The evolution of frontier fixed income

Welcome to the latest edition of the Exotix Capital Developing Markets Guide. This is the sixth edition, the previous one having been published in February 2011, when the concept of investing in frontier[1] economies was beginning to gain traction again after being derailed by the GFC. A lot has happened since then.

Developments in frontier sovereign debt – past, present and future

The evolution of the frontier/EM fixed income landscape over the past decade or so has been characterised by two features. First, significantly more hard currency (eurobond) issuance, albeit mainly from sovereigns (developing market corporate issuance has generally lagged). Second, continuing sovereign defaults. Looking at the recent history of these sovereign defaults, we highlight what we think are three interesting characteristics of the recent sovereign debt restructuring experience. These are:

1. Proactive creditor committees;
2. Bondholders have generally done well in recent restructurings; and
3. A decline in exit yields.

Going forward, we think other issues will come to the fore to test or change the existing international financial architecture. We highlight here two issues. First, the role of China as a significant lender and investor in emerging and frontier economies and how its presence will challenge the established world order in terms of crisis prevention and resolution. Second, if the focus of international policy on emerging market sovereign debt over the past 20 years has been focused on trying to make debt restructurings more orderly, an agenda that has in no small part been influenced by the official sector's fears over demonstration effects of the holdout litigation in Argentina, then the future policy agenda may be shaped by current initiatives to promote sustainable lending and greater transparency in lending, which – although at an early stage – could have similarly wide-ranging implications.

The growth in frontier bond issuance[2]

Frontier sovereign hard currency bond issuance has boomed over recent years (Figure 1). On our count, there were 33 debut sovereign issuers (excluding those issuing bonds through restructurings) over the period 2007-18, of which there have been 21 since 2012. Before 2007, the frontier universe was smaller (depending on interpretation), consisting of c20 or so countries, including a number of less liquid or smaller EM issuers that could have been considered frontiers (and still are), and a few other smaller bond issues or issued that came out of previous restructurings. For instance, the Dominican Republic, Ecuador, El Salvador, Jamaica, Pakistan, Ukraine and Vietnam all had bonds by then, and smaller issuers included Barbados, Fiji, Macedonia, the Seychelles and Trinidad & Tobago (for us, Argentina and Venezuela have also drifted in and

[1] We don't define "frontiers" in a strict sense, but such markets tend to share characteristics of illiquidity in securities trading, lack of market depth, under-developed capital markets, and weaker policy making frameworks and institutional governance than more mainstream EMs.
[2] Our focus here is sovereign hard currency debt. We exclude corporate bond issuance and domestic debt (local currency) markets, where similar drivers apply and similar trends can be observed (albeit not to the same magnitude as with hard currency sovereign debt).

out of this category over this period). Adding them together would take the universe to something like 57 countries today. In other words, with the issuance over the past decade, the number of frontiers has just about tripled.

And many frontiers have also become repeat issuers since their debuts, having two or more bonds outstanding. Moreover, they are also issuing longer tenors, with 15- and 30-year maturities now more commonplace. In Sub-Saharan Africa excluding South Africa (SSA), for example, Nigeria issued the region's first 30-year bond in November 2017, and has been followed in 2018 by Kenya, Senegal, Cote d'Ivoire, Angola and Ghana (although Ghana's recently reported plans for a jumbo century bond, following in the steps of Argentina in 2017, might be stretching things a bit far).

Perhaps indicating another sign of market maturity, Ghana (2017), Gabon (2017) and Nigeria (2018) have all repaid bullet maturities on due date, with their ability to do so aided by being able to retain market access in order to refinance these debts.

Figure 1: Frontier hard currency debut issues

Year	Total number	Debut issuers				
2007	3	Sri Lanka-12	Ghana-17	Gabon-17		
2008	1	Georgia-13				
2009	1	Senegal-14				
2010	4	Belarus-15	Montenegro-15 EUR	Albania-15 EUR	Jordan-15		
2011	3	Nigeria-21	Serbia-21	Namibia-21			
2012	4	Angola NL-19	Zambia-22	Bolivia-22	Mongolia-22		
2013	6	Paraguay-23	Tanzania-20	Honduras-24	Rwanda-23	Armenia-20	EMATUM-20
2014	5	Azerbaijan-24	Kenya-19 and 24	Ivory Coast-24	Kazakhstan-24	Ethiopia-24	
2015	1	Cameroon 25					
2016	1	Suriname-26					
2017	3	Iraq-23	Tajikistan-27	Maldives-22			
2018	1	PNG-28					

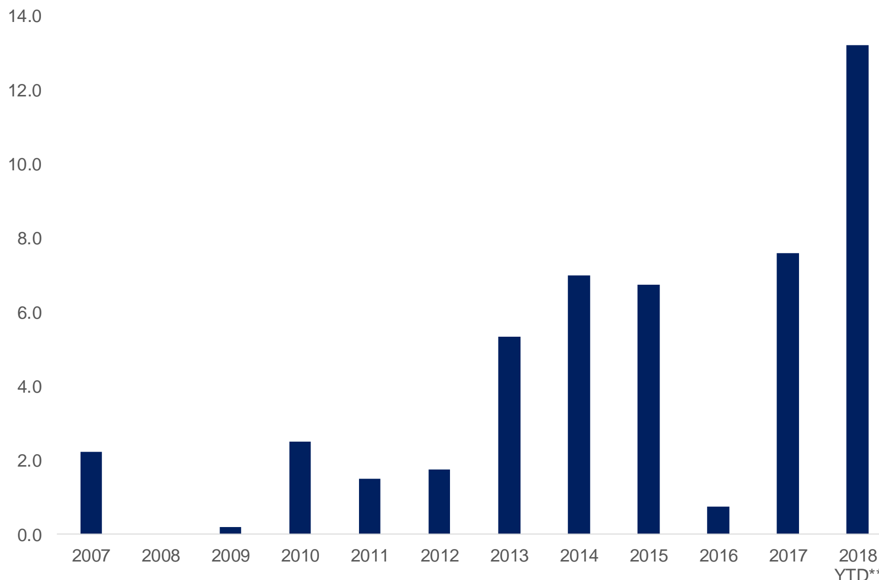
Source: Bloomberg

A number of new issuers are included in this Guide. There have been 24 new frontier sovereign issuers since our last edition (excluding those with bonds arising out of previously restructured debt and Brady bonds). These include Azerbaijan, Kazakhstan, Mongolia, Suriname, Tajikistan and much of SSA, including Angola, Cameroon, Ethiopia, Kenya, Mozambique, Nigeria, Rwanda and Zambia. At the time of writing, Papua New Guinea had come to the market too.

Today, SSA, in particular, has US$44bn of sovereign bonds outstanding, across 16 issuers, of which 90% has been issued since 2013 (and just under half since 2017). Indeed, 2018 has seen the highest issuance ever out of the region (Figure 2).

But frontiers are not just about Africa. As we like to say, most of the world is a frontier.

*Figure 2: Sovereign eurobond issuance in SSA (US$bn)**



*Source: Exotix, Bloomberg. *Gross issuance including restructurings. **Year through end-September.*

Outstanding hard currency sovereign bonds in this Guide, across 38 issuers, amount to cUS$234bn (excluding Greece). And, on a broader sweep, including another 19 frontier issuers not included in this book, with a total amount outstanding of US$99bn, that takes a rough estimate of the size of the frontier sovereign hard currency bond market to cUS$332bn in 57 countries (by comparison, we note the JPM NEXGEM index, the only frontier bond index, only covers part of this universe, comprising 35 countries at end-17, with a nominal amount outstanding of US$116bn). Nearly one-third of these (17 countries) had not even issued a bond until four years ago (2013).

The boom in frontier bond issuance reflects a combination of push and pull factors, which have tended to increase capital flows to frontier markets and lowered their borrowing costs. Push (external) drivers comprise buoyant global liquidity conditions since the global financial crisis whereby, until recently, markets have enjoyed low global interest rates on the back of ultra-loose monetary policy in the G3. Lower global interest rates have encouraged the search for yield into frontiers, and lower sovereign borrowing costs too. The question of what happens to frontier borrowers, who either want to issue to finance budget deficits, or to refinance upcoming maturities, when liquidity conditions are less benign will be a major theme over the next few years.

Positive external factors also include generally supportive commodity prices (notwithstanding the 2014-16 oil and commodity price crash) and, for many, the cleaning up of sovereign balance sheets post-HIPC debt relief (leading to concerns over the financial health of some countries that have used the borrowing space that was provided by debt forgiveness to re-leverage). Pull (domestic) factors that have made these countries more attractive to foreign investors include improved domestic macroeconomic policy frameworks, stronger growth prospects and rising per capita incomes, natural resource endowments, strengthening institutions and governance, and broadening democracies. These drivers have helped to lower frontier sovereign borrowing costs through lower country risk spreads.

The stronger GDP growth prospects for frontiers (although partly a function of income convergence), and their potential for portfolio diversification and lower correlations with other asset classes (although this might in part be a function of illiquidity and the time horizon), has been among the arguments leading to more mainstream acceptance of frontier investing.

All nine of the fastest-growing countries in the world in 2018, those growing at 7% or more according to IMF WEO projections, are emerging markets, of which eight are frontier (India being the exception), with four in SSA and three in Southeast Asia. Of the eight frontiers, four have eurobonds (Ethiopia, Cote d'Ivoire, Rwanda and Senegal). Taking an average over the past decade, which includes the period of the GFC, frontiers again dominate the list of the 11 fastest-growing countries (7% or more), with eight markets, of which Rwanda, Mongolia, Ghana and Ethiopia are investable (the three non-frontiers are China, India and Qatar). But growth does not always equal returns.

Moreover, the evidence for whether such large-scale borrowing through the eurobond market has indeed been used for productive purposes to boost potential growth rates seems somewhat mixed, or at least it is too early to be certain. Although bond proceeds are often earmarked for infrastructure spending, project selection and appraisal can be weak, and there may be concerns that borrowing has merely fuelled higher current spending.

The compression of yields on hard currency frontier sovereign bonds has also led to more interest in frontier market local currency opportunities, to take advantage of higher local interest rates (carry trade) and/or prospects for currency appreciation, as well as the possibilities it offers for greater diversification and lower market correlations. The local currency market has grown, although perhaps not at the rate observers were expecting a decade ago. There may be a couple of reasons for this. First, investor interest has been punctured by episodes of global market distress, such as the GFC, the eurozone crisis of 2010-12 and commodity price crash of 2014-16. And it seems to take longer for investor interest to return to local markets than it does hard currency bonds. Second, local currency performance is also influenced by the performance of the US dollar. The period of US dollar strength, and hence EM currency weakness, over 2014-16 and again throughout 2018 has dented local currency appetite, and again, it can take time to recover.

Moreover, liquidity remains an important factor for many investors and the still relatively small size of domestic government bond markets in most frontier countries can be a deterrent, with small primary issues and generally little secondary market activity. Although some frontiers have been able to tap into this source of foreign capital, with non-resident holdings of domestic government securities becoming significant in, say, Nigeria, Zambia, Egypt and Ghana, this has not been able to displace the volume that treasury managers can obtain on the international market; and of course, it can also be a source of financial instability if the capital is repatriated quickly (eg as may have been in part the case for Argentina in early 2018).

Recent sovereign default experience

Since our last Guide was published, 10 countries have defaulted (classified by missed payments, announcements of a moratorium or an involuntary exchange) on their sovereign international bonds (or guaranteed issues) and there have been 14 instances of default (Belize and Mozambique have defaulted twice and the Republic of Congo three times; Figure 3). And there have been 17 instances of default

stretching further back over the last decade. Background to these default events is given in this Guide (except one, St. Kitts and Nevis). These defaults have tended to be in frontiers, covering small bond stocks, rather than in the more mainstream markets (Argentina, Venezuela and Greece being notable exceptions). We also observe that whereas some saw hard defaults (missed payments), some were cases of pre-arrears restructuring, namely Greece (2012), Ukraine (2015), Mozambique's EMATUM exchange (2016) and Belize (2017), while others saw missed payments but no action was taken by creditors as they were prepared to wait in the belief that the authorities would cure the situation later – eg in the case of Argentina (2014), the Republic of Congo (three times) and, going further back, Cote d'Ivoire (2010).

As at end-September 2018, there were three ongoing defaults on sovereign eurobonds – Barbados (US$0.5bn), Mozambique (US$0.7bn) and Venezuela (US$31.1bn) – covering cUS$32bn (nominal) in bonds (although most of this, c96%, related to Venezuela). Including defaulted PDVSA bonds in Venezuela (another US$25bn), the total sovereign and related bonds in default amounted to US$57.7bn. This, however, excludes other commercial loans in default in the case of Mozambique (two commercial loans, MAM and Proindicus, amounting to about US$1.1bn combined) and Barbados, and in Barbados's case domestic debt in default as well (cUS$6bn equivalent in BBD$ claims), which would bring defaulted commercial claims (domestic and external) to some US$65bn.

Of the three sovereign bond defaults, by end-September 2018, Mozambique's bond default was 20 months old, Venezuela's was 10 months old and Barbados's three months old. Other than these, some other countries that have outstanding eurobonds are in some sense distressed, including the Republic of Congo (in default on some loans, and official debt, and looking to restructure large parts of its public external debt, although its own US$ bond has been excluded). And, of course, the long-running commercial debt (loan) defaults continue in Cuba, North Korea (both markets being subject to US OFAC sanctions) and Sudan, while Zimbabwe also seeks to normalise its own debt situation with arrears mainly to multilateral creditors.

What does this tell us?

Although each of the dozen or so sovereign bond restructurings over the past decade has had its own circumstances particular to it, we make three observations from these experiences:

1. **Proactive creditor committees.** We think bondholders have become more proactive in organising themselves, forming robust and well-coordinated committees. This should be a positive in terms of helping to facilitate a rapid resolution. Examples of well-organised groups include Ukraine (2015), Belize (2012, 2016), Greece (2012), Grenada (2013), Mozambique (2016-), and Barbados (2018-). The Republic of Congo's London Club restructuring (2007) is a good example of creditors organising themselves pre-emptively and agreeing restructuring terms even before an official sector treatment. This observation is counter to the prevailing view during the 1990s/early 2000s that held that the shift in international finance away from syndicated bank lending towards more fragmented and diverse bondholders would complicate sovereign debt restructuring. In fact, it might be said that the resolution of bond defaults has been faster than with loans. The use of collective action clauses (CACs) in bonds, whereby acceptance of a super-majority of holders is binding on everyone else, might also have played a role too, in terms of speeding up the process.

Figure 3: Summary of recent sovereign bond defaults and restructurings[1]

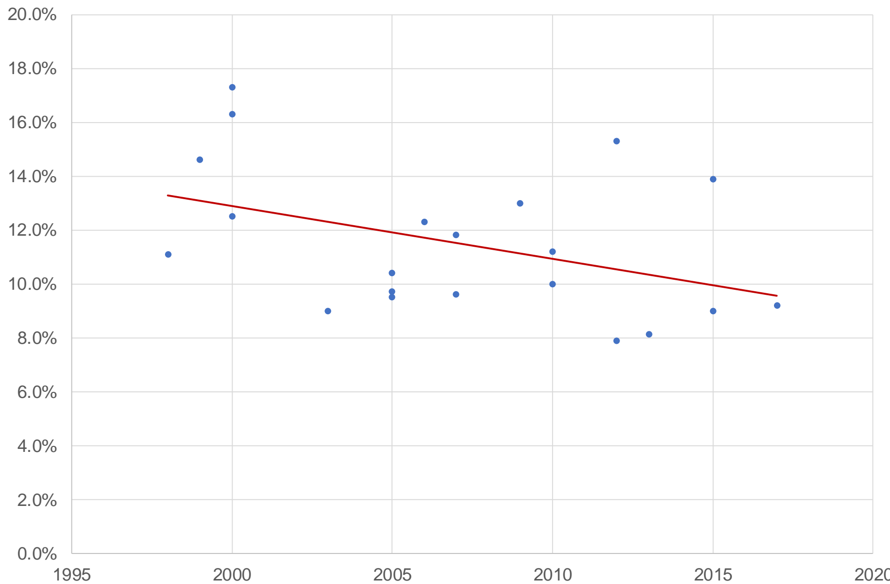
		Default date[2]	Exchange date[3]	US$ or foreign law bonds covered (principal, US$bn)	Nominal haircut (%)	NPV loss (%)
2008	Seychelles	Oct-08	Jan-10	0.2~	50	56.2
2009	Ecuador	Nov-08	May-09^	3.2	65	67.7
2010	Cote d'Ivoire	Dec-10	Resolved[5]	2.3	0	n/a
2011	St Kitts[4]	Jun-11	Mar-12	0.2~	50	62.9
2012	Greece	Feb-12*	Mar-12	26.3†	53.5	64.6
	Belize	Aug-12**	Mar-13	0.5	10	29
2013	Grenada	Mar-13	Nov-15	0.2~	50††	49
2014	Argentina	Jun-14	Resolved[6]	25.3	0	n/a
2015	Ukraine	Mar-15***	Nov-15	18.0	20	20†††
	Rep of Congo	Dec-15	Resolved[7]	0.4	0	0
2016	Mozambique#	Mar-16	Apr-16	0.85	0	n/a
	Rep of Congo	Jun-16	Resolved[8]	0.4	0	0
2017	Mozambique	Jan-17##	Ongoing	0.7~	n/a	n/a
	Belize	Nov-16###	Mar-17	0.5	0	20
	Rep of Congo	Jun-17	Resolved[9]	0.4	0	0
	Venezuela	Nov-17####	ongoing	56.5+	n/a	n/a
2018	Barbados	Jun-18	ongoing	0.5~	n/a	n/a

*Source: Exotix, Bloomberg, IMF, Cruces and Trebesch. Notes: [1]Including government guaranteed bonds but excluding non-bond defaults (eg loans) and defaults of SOEs (except Venezuela's PDVSA). [2]Payment due date rather than end of grace period, or date of restructuring announcement/ moratorium; [3]In the cases where default was not resolved through an exchange offer, they were usually cured through payments being made at a later date. We label these "resolved" but leave undated as it is not always possible to discern when the default was actually cured (see also respective footnote for additional detail). [4]Not covered in this book; *Technically Greece did not default (miss payments) on its international law bonds. Completion of a debt exchange became a prior action for the IMF's EFF programme that was approved in March 2012, and terms of a PSI offer were announced in February 2012; **In announcing an intention to restructure, the government paid half the August coupon as a show of good faith; ***Debt restructuring (PSI) was part of the IMF programme approved in March 2015. The government set out the restructuring parameters in April 2015 – a bond default occurred in September and October 2015; #Exchange of the government guaranteed EMATUM bond which may be viewed as a default as an involuntary exchange, in which the bond's CAC was activated, even though financial terms were broadly NPV neutral to positive and no payments were missed. S&P classified it as selective default. Fitch did not. ##Announcement of intention to seek a restructuring came in October 2016 – the government later missed the January 2017 coupon payment on the MOZAM bond; ###Announcement of intention to seek a restructuring came in November 2016 – the government later missed the February 2017 coupon payment on the bond; ####Announcement of moratorium and intention to seek a restructuring – the government later defaulted, selectively, on most of its sovereign and PDVSA bonds; ^Cash buyback at 35 cents on the dollar; [5]No exchange took place, rather a repayment plan for missed coupons was agreed in November 2012; [6]No exchange took place – missed payments were eventually paid when legal restrictions were lifted; [7]No exchange took place, payment was made within grace period; [8]No exchange took place, payment was made after grace period; [9]No exchange took place – payment was blocked by legal action, which was later overturned, and payment was made after grace period; ~Excludes other debt in default; †Excludes other debt in default. We show EUR19.9bn in foreign law sovereign and government guaranteed bonds, equivalent to US$26.3bn at average US$/EUR exchange rate in March 2012, out of a total eligible debt of EUR205.6 billion (US$271.4bn) consisting of domestic and foreign law, sovereign and state-enterprise debt, including guaranteed bonds; +Comprising US$31.1bn in defaulted sovereign bonds (excluding 36s, which is subject to OFAC sanctions, where payment details are not generally available) and US$25.4bn in defaulted PDVSA bonds (all its bonds except the collateralised 20s, which are current); ††50% nominal reduction in two tranches, second tranche being conditional on satisfactory performance under the IMF programme; †††Excluding GDP warrants.*

2. **Bondholders have generally done well in recent restructurings.** We think bondholders have generally been able to extract good terms in recent sovereign debt restructurings, based on, for example, comparing the final outcomes to the initial restructuring request, or looking at the behaviour of bond prices over the default period. This might be attributed to two reasons. First, is creditor power, as bondholders form strong and well-coordinated committees, and therefore hold stronger bargaining power. This might be seen from Ukraine (2014-15), Belize (2012 and 2016) and even Greece (2012). And bondholders may have been able to do just as well in bigger and more complex restructurings, such as Ukraine (with multiple bonds), as they have in the case of restructurings on a single bond (Belize). Yet it remains to be seen whether such positive outcomes apply in situations involving multiple and more diverse bonds (the inclusion of aggregation clauses is a more recent innovation), and more complex capital structures (eg in the case of Venezuela, with sovereign and PDVSA debt). Second, is better debtor government behaviour, with improved debtor-creditor dialogue (guided by the IIF principles on sovereign debt restructuring) and a stronger commitment by debtor governments to pursuing economic reforms (often in the context of IMF programmes), which is more likely to be rewarded by investors over the longer term. As such, the take it or leave it unilateral offers of Argentina (2005) or Ecuador (2009) may increasingly be seen as the exception rather than the rule. In fact, it might be that it was the very presence of the IMF (during the crisis period and workout) that meant bondholders did well in those cases compared with those instances when there was no IMF engagement.

3. **Decline in exit yields.** The exit yield (discount rate for the new restructured bonds) is an input to the calculation of recovery values (and the size of PV losses) and its downward trajectory over recent years may be another factor explaining why bondholders have seemingly enjoyed better recoveries in recent restructuring cases compared with the past (it means discounting future cash flows at lower rates, so enhancing PV gains, and/or making it easier for bondholders to accept cash flow relief); although lower exit yields per se do not explain why creditors may have been able to get better terms. Over the past 20 years, we observe a downward trend in exit yields (Figure 4). This trend in part mirrors the downward path in global interest rates over this period. The decline in US bond yields is part of the explanation, with the average 10-year UST yield over 2015-17 at c2.4%, compared with c5.5% over 1998-2000 (during the restructurings of Pakistan, Ecuador and Cote d'Ivoire). Hence, on some occasions, the lower exit yields we have seen recently might be explained entirely by lower US bond yields. The spread between the exit yield and the risk free in the recent cases of Ukraine, Grenada and Belize is little different to that seen in those earlier episodes. But nominal EM yields have also fallen because of the narrowing in EM country risk premia (credit spreads) too, with the general improvement in EM fundamentals. One measure of country risk, the JPM EMBIGD spread, has fallen from 600-1,000bps over 1999-2000 (admittedly, a time of systemic EM crises), to a narrow range of c225-450bps over most of the past eight years (2010-18). So, in other cases (such as those over 2010-13, and some of the restructurings in the mid-2000s), lower exit yields have been driven mainly by lower risk premia. Either way, this downward trend may force the need to reappraise traditional benchmark discount rates when analysing restructuring proposals, although a case-by-case approach is certainly needed (we have tended to use a benchmark rate of 12%, but see why 10% might be more relevant nowadays). That said, the tightening of post-GFC easy liquidity conditions might be a harbinger of higher yields in the future and cause exit yield assumptions to become more conservative again.

Figure 4: Exit yields in recent sovereign debt restructurings (%)



Source: Exotix, Bloomberg, IMF, Cruces and Trebesch database

Future issues in frontier debt markets

1. China

Perhaps the biggest issue confronting Western policymakers (and investors) today that could test the prevailing world order is the emergence of China, and other non-traditional creditors, as a dominant lender to emerging and frontier markets, with seemingly less conditionality, as well as the emergence of other quasi-official lending institutions.

Of itself, new borrowing is not a bad thing, if the money has been used productively (Africa's infrastructure needs, for instance, are still in the tens of billions per annum) and a more diverse creditor base is a positive. But the rise in public debt burdens across EMs, and especially in frontiers and across SSA, only a decade after many benefitted from significant debt forgiveness from the HIPC initiative, is a concern, and the pace of new borrowing may have outpaced the borrowing countries' capacity to manage the proceeds and debt stock appropriately. For many frontiers, bond issuance is still a relatively recent phenomenon and they have yet to fully establish track records of prudent borrowing and debt management over a full economic cycle.

But the often-opaque nature of new lending from non-traditional bilateral creditors is a growing cause of concern. This is particularly an issue for Chinese lending, because of its sheer scale (Figure 5), but the wider point is relevant to new lending provided by other lenders, including Russia, India and the Middle East. There is often very little public information on such lending, from the creditor and debtor, on both the amount and its terms, which are often at commercial rather than concessional rates. And such lending and investment is only going to increase under China's transformational Belt and Road Initiative (BRI).

The existence of such large non-traditional bilateral lending in general, and Chinese lending in particular, could provide a major test of the international financial architecture in regards to the official sector response to emerging and frontier market debt crises. Of course, non-traditional bilateral debt has been present in previous sovereign debt workouts, although it was then often much smaller than traditional bilateral lending (usually from Western governments and their export credit agencies) and easier for the Paris Club to push its principle of comparability of treatment onto smaller lenders. It is the scale of such new non-traditional bilateral lending, and the lenders' growing geopolitical clout, that makes it different and could test the traditional sovereign debt workout mechanisms (eg the Paris Club).

In managing future debt crises, there seem to be three potential scenarios:

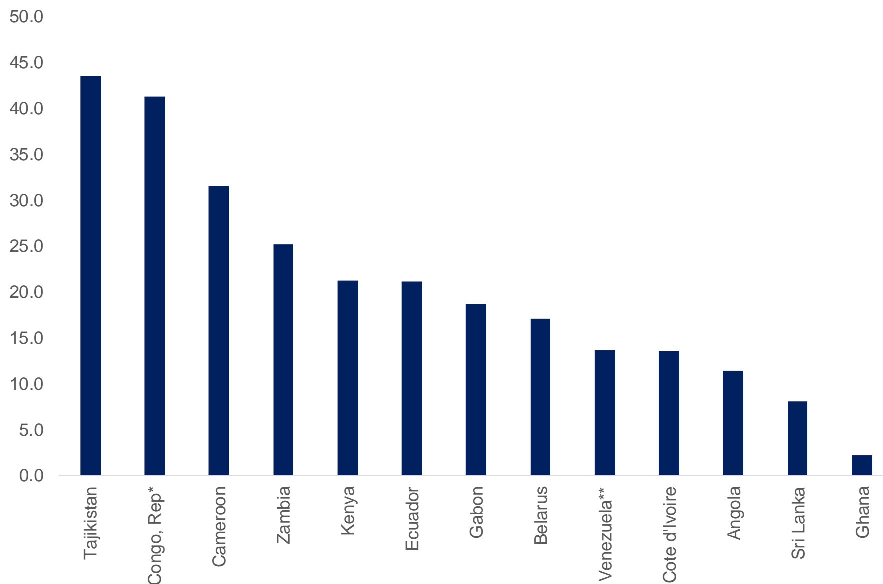
1. Could such bilateral lenders be brought into the traditional Paris Club forum (ad hoc or permanent)? This, though, might require a degree of transparency that such lenders are not comfortable with, especially in regards to providing enough detail on their lending in order for the IMF to carry out proper debt sustainability tests and ensure suitable programme design (as in such situations, the existence of an IMF programme is often a pre-requisite for Paris Club relief). It will also test such lenders' willingness to adopt some general and well-established principles; for instance, IMF supervision and comparability of treatment.

2. Or might there be more ad hoc bilateral debt agreements outside the Paris Club, treatments that themselves are non-transparent, and that could complicate the IMF's own role in programme lending? An ad hoc treatment with China was seen in the recent case of Ethiopia Airlines' reprofiling of its Chinese debt. Ecuador and Zambia also, in 2018, and Venezuela before then, all turned to China to restructure their bilateral debt (although, to date, neither Ecuador nor Zambia have been able to restructure their Chinese debt). And the Republic of Congo, which needs an IMF programme and is seeking to restructure its debt, in which China is a significant creditor, could be a first test of whether such situations will follow the traditional route or a more ad hoc approach.

3. Or could there be a breakaway or formation of a new non-traditional bilateral lending club as direct competition to the Paris Club – the Beijing Club, say? This would require a greater degree of inter-agency cooperation and coordination amongst such lenders across countries than seen hitherto.

Moreover, such non-traditional bilateral lending sources may have implications for the role of the IMF and other official sector lending in crisis prevention. The possible fall-back of seemingly generous Chinese financing without policy conditionality could delay calls to Washington for help, or lead to one being played off against the other (or create a risk that China effectively free rides on the Fund, effectively ensuring the IMF finances the country's ability to repay its debt to China, something we think the Fund will want to avoid), while the existence of sizeable bilateral debt and its lack of transparency could complicate the IMF programme discussions themselves, given the need for the IMF to assess debt sustainability and financing gaps (the Fund cannot credibly assess these if it only knows half the picture).

Figure 5: Chinese debt as a share of public external debt in selected countries (%)



*Source: Exotix. Based on official figures. *Based on media reports. **Exotix estimate.*

Test cases of China's willingness to abide by traditional rules of the game might be provided in the Republic of Congo, Pakistan, Zambia and Venezuela. We think the Republic of Congo is likely to be the first example, albeit on a small scale, of a situation in which a country requires an IMF programme and needs to restructure its debt, and where China is a significant creditor. China needs to be part of the solution. But this immediately throws up two key issues. First, debt reconciliation and coordination across the various Chinese lending arms. Second, obtaining the necessary financing assurances from major creditors, including China, for a Fund programme to go ahead. Both of these will require greater transparency from China than seen hitherto. On a bigger scale, another test case will come from Pakistan, which has recently requested Fund support, and where China is also a significant creditor (although there is no suggestion of a restructuring of its commercial debt). Meanwhile, Zambia is seeking comfort on its Chinese debt, seemingly either before it re-engages with the IMF or decides that it does not need the IMF. Venezuela, which is already in default on most of its bonded debt, will also be an important test case of debt resolution where China is a major bilateral creditor (if and when the time comes).

Yet, it is also worth noting in some cases that even Chinese lending has its limits. It often comes at a big cost (financially and politically) when borrowers get into trouble, and they have little choice but to transfer assets in return, as we have seen in the cases of Sri Lanka and Djibouti handing over ports to China. This could prompt public unrest in the home countries. Examples where countries have shown more resistance to Chinese lending, or demanded greater scrutiny and more prudent borrowing, include Malaysia (cancelling three BRI projects), Bangladesh, Indonesia, Thailand and Sierra Leone.

2. Transparency in lending

If the focus of international policy on EM sovereign debt over the past 20 years has been focused on trying to make debt restructuring more orderly, then the future policy agenda may be shaped by global initiatives

to promote sustainable lending and greater transparency in lending, such as the IIF/G20 Debt Transparency Initiative, as a direct reaction to recent events. This should have benefits both in terms of crisis prevention and, if it comes to it, crisis resolution.

The international agenda for much of the past 20 years has in no small part been influenced by the official sector's fear of 'holdout creditors' (aka vultures), following Argentina's post-default 2001 default experience. Arguably, it was also because the debtor behaved so badly, through its 'take it or leave it' offer, but the threat of holdouts destabilising future restructurings forced the notion of mechanisms to ensure orderly restructurings up the agenda. The IIF/G20 best practice, codified in the *Principles for Stable Capital Flows and Fair Debt Restructuring* (November 2004), was an important step on this road. Specifically, bond contracts have pursued legal remedies; first, through the mainstream introduction of CACs for EM sovereign bonds (commencing with Mexico in 2003); and, second, more recently, with the introduction of aggregation clauses to better bind the majority over a series of bonds.

What next? As recent experience of some developing markets shows, perhaps there needs to be more attention paid to controlling sovereign borrowing, and shadow borrowing, in the first place. The experience of Mozambique's hidden debt saga might be another example where one incident can set a global agenda and have repercussions for some time to come. It has shone a light within the IMF and wider official sector community over borrowing and lending practices, governance and data reporting. But this is not easy for the IMF and IFIs to police, especially outside a Fund programme (when a lot of lending that could eventually cause distress occurs), when they have less influence and leverage, especially when there is always a willing lender given the size of the global capital market (private and official).

As a result, the notion of debt transparency is moving up the international policy agenda. One idea is to encourage lenders to disclose more information about the nature of their lending through a voluntary code of conduct (eg the amount of a new loan, interest rate and repayment profile) and make comprehensive debt data more accessible. One idea is even to create a central registry of lending, but this not without its difficulties. We make three observations here. First, the focus it seems is very much on private sector discipline, although, given the preceding discussion, the same emphasis should also be applied to non-traditional bilateral creditors too. Second, regarding private sector lending, while there may be little impact on the public side (bond issuance), which by nature tends to be fairly transparent, it would have wider repercussions for private placements, bank lending and the loan market, which by definition tends to be less transparent. Third, although there is no intention to promote this transparency initiative through force (the focus is on voluntary framework), private sector lenders in particular might worry that slow or limited uptake could lead to a more coercive approach. Yet, in sum, if it means less, and more expensive, but higher-quality lending, that may be applauded. It will demand greater responsibility from both sides, creditors and debtors, especially in the strengthening of debt management operations of frontier issuers with limited track records in the market and weaker institutional capacity.

Ultimately, whether the official sector takes a stick rather than carrot approach or relies on self-regulation will be determined in ongoing discussions within the various official fora on this topic, such as the new G20/IIF work on voluntary debt transparency principles launched in April 2018. However this initiative unfolds, and we think there is sufficient momentum from both the official sector and private sector, including lenders and financial firms, as well as civil society, to ensure it does not just fade away, it is likely to lead to some changes.

And finally

This Guide is written for the serious frontier market investor, policymaker or academic analyst who is looking to maximise returns, improve policymaking or advance research through superior knowledge. We provide analysis and outlooks for 42 frontier economies (with additional countries available on our website), along with detailed descriptions of their debt histories and restructuring experiences, and with the main investable instruments in the hard currency sovereign and corporate space in each. We aim to give our clients a convenient reference point to check details on loans and illiquid bonds and include as many frontier markets, illiquid instruments, nonperforming or restructured bonds and loans as possible.

We hope you enjoy reading and using the latest edition of the Exotix Capital Guide.

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