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The COVID-19 pandemic and emerging market restructurings: The view one year later

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As was widely forecast over a year ago when the pandemic first struck countries around the world, the global economy suffered a major contraction in 2020, and the emerging markets also experienced a significant decline in GDP (although not as steep a decline as the advanced economies). Global growth declined by approximately 3.3% in 2020, and growth in emerging economies and developing countries declined by approximately 2.2% over the same period, according to the International Monetary Fund (IMF).

The economic landscape

However, one possible surprise has emerged: the global economy has recovered more quickly than expected, and the emerging economies in aggregate have rebounded as well. Indeed, the latest economic projections from both the World Bank and the IMF indicate that global economy overall and the emerging economies in particular are projected to grow in 2021 and 2022. For example, in its late March "World Economic Outlook" report, the IMF was forecasting growth for the global economy of 6.0% in 2021 and 4.4% in 2022 and was forecasting growth for the emerging economies of 6.7% in 2021 and 5.0% in 2022.

China, whose economy was the first to shut down in the wake of the spread of COVID-19 in China during the first quarter of 2020, began to recover quickly in the second quarter of 2020 when factories in China started to reopen and Chinese workers started to return to their jobs. In fact, China registered GDP growth of 11.5% in the second quarter, making China the only country among G20 countries to grow during that time, according to the OECD. After growing a mere 2.3% in 2020 (China's lowest growth rate in several decades), China is expected to grow at a fairly robust 8.4% in 2021 but at a slower rate of 5.6% in 2022, according to the latest projections from the IMF.

Other major emerging economies are also expected to experience relatively healthy growth rates, especially when compared to their growth rates in 2020 when global growth collapsed as it has just a few times in the last century or longer.

For instance, just a couple of months ago, India was expected to be a star performer in the global economy in 2021, and the IMF was projecting in its late March forecast that India's economy would grow by 12.5% in 2021 and by 6.9% in 2022. Yet, those forecasts were made before India was unfortunately struck by a devastating second wave of COVID in recent months. Projections for GDP growth in India that were made early this year, before the onset of the second wave in India, will almost certainly need to be recalibrated in order to take account of that recent surge in COVID and its expected adverse impact on the Indian economy.

The emerging economies as a whole have relatively strong tailwinds behind them for 2021, particularly with the expected growth in the Chinese and US economies. The US economy is projected to grow by 5.1% in 2021 and 3.6% in 2022, according to the latest IMF projections. The US economy is expected to be propelled forward by the trillions of dollars being pumped into the economy in connection with, among spending programmes, the recently enacted US$1.9 trillion recovery plan and, if enacted in one form or another, the potential infrastructure plan and social spending programmes that have been proposed by the Biden administration.

While commodity prices across the board

plummeted in the early months of 2020, they have since recovered, and this has naturally benefited a number of the many emerging markets whose economies are heavily dependent on commodity exports. For instance, the US Energy Information expects the price of oil to average above US$60 per barrel in 2021 from an average price of just below US$42 per barrel in 2020 (although the price was much lower at certain points in 2020), and many non-oil commodity prices such as various metals are reported to have recovered even more strongly than oil prices.

Furthermore, the resumption of global trade, after its virtual collapse particularly in early 2020, has been a boon to those emerging economies which are very trade-dependent, such as those emerging economies that are heavily tied into global supply chains.

Nonetheless, the aggregate numbers for the emerging economies mask certain underlying realities that belie the seemingly relatively bright prospects for the emerging economies in the next few years. In the first place, as in the wake of the global financial crisis in 2008-09, China is contributing the lion's share of growth among emerging economies as a whole. Specifically, without China in the picture, the growth rate in emerging economies and developing countries for 2021-22 drops from 4.6% to 3.5%, according to World Bank forecasts.

Further, the aggregate numbers do not point up the divergent growth rates in different regions around the world. For example, a group of five major emerging economies in Southeast Asia are expected to grow at a decent (although certainly not blockbuster) rate of 4.9% in 2021 and 6.1% in 2022. However, emerging economies in other geographic regions, such as Latin America/Caribbean, the Middle East/North Africa, and Sub-Saharan Africa, are expected to grow more slowly. This is part of what economists are referring to as a "multi-speed" economic recovery.

Finally, the aggregate numbers for the emerging economies, which generally look encouraging, do not highlight another less positive fact — namely, what those numbers would have looked like if there had been no COVID crisis. The bottom line is that the COVID crisis is believed to have essentially shaved off a few percentage points of GDP growth in the coming years for many emerging economies and developing countries (compared to what had been projected pre-COVID). Indeed, the IMF has pointed out that many emerging market and developing countries are not expected to return to pre-pandemic growth levels until 2023.

Even with the improved economic growth expected for the emerging economies in the next couple of years compared to the major contraction experienced by many of these economies in 2020, the emerging economies are not yet completely out of the woods. To begin with, the availability of the COVID-19 vaccines has been fairly limited in many emerging economies and developing countries. Thus, as has been widely discussed by public health experts, there is always the risk the pandemic could continue to fester in some of these countries for the foreseeable future and that new variants emerging in these countries could then spread to other countries (with the associated deleterious health and economic effects).

Apart from the tragic and heartbreaking situation in India discussed above, other important emerging economies have not emerged from the danger zone when it comes to the pandemic. For instance, the two largest economies of Latin America, Brazil and Mexico, have continued to experience high COVID infection and death rates, and the vaccination rates in both of these countries have been fairly low so far.

Despite the more positive outlook expected in 2021 for the global economy as a whole and the emerging economies in particular, there will continue to be several vulnerabilities in the emerging economies going forward. First, several of the sectors that were hardest hit by the COVID-related economic slowdown — including, for example, tourism/hospitality and the airline industry—could continue to suffer for the foreseeable future.

In fact, the global airline trade association, the

International Air Travel Association (IATA), has predicted that global passenger traffic will not return to its pre-pandemic levels until at least 2024. Further, a full-scale resumption of international air travel may depend in no small part on countries and/or airlines instituting a system based on so-called vaccine passports or similar travel passes.

Accordingly, the many emerging economies around the globe that are heavily dependent on international tourism may experience a noticeably slower recovery than some other economies less dependent on tourism.

Second, many emerging economies and developing countries may suffer now and in the coming years from what economists are now referring to as the "scarring" effects of the COVID crisis — i.e. the longer-term negative fallout from the crisis. Most notably, it is estimated that over 100 million people worldwide have fallen back into poverty as a result of the COVID crisis, according to the World Bank. Moreover, with nationwide lockdowns leading not just to the closure of businesses but schools as well, millions and millions of children in these countries risk falling seriously behind in their education which represents a serious blow to the development of human capital in these countries.

Third, with national budgets strained by the COVID crisis, governments have not been able to make the necessary investments in infrastructure development which is considered key to economic development in these countries. In addition, with constrained cash flow resulting from the economic slowdown, many businesses have not been able to make the necessary investments in capital equipment which is considered essential to productivity gains in these economies.

Sovereign debt restructuring

As was foreseeable a year ago and indeed as was predicted by many observers, emerging market sovereigns experienced rough sledding in the last year. There were a record number of sovereign defaults among emerging market economies during this period. Six emerging market economies defaulted over the last year, including Argentina, Belize, Ecuador, Lebanon, Suriname, and Zambia. Separately, a number of countries, at least those which still had the capability to tap the debt markets, may have layered on additional sovereign debt during the COVID crisis and thus may have further exacerbated any debt sustainability challenges that those countries were already facing pre-pandemic.

While the past year was a fairly active year on the sovereign debt restructuring front, this area is widely expected to become even more active in the next few years as the impact of the pandemic-related economic slowdown continues to work its way through the system. Moreover, on the debt sustainability front, many emerging economies and developing countries are currently considered to be (or, in the coming years, are expected to be) in a state of debt distress or at high risk of debt distress.

Serial defaulter: Argentina

A few restructuring situations that were in progress early in 2020, such as those involving Ecuador and Argentina, came to successful conclusions in the third quarter of 2020. Argentina upheld its reputation as a serial defaulter with its bond default late last May, a record ninth default for Argentina since it became an independent nation in 1816. But even before the default in May 2020, Argentina had been engaged in debt restructuring negotiations with its foreign bondholders. After months of a somewhat tortuous negotiation process, Argentina finally struck a deal with its foreign bondholders in early August 2020.

The Argentine sovereign debt restructuring was notable for several reasons, among them the fact that it was clear that the pandemic affected the ultimate outcome. Indeed, it may have even cost the creditors at least a few cents on the dollar in their projected recoveries under the restructuring plan that was ultimately agreed to by Argentina and its creditors — i.e. what might be termed a "*pandemic discount*."

In the restructuring negotiations, the creditors were basically walking a very fine line. On the one hand, the bondholders naturally wanted to maximise their recoveries and were therefore motivated to drive as hard a bargain as possible with the Argentine government. On the other hand, the bondholders needed to be sensitive to the fact that if they pushed too hard for a higher recovery, they might be perceived as forcing the government to prioritise debt service payments over necessary health care expenditures to combat COVID (and thereby putting the lives of Argentineans at risk).

As one of the most important post-restructuring pieces of business, Argentina for the last several months has been engaged in discussions with the IMF over how to address, whether through refinancing, debt reprofiling or otherwise, the IMF's outstanding loan of US$45bn to Argentina, the largest ever in the history of the IMF.

The purpose of the loan was to help the Argentine government of President Mauricio Macri to address an economic crisis that was confronting Argentina in 2018, including a serious run on the Argentine peso that was then underway. Nonetheless, the loan was not able to stem the continued deterioration in the Argentine economy.

At the present time, Argentina needs to reach a deal with the IMF because it has very heavy debt service payments due to the IMF in the next few years, including approximately US$4.8bn due by the end of 2021 and approximately US$38bn due in the following two years. Yet, to put it mildly, the IMF has never been particularly popular in Argentina, and as a result Argentina has not enjoyed especially cordial relations with the IMF over a long period of time. Even so, Argentina's new president since December 2019, Alberto Fernández, and his Economy Minister, Martin Guzman, have tried to keep the Argentine government's current relationship with the IMF on a relatively even keel.

By contrast, Vice President Cristina Fernández de Kirchner, formerly Argentina's president from 2007-15 and still a very influential voice in the Argentine government, has been seemingly marching to a different drummer. She has argued that Argentina should not repay the IMF loan since she considers to the loan to have been "illegal," and she has said, for instance, that the loan was used only to finance capital flight from Argentina and that Argentina should therefore not feel bound to repay the loan.

In short, it remains to be seen what type of deal the Argentine government will be able to reach ultimately with the IMF. Specifically, the issue will be how accommodating the IMF will be vis-à-vis Argentina in light of Argentina's current economic travails, as well as how receptive the Argentine government will be to any demands from the IMF that it adopt stringent austerity measures as part of any new IMF deal , particularly with upcoming mid-term legislative elections in a few months.

Failing states: Lebanon and Venezuela

Other sovereign debt situations continue to frustrate any easy resolution, mostly because the underlying economic and financial circumstances of the countries in question are so dire and the political situations in the countries are in such disarray. As will be discussed more fully below, Venezuela is a dramatic case in point of a failing, if not a failed, state, but Lebanon is also another example of a deeply troubled state.

The fundamental questions with respect to failing (if not failed) states conducting sovereign debt restructurings are essentially two-fold: First, how does one restructure a country's sovereign debt when the underlying national economy that will ultimately generate the revenues to repay that restructured debt is in a state of collapse or near-collapse? Second, how can creditors have meaningful restructuring discussions and negotiations with a sovereign debtor whose government/political system is in substantial disarray?

Lebanon, which has approximately US$31bn of outstanding sovereign bonds, defaulted on a US$1.3bn Eurobond in March 2020. However, Lebanon has had major financial and economic difficulties for several years even pre-pandemic — difficulties that have only worsened in the recent months. The Lebanese economy is suffering from rampant inflation, an increasingly weakened currency, high unemployment, dwindling foreign exchange reserves, and a stagnant growth for a number of years followed by a 25% contraction in the economy in 2020 (with a further 9.5% contraction expected in 2021). Lebanon also has a nearly insolvent banking system.

In a very troubling new report released in early June just as this article was going to press, the World Bank expressed the view that Lebanon's economic and financial crisis is likely to rank as one of the three most severe crises that the world has seen in more than 150 years. Lebanon is also facing myriad serious social ills, including very high levels of poverty among its population as well as major shortages in essentials such as medicines and fuel.

But Lebanon's political situation is almost as equally unsettled and dysfunctional as its economic/financial situation. In fact, Lebanon has only had a caretaker prime minister since last August. The dysfunction in Lebanon's governance was brought into sharp relief by the huge, tragic port explosion in Beirut in early August 2020.

Since Lebanon's default just over a year ago, a rescue package from the IMF has been viewed by the acting Lebanese government (such as it is) as effectively the silver bullet that would resolve Lebanon's difficulties or at least put Lebanon on a path to recovery. But under the current circumstances in Lebanon, it is hard to imagine that the IMF could or would enter into a major rescue package with Lebanon.

Specifically, with the Lebanese government in such disarray, which officials in the Lebanese government could the IMF negotiate with in a meaningful way, and who would there be in the government to carry out any "reforms" that the IMF would almost certainly insist upon as part of any rescue package? Moreover, with the Lebanese economy in a state of near-collapse, how could the IMF (or any other creditors, for that matter) have confidence that Lebanon would be able to climb out of its deep economic and financial hole anytime soon, with or without any "reforms" that would be proposed by the IMF?

For its part, Venezuela has been in default on over US$60bn in bond debt since late 2017. Yet, a debt restructuring seems to be no closer at hand today than it was a year or two ago. It is hard to conceive of a debt restructuring taking place between Venezuela and its international creditors as long as the Maduro regime remains in power and also as long as the current US sanctions remain in place (since among things, US sanctions prevent US persons from negotiating with certain "specially designated nationals" in the Venezuelan government).

Even if Venezuela could get to a place where it could undertake a debt restructuring, it would face truly daunting challenges. Of paramount importance, the Venezuelan people are facing an absolutely grave humanitarian crisis which is reflected in extremely high levels of poverty, malnutrition and disease.

Moreover, the Venezuelan economy has been collapsing for the last several years, and it contracted by approximately 65% between 2013-19 and was estimated to have contracted by approximately 25% in 2020, according to the IMF.

In its current condition, Venezuela is widely considered to be a failing state, if it is not already a failed state. Consequently, conducting a sovereign debt restructuring — and, crucially, also rebuilding a national economy — under those circumstances will be incredibly difficult at best, particularly if in the interim the Venezuelan economy continues its precipitous decline of recent years.

Zambia's default and the China/bondholder dynamic

Zambia, one of the world's largest copper-producing countries, went on a borrowing spree starting roughly in 2012 and built up a debt burden of over US$12bn, resulting in a high debt-to-GDP ratio, always a red flag for creditors and investors. Zambia ended up defaulting in November 2020 on a US$42.5m coupon payment to the holders of its Eurobonds, the first default of an African sovereign during the pandemic.

Just prior to its default in November 2020, Zambia had been attempting to negotiate with its bondholders a deferral of debt service payments until April 2021. Zambia said it would try by that date to work out an overall restructuring deal for all of its outstanding debt (including reaching a possible deal with the IMF).

In considering this deferral request from Zambia, the bondholders were reportedly seeking greater transparency concerning the terms and scale of the Chinese loans to Zambia since they were apparently concerned that any debt relief that they provided to Zambia might be used to repay Chinese loans. The bondholders were also reportedly seeking greater clarity as to how Zambia intended to deal with other creditors, including Chinese lenders, and in particular whether there would be equal treatment among all creditors. Moreover, the bondholders were apparently not convinced that the Zambian government was firmly committed to reaching a deal with the IMF (including agreeing to any associated IMF "adjustment" program) which the bondholders considered to be an essential element in resolving Zambia's overall debt sustainability issues.

The Zambian government's finance minister took the position that confidentiality agreements "prevented him from disclosing [to the bondholders] the terms of the country's loans from China," as reported at the time in the *Wall Street Journal*.

As a result of the impasse between Zambia and the bondholders over disclosure of information concerning the terms and scale of the Chinese loans to Zambia as well as other bondholder concerns (including what they claimed was a lack of engagement with them by the Zambian government), the talks between Zambia and its bondholders eventually collapsed, and that ultimately led to the bond default by Zambia.

For our purposes, the Zambian default is significant because it could, in a manner of speaking, be the "canary in the *copper mine*" as to what may be to come with other sovereign issuers of debt in Sub-Saharan Africa (SSA). A number of these countries in SSA tapped the capital markets for first time ever in the last several years, and thus in any future restructurings involving SSA sovereigns, bondholders may well constitute an important creditor constituency for SSA sovereigns in view of all of the capital market debt that has been issued by new and old SSA issuers alike.

Moreover, of critical importance, China in recent years has also become the largest bilateral lender to countries in Africa generally, but its lending activities and the terms of its loans are considered to be fairly opaque. Also, China lends through many different types of institutions, from its policy banks (e.g. China Development Bank, China Export-Import Bank, etc.) to some of its large state-owned commercial banks as well as some of its state-owned enterprises, and the Chinese approach to restructuring in any particular case may depend in part on what types of Chinese lending institutions are involved.

However, at least in the COVID era, the Chinese playbook for sovereign debt restructuring in the emerging markets and developing countries may still be a work-in-progress, or, to a certain extent, that playbook may simply not be well understood by non-Chinese creditors, possibly in part because of what many consider to be the fairly opaque nature of China's lending and restructuring transactions.

Many SSA nations are currently either in a state of debt distress or at high risk of debt distress, according to a recent IMF report, and this could potentially give rise in the not-too-distant future to a number of new SSA sovereign debt restructurings and/or sovereign debt defaults. Thus, there is a distinct possibility in the coming years that other SSA sovereigns may undergo their own Zambia-type debt restructuring scenarios marked by serious intercreditor conflicts between parties such as Chinese lenders, bondholders, and even non-traditional lenders (e.g. multinational mining/commodity trading firms such as Glencore).

Only time and experience will tell whether the recent G20 initiative known formally as the "Common Framework for Debt Treatments beyond the DSSI" will provide a reliable mechanism for addressing, for instance, the types of intercreditor disputes discussed above in sovereign debt restructurings in the emerging economies and developing countries. Nonetheless, since Zambia was one of the first sovereigns to request a "debt treatment" under the Common Framework, it may serve as an early test case of the efficacy of the Common Framework in resolving relatively thorny restructuring situations, and the Zambia case (together with a few other recent cases) may also illuminate whether in practice the Common Framework will be able to fully engage all creditors – private creditors, Paris Club creditors, and non-Paris Club bilateral creditors such as China – in equitable burden-sharing.

Corporate debt restructurings

For the emerging economies (possibly like advanced economies), insolvency filings have been fairly muted over the last year, and this is a likely result of several factors. Of course, the expansionary fiscal and/or monetary policies that were adopted in many economies in response to the COVID crisis helped to soften the economic blow from the pandemic. Further, lenders in many jurisdictions granted borrowers forbearance (including payment deferrals or holidays) for an extended period of time, and thus as a result the number of defaults in these jurisdictions was in effect artificially reduced.

In addition, the governments in many jurisdictions adopted changes to their insolvency laws that, among other things, relaxed requirements that companies file for insolvency upon the emergence of financial distress. Meanwhile, other jurisdictions (such as India) suspended the operation of their insolvency laws altogether for a specified period of time during the COVID crisis.

The flip side of this is that once these developments — such as the expansionary government policies, the bank forbearance policies, and the insolvency law relaxations — come to an end, then the number of insolvency filings could surge. Some observers are even predicting that there might be a tsunami of insolvency filings at that point, but whether or not there will be a tsunami of filings or rather instead a smaller but still not insignificant surge of filings remains to be seen. It is expected that small and medium-sized enterprises (SMEs) in particular could constitute a large part of the universe of firms that may experience financial distress in the coming period.

Furthermore, even as emerging market and developing country corporates entered the COVID crisis with a high level of corporate debt, there has been a further major buildup of debt among corporate borrowers during the COVID crisis itself. This could lead to debt servicing difficulties among corporate borrowers and could usher in a new wave of defaults, restructurings, and non-performing loans (NPLs) in the emerging economies and developing countries.

Nonetheless, if and when there is a sharp increase in insolvencies and restructurings in emerging market jurisdictions, this could pose a major problem for the court systems in the emerging economies and developing economies. These court systems, which even in the best of times do not necessarily have the capacity to deal with a large volume of cases and/or cases involving any degree of complexity, may find themselves overwhelmed with new filings.

In sum, if they are to be able to deal effectively with the expected surge in insolvencies and restructurings, the governments in the jurisdictions in question may need to encourage the relevant stakeholders to make much greater use of out-of-court restructuring mechanisms as opposed to formal in-court proceedings. Finally, the governments will have to do their part in developing the legal/regulatory frameworks and/or institutional platforms that could help facilitate expedited out-of-court restructurings.

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