations for DSSI-eligible countries in 2019, more than debt payments to China.[14] These creditors have not extended any relief under the DSSI, forcing countries to make tough choices over which (if any) creditors will be paid on time, and who should be approached for restructuring. The consequences of defaulting to bondholders are stark: Zambia defaulted on Eurobonds in late September and was quickly punished by capital markets, while Angola was rewarded for pledging to honor bond payments as it sought to restructure the rest of its debt. These constraints will persist, and partially explain China's secrecy. Like any creditor, China is reluctant to publicize restructurings for fear that its relief will benefit other creditors. Whether countries can obtain relief from private creditors will have a major impact on China's willingness to restructure. Ecuador's decision to make bond payments in March, rather than use funds for its COVID-19 response, paved the way for a restructuring of several bond obligations. Chinese banks subsequently approved deferrals for nearly USD 900 million and are on track to provide several billion in new lending later this year.

Conclusion

Sovereign debt management will be a critical issue for emerging markets through next year, and as a major bilateral creditor, China's approach will influence the timing and extent of economic recovery in many of these markets. Our data suggests that Beijing will need to agree to substantial deferrals, especially if the DSSI is extended through 2021. However, Beijing does not appear to be interested in participating in coordinated negotiations, even if those negotiations might produce better outcomes.

As they deal with the fallout from 20 years of aggressive lending, China's banks face a stark reckoning. As much as 25% of China's overseas debt has already run into trouble. Ongoing domestic efforts to rationalize China's overseas lending–-through the establishment of a new aid agency (CIDCA) and the introduction of new debt sustainability frameworks for policy banks—are becoming more urgent in a world shaken by COVID-19.

Disclosure Appendix

[13] Acker, Brautigam, and Huang (2020) "Debt Relief with Chinese Characteristics".

[14] Excluding Chinese loans. China has also pointed out that the single largest creditor to DSSI-eligible countries remains the World Bank, though the gap is less than USD 10 million.