Bonds Issuance and the current debt levels in Sub Saharan Africa

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Introduction

After the global financial and economic crisis of 2008, there has been a substantial increase in sovereign bond issuance in Sub Saharan Africa. The total value of bonds issued increased by over 620% from $1 billion in 2011 to $6.2 billion in 2014[1]. Steady global market conditions and the potential for higher returns for investors have helped pave the way for more access to international markets, where the average return for these bond issuances is about 6.6%, with an average maturity of 10 years[2]. These bonds have contributed to 147% increase in external debt stock for Sub Saharan Africa between 2010 and 2015. The total debt stock increased from US$282.9 billion to US$416.3 billion respectively[3]. While additional resources from the issuance of bonds go a long way in providing sovereigns with the additional resources for development, they will have negative implications on the economic development of the debtor country if not managed properly. The focus of this policy brief is on how bond issuance has contributed to an increase in debt external debt levels and what lessons can be learnt as result bond issuance experiences.

1 (IDS, 2016)
2 http://blogs.worldbank.org/opendata/sub-saharan-africa-s-sovereign-bond-issuance-boom
3 World bank

Bond issuance and debt management in Sub Saharan Africa (SSA)

Sovereign bonds present African countries with 'relatively' inexpensive new sources of external sources of external finance for economic growth. A government bond is a debt security issued by a government to support government spending. The issuance of bonds, once a rare phenomenon in Sub Saharan Africa, is now on a rising trend. This new phenomenon has raised a number of questions such as: i) Have SSA countries made the right choice in issuing sovereign Eurobonds and when should they issue more bonds? ii) What is the development impact of sovereign Eurobonds? These are questions that should not be ignored by policy makers and debt management campaigners in Africa.

There has been more focus on how bonds change the composition of public debts. However, there is need to shift focus on how they increase the debt level of issuing countries. As depicted in Figure 1, since 2008 there has been a noticeable increase in the value of bonds and the value of the external public debt of SSA.

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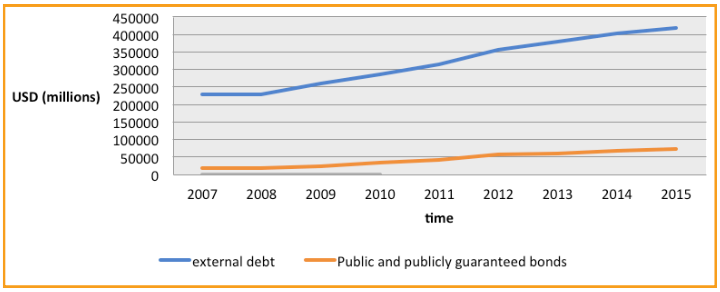
Bonds and HIPC

It is interesting to note that even though some African countries had managed to lower their debt levels under the HIPC and Multilateral Debt Relief Initiative (MDRI), however since 2008 most of these countries debts have continued to increase. After receiving the reliefs, external debts fell. However, the relief seem to be temporal since the savings of countries will be spread over a long time and countries would continue to borrow. For example, Tanzania's external debt fell from $3.8 bn in mid-1999 to $2.6 bn in 2001, expressed in net present value. The same is for Mozambique whose debt rose more than double after the issuance of bonds. Recent data points out that sovereign bond issuance are correlated to external debt level[4].

Figure 1: Trends of public and publicly guaranteed and external debt in SSA



Source: World Bank (2017)[5]

The growing trend in the level of external debt in SSA is partly explained by the issuance and guaranteeing of bonds by governments. From 2007 to 2008, the value of bonds has increased by 402%. As it shall be noticed, the share of bonds has steadily increased compared to other types of debts. The increase in bond issuance is attributed to the fact that they offer an alternative source of finance; the money is not subject to the conditions usually attached to loans from rich countries or multilateral organizations; critical infrastructure can be financed at cheap rates generated by relaxed monetary policies pursued by developed countries; and bonds carry less stringent terms with reasonable periods of repayment.

Drivers of bond issuance

There are a number of reasons why the issuance and guaranteeing of bonds is now fashionable. The drivers of bond issue are categorized into two, namely: international investor demands and country specific factors.

a. International investor demand

Prospects for economic growth in advanced economies have been muted with a prospect of the new averages in the major advanced and emerging economies. This has led investors to hunt for higher yields outside the advanced and emerging markets. The opportunities presented by the African regions positive growth and economies also increased the appetite for investors to buy bonds. Capital has flowed into frontier markets through a number of investment vehicles. The broadening of investor classes that included regulated funds was encouraged by high returns in 2012 and 2013 which led to increased flows into frontier market funds. The broadening of the investor base increases the potential pool of capital that can be mobilized for investment.

4 Overseas Development Institute (2014)
5 http://datatopics.worldbank.org/debt/ids/country/MOZ

b. Country specific factors

i. **Macroeconomic fundamentals** - The demand for bonds from the SSA have been driven by investors views termed "Africa rising" in financial markets. Africa's general macroeconomic outlook has improved with better management and stability of macroeconomic fundamentals giving strong differential growth relative to other economies. Perceptions of social and political factors and the business environment have also improved.

ii. **Credit ratings** – The credit ratings of many SSA countries have significantly improved as a result of debt cancellations under the High Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Programme (MDRP). This has positively affected the categories within which the bond issues were marketed. Credit ratings are important because they determine a market consensus relating to the credit risk of a bond.

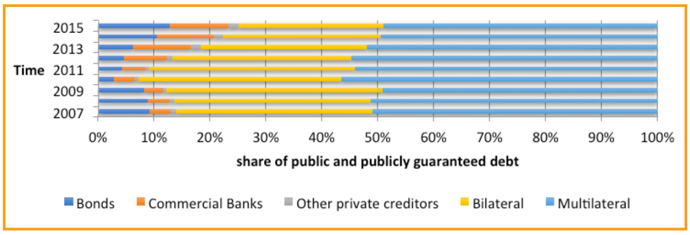
iii. **Attractiveness of issuing terms** - Generally, there is a preference for bonds to be listed on international stock exchanges with legal governance in established jurisdictions for financial markets. These allow ease of secondary trading, price discovery and trusted legal processes in the event of any default or disputes.

iv. **Financial market development** – Many SSA countries have managed to present opportunities risk management and this has resulted in the growth of the investor base and appetite. The financial market has also developed through improvements in foreign exchange, interests and credit derivates.

The growing share of bonds in relation to other types of loans

Bond issuance and guaranteeing has resulted in changes of the composition and patterns of public and publicly guaranteed debts and creditors. Expressed as a percentage of the external debt stock, the share of public and publicly guaranteed bonds has risen from 7.95% in 2007 to 17.41% in 2015 in the SSA region. Recent data shows that sovereign bonds have generally reduced the share of multilateral and bilateral debts. After the debt cancellations of 30 SSA countries, there has been a shift towards the issuance of bonds as they provided an alternative source of finance for development.

Figure 2: Patterns and composition of public debts in West Africa[6]

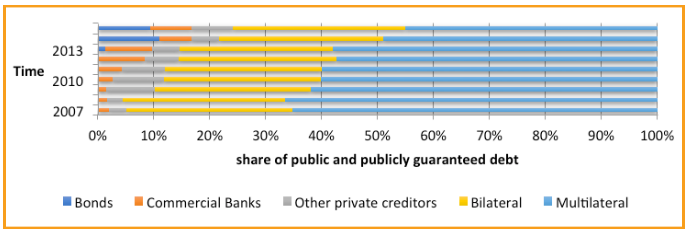


In West Africa, on average, the share of bonds soared from 2007 to 2010 as result of the increase in the share of bilateral loans. The major contributors of bond share in this region are Ghana, Guinea, Cote d'Ivoire, Nigeria, and Senegal. In 2011 they steadily increased from about 4% to about 12% in 2015. During that same period, the share of commercial loans from banks also significantly increased. This has resulted in the decrease in the share of bilateral loans from 38% to 28% and multilateral loans from 54% to 49%. Loans from other private creditors are

6 West Africa: Cote d'Ivoire, Nigeria, Senegal Gambia, Ghana Guinea Guinea-Bissau Liberia Mali Niger Sierra Togo Mauritania Leone Sao Tome and Principe Sierra Leone

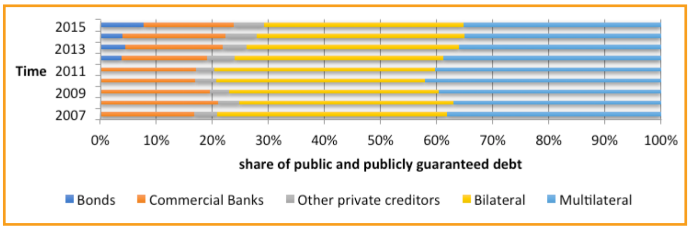
hovering below 3% between 2007 and 2015. This is because they attract high interests and short periods to pay.

Figure 3: Patterns and composition of public debts in East Africa[7]



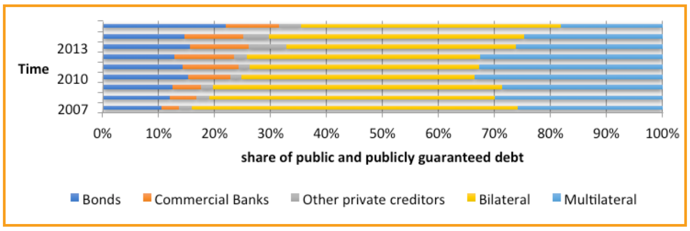
Data for East Africa concerning bonds is from 2013 to 2015. This probably due to the fact that no bonds were issued or there is no data for the other years. The share of bonds in 2013 stood at about 1% and rose drastically to 11% in 2014. In 2015, it slightly soared by 2% to 9%. Kenya (which has the largest share), Ethiopia and Rwanda are only the only contributors to the bonds share in the region. Commercial loans from banks also increased during the period under review. The general trend is that this has resulted in declining of the share of multilateral debts to less than 50% of total loans. Bilateral loans have generally maintained their share of about 30%.

Figure 4: Patterns and composition of public debts in Southern Africa[8]



Countries in the SADC region began issuing bonds in 2012. DRC was the first to issue USD 4424000 million worth of bonds in 2007 followed by Angola in 2011 then came Zambia in 2012 and Mozambique in 2013. The average amount of bonds issued in 2012 was USD 159,573,909.1 million, constituting 3% of total share of all debts. It then gradually increased to about 8% in 2015. Commercial bank loans fluctuated between 15 and 20% during the time under review. The shares of bilateral loans and loans from other private sources have also been relatively constant. However, multilateral loans grew steadily to about 42% in 2010 and began to shrink to around 35% in 2015.

Figure 5: Patterns and composition of public debts in Central Africa



Bilateral loans constitute a greater share ranging from 45% to 60% as compared to other types of loans. The share of bonds has fluctuated between 11% and 14% between 2007 and 2014. In 2015 there was a sharp increase to 22% (USD 673512200 million). The major contributors are The Republic of Congo, Gabon and Cameroon. Commercial loans increased from 3% to about 10% in 2015. Other loans from private creditors hovered below 8%. They peaked up to 7% in 2013.

7 East Africa: Ethiopia, Kenya, Rwanda
8 Southern Africa: Angola, Zambia, Tanzania

From the figures above it can be observed that there is a growing trend in the issuance of international bonds by SSA countries. On average, countries in the Central African region have the largest share of bonds, followed by Western, Eastern and Southern Africa. The issuance of bonds has resulted in the souring of concessional multilateral loans which roughly carried an average interest rate of 1.6% and a maturity of 28.7 years. The financing from sovereign bonds comes at an average floating coupon rate price of 6.2% with an 11.2 year maturity period. As observed earlier; this has increase in the debts and worsened the debt sustainability of issuing countries of many countries to levels above the pre HIPC era.

Risks associated with Bonds

One of the greatest risks of bonds is on the cost of finance for them. The need for internal analysis of the exchange rate risk is critical, unless the country truly believes that it has the capacity to raise the resources for repayment of the debt from commodity export revenue. Recent data shows that economic indicators are threatening. They are pointing to a slowdown in demand for commodities from China, a possible increase in bond yield rates by the US, lowering oil prices and downgrading of global growth indicators. These factors will put pressure on countries that have issued sovereign bonds.

Debt sustainability is also another risk associated with bond issuance. This risk is associated with poor management of the proceeds of the Eurobond. In many instances, proceeds from Eurobonds end up being invested in non income generating social infrastructure to the extent that the government is unable to raise the necessary funds to repay the loan. For example, Zambia unwisely spent a big chunk of the money from the sovereign debt on salary increases for its public servants. Mozambique borrowed $850 million for its national fishing industry but instead spent the money on military boats and equipment. Other country such as Rwanda, Gabon and Ghana have used part of their Eurobond proceeds to re-finance public debt.

If the proceeds from the bond loans are invested in non productive sectors, chances are high that countries will default. A number of countries have already defaulted on bond loans. Mozambique became the first African country to default since Ivory Coast in 2011 when it failed to settle an almost $60 million coupon which was initially due in January 2017. With a 5.6% probability, Senegal is the African bond issuer most likely to default in the next 12 months. Ghana turned to the International Monetary Fund for a bailout of almost $1 billion in 2015 after public spending and fiscal deficits ballooned. Its probability of defaulting has risen more than tenfold since 2011 to 3.4%. Zambia is classified as medium risk, with a 1.04% chance of missing debt payments in the next year. As per the Bloomberg model, countries such as Kenya, Angola, and Ivory Coast are classified as low risk.

Another risk associated with bond loans is the creation of vulture funds. Vulture funds prey on sovereign debt on the secondary market to own the debt of a sovereign nation. They undermining the progress achieved under the HIPC Initiative by refusing countries to enter into any negotiations for debt reduction, or any bilateral agreement negotiation with the debtor nation. Instead, the fund turns around and sues the state for the full value of the loan, plus interest, arrears and legal fees, attempting to recover 3-20 times the purchase price of the debt.

Lessons for the rest of Africa

In general, it is not a bad idea for a country to contract loans. Careful considerations should be taken on the type of debt and its implications on national development. The problem with loan contraction is when a country invests in non productive sectors. Non productive sectors have no capacity to generate resources for loan repayments. The repayment of loans in the non productive sectors implies that resources that are meant for social and economic development (e.g health and education) are diverted. This therefore calls for African governments to invest contracted loans in productive sectors rather than in consumptive sectors and use the funds for the specific purposes specified in the bond prospectus.

Countries also need to consider their absorptive capacities and the general micro and macro-economic environment. Before a country can commits itself to bond issuance, it has to take into account that it does not have budget deficits, non performing bank loans political instability and has good foreign reserves. At times projects will commence long after funds have been disbursed. This will reduce the maturity period thereby burdening the issuing country. This has brought a lot of problems to Cameroon after its bond funded infrastructural project began three years after the disbursement of the funds. Furthermore, although the banks are meant to assist with developing the bond market, they have a conflict of interest as they also wish to make loans to corporates who might consider issuing bonds.

Government debt management legislation is a central element that is aimed at ensuring sound financial policies and clear responsibilities, accountabilities and transparency. Chapter two of the Borrowing Charter talks about predictable rules and regulations regarding debt management. AFRODAD's Borrowing Charter Section 2.1 states that all the loan contraction rules and regulations must be anchored on the constitutional provisions defining how public loans should be obtained, used and serviced. The predictable rules and regulations on debt management must include the borrowing powers, borrowing ceilings, borrowing approval and the authorization process[9].

The loan contraction process should be transparent and governments should be accountable to the tax payers whose money is used to repay he contracted loans. Transparency and accountability in loan contraction ensures that the taxpayers through their elected representatives will approve all the government loans and are given feedback on the performances of the loans through regular reports from the ministries of finance.

Because of the strong investor appetite, sovereign bonds markets have provided a liquid source of funds and an opportunity to raise financing much more rapidly than lending where

9 Chilunjika, Chikova, Uwiyizeyimana 2016

lead times can be long. African governments should take note of the fact that they may get carried away by accessing these funds there by pushing their external debts to unsustainable levels. They should be cautious of the borrowing and guaranteeing limits which should be set in the debt management legislation. They should also strike a proper mix between all the types of loans and focus more on concessional loans.

Conclusion and Recommendations

Bond issuance is one of the ways which governments can use to access financial resources from the international market. Despite having relaxed conditions and monitoring, bonds increase the external debt stock of a nation. There is need for SSA countries to manage their debt portfolios prudently. Before countries contact loan, they need to take into account of the following factors: absorptive capacity, political stability, budget deficits, foreign reserves and non performing loans.

Loan contraction and the issuance of sovereign bonds should be transparent and the government should be answerable to the taxpayers who will have to repay the contracted loans. The terms and conditions of the financing agreement should be disclosed to the sovereign borrowers.

Contracted loans should be invested in productive sectors which have the capacity to generate resources for repayment. This eases the debt burden on the taxpayers and allows the governments to provide more resources for social and economic development.

Debt management legislations should put a cap on the borrowing and the guaranteeing of both public and private loans. In countries where these legal procedures are already im place it is important to ensure that bond issuance is following the normal debt contracting processes in line with the governments own constitution, institutional and legal frameworks.

There is need to put in place mechanisms that ensure that funds are used for their specific purposes they have been borrowed for. Countries without legislation should put in place comprehensive legal frameworks that define the procedures, responsibilities and accountabilities in the bond issuance process to ensure that the process is in the best interests of the citizens.

Sub Saharan Africa sovereigns should put in place robust contractual instruments to facilitate a possible restructuring whether in terms of enhanced collective action closes, modified pari passu or to support the establishment of a Sovereign Debt Workout Mechanism at the global level.

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