

ZAMBIA RESEARCH NOTE

## Bond-holders shrug off the IMF's pointed warning

*The statement delivered by the IMF team on Friday morning, at the conclusion of its latest mission, amounted to a **wake-up call for those holding their collective breath for a deus ex machina.***

*After all, here was the Fund back in Lusaka, less than four months after its last visit.<sup>1</sup> In the interim, Zambia's Cabinet had formally authorized the finance ministry to approach the IMF for an economic support package, fueling speculation that a deal was in the works.*

*The Fund's blunt language should have dashed such fanciful hopes<sup>2</sup>. **Instead, bond-holders chose to shrug off the pointed warning.***

1) The Mission's statement opens with the laconic assessment,

**"The Zambian economy is under intense pressure [...] Government finances are under immense stress. Expenditure is running far above budget ..."**<sup>3</sup>

2) It then notes the stated intention of the Zambian authorities that, *"(N)otwithstanding the upcoming general elections, they are committed to addressing the budgetary pressures, including moving to cost-reflective energy pricing, and scaling back on discretionary spending while safeguarding social protection programs."*<sup>4</sup>

3) The statement concludes as bluntly as it began:

**"Delays in implementing corrective measures will only worsen the situation, increase the adjustment cost and postpone the recovery."**<sup>5</sup>

4) And yet, in the midst of this evident debacle, **Zambia's bonds gapped up by an average of 4 $\frac{1}{2}$  points<sup>6</sup> on the day, with the benchmark 8.5s of 2024 tightening by a full 110 b.p.<sup>7</sup>** Such an explosive performance begs the question, what could have fuelled this wild exuberance?

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<sup>1</sup> According to the relevant Statement, *"It was agreed that the authorities and IMF staff would remain closely engaged in the period ahead. The Zambian authorities undertook to conduct internal consultations based on the outcome of the mission, with a view to defining the forms and timing of engagement."* - See *IMF Press Release No. 15/531*, issued Nov. 20, 2015.

<sup>2</sup> We ourselves have poured cold water on these delusions - See *"Deteriorating fundamentals signal further spread-widening"*, Feb. 26, 2016.

<sup>3</sup> See *IMF Press Release No. 16/120*, issued Feb. 18, 2016. N.B. the opening sentence indicates a significant deterioration since November, when the economy was merely described as being "under stress".

<sup>4</sup> The credibility of these 'assurances' is undermined by the Government's astonishing profligacy over the last four months. Indeed, on the very day the IMF team arrived in Lusaka, President Lungu was awarded his third salary increase in 15 months – a frequency suggesting its de facto indexation to inflation.

<sup>5</sup> This time around, there is not even the fig-leaf of the two parties agreeing "to remain closely engaged in the period ahead", as was the case last November.

<sup>6</sup> This was more than twice the average price gain recorded by the African sovereign sector that day.

<sup>7</sup> And, this on the same day Standard & Poor's downgraded Zambia's B/B sovereign credit outlook to negative, noting inter alia that *"Zambia continues to face multiple challenges that influence our assessment of its creditworthiness."* - See *"Republic of Zambia Outlook Revised To Negative on Weaker Growth; 'B/B' Ratings Affirmed"*, Mar. 18, 2016.

5) The simple explanation appears to be a wire-service bulletin, posted that morning under the dramatic headline, **“Zambia, IMF to conclude talks on formal program in mid-April”**.

The single source for this remarkable piece of misinformation: **a piece of damage-control issued by the local authorities**<sup>8</sup>, ahead of the damning statement they knew the IMF would be issuing.

6) Yet even a casual reading of the Treasury’s statement should have set the alarm bells ringing. In the first place, the said document describes the main objective of the IMF mission as,

**“(I)nitial discussions on what steps are required to be taken for the country to engage the IMF on a formal programme within 2016.”**<sup>9</sup>

7) But this limited agenda is completely at variance with the fanciful outcome that Mr. Yamba presents in the final operative paragraph of his creative release, viz.:

**“Regarding a programme with the IMF, we initiated discussions, which will conclude during the annual IMF/World Bank spring meetings to be held in mid-April 2016.”**<sup>10</sup>

8) Set against the Fund’s authoritative statement, contradictory assertions by the Treasury secretary simply fail to stand up.

Not only is the prospect of an IMF agreement far from imminent<sup>11</sup>; **not even the basic preconditions for commencing formal negotiations are in place** – a point which the Fund’s own statement delivers with crisp efficiency (as illustrated above).

9) It is therefore our view that **the pricing of Zambia’s bonds is now significantly out of line with the country’s fundamentals**.

Nevertheless, we concede that the current spread levels of approximately 1,000 b.p. may well persist for the next three weeks, until the inevitable collision with reality during the IMF’s Spring meeting. **But by then it may be too late for an orderly exit**.

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<sup>8</sup> See ‘Media Release by Secretary to the Treasury Fredson Yamba at the Conclusion of an IMF Staff Visit to Zambia’, emailed to media outlets on Mar. 18, 2016 at 6:14 AM and simultaneously uploaded to the Facebook page of the ruling Patriotic Front, under a post with the intriguing caption **“IMF had a successful meeting (sic)”**.

<sup>9</sup> See Para. 2, *ibid*.

<sup>10</sup> See Para. 7, *ibid*.

<sup>11</sup> For a study in contrasts, it is worth reviewing the language of the final post-mission statement, issued by the IMF staff in Nov. 2014, when the negotiations on an Extended Credit Facility program for Ghana still had another three months to run. **“The IMF team will continue to support the authorities as they work in the coming weeks in several areas, including to take concrete steps in cleaning up the payroll, finalize the remaining details of their medium-term reforms and to seek external financing assurances from bilateral donors and international institutions. Once this work is completed, a financial arrangement to support Ghana’s economic program would be agreed at staff level before being proposed for the IMF Executive Board’s consideration** (emphasis added).” – See *IMF Press release No. 14/532*, issued Nov. 20, 2014.

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