NOPOOR POLICY BRIEF

nopoor Enhancing Knowledge for Renewed Policies against Poverty

NO. 32

FINANCE FOR DEVELOPMENT: ARE SOVEREIGN BOND ISSUES IN SUB-SAHARAN AFRICA SUPPORTING SUSTAINABLE DEVELOPMENT?

January 2017

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In the past sub-Saharan African countries have mainly relied on grants and loans from bilateral and multilateral donors to finance development. However, since 2006 this has changed considerably: Fifteen countries have now issued sovereign bonds. This brief provides an up to date overview of these bond issuances and discusses the associated opportunities and risks.

INTRODUCTION

In 2006 the Seychelles were the first sub-Saharan African country to issue sovereign bonds. Another fourteen countries have followed suit and these loans from the international markets amounted to about $26 billion by the end of 2015. At the root of these changes in finance is the global financial crisis. Low returns in high income countries made investors look for new opportunities and they found them in the frontier economies in sub-Saharan Africa. Natural resource discoveries, e.g. oil in Ghana, high commodity prices and GDP growth rates resulted in a strong economic outlook. For African governments borrowing in the international markets is an attractive option, because they can use the funds for purposes of their choice rather than adhere to the conditions stipulated by donors.

A sovereign bond is a debt issued by a national government. Money is borrowed and interest is paid until the loan matures, i.e. has to be repaid. Maturity rates for sub-Saharan African bonds are typically between ten and fifteen years. The terms of the bond sale depend on the maturity period and the government's creditworthiness. All of the sub-Saharan African government bonds are issued in dollars. When governments run into financial difficulties lenders typically agree to either delay in the repayment (debt restructuring) or to reduce the debt ("haircut" or "write-off"). A complete default on sovereign debt is extremely rare. More recently concerns have been rising regarding the sustainability of African debt. This is evidenced by the higher yields that are on offer with the more recent bond issues. For example Ghana paid a yield of 10.75% for their 2015 offer compared to the 8.5% yield offer for the 2007 and the 2013 bonds. Ghana's total debt to GDP ratio now stands at 78% of GDP. An even stronger indicator that the level of debt is not sustainable is that not only Ghana but also Angola and Mozambique turned to the IMF for help in 2015.

In this policy brief we provide information on bond issuances in sub-Saharan Africa and provide an assessment of the countries' debt sustainability.

EVIDENCE AND ANALYSIS

So far fifteen countries in SSA have issued sovereign bonds: Angola, Republic of Congo, Côte d'Ivoire, Ethiopia, Gabon, Ghana, Kenya, Mozambique, Namibia, Nigeria, Rwanda, Senegal, Seychelles, Tanzania and Zambia. There are number of reasons why African governments have been turning to the international market. Loans from multilateral development banks typically come with conditions attached, such as the reduction of public spending, fighting corruption and raising of tax revenue. In contrast, funds resulting from bonds are non-concessional loans. It is also only recently that African bond issues have become interesting for investors. Since the global financial crisis, interest rates in high income countries have been low and investors perceived sub-Saharan Africa is perceived as a region with high natural resource wealth and potential further income growth opportunities.

African governments raise funds for a number of different purposes and the issue prospectus states the intended use of the funds. Infrastructure investments and debt restructuring of existing debts are the main uses. However, government bonds can also be used to benchmark prices on the international markets for their corporates to borrow, examples include Nigeria and Kenya. The intended use is not disclosed in some cases (e.g. Tanzania). Figure 1 shows the amount of funds raised through bonds issuances. Côte d'Ivoire issued the highest total value of bonds ($4,050 million), followed by Ethiopia ($4,000 million) and Ghana ($3,500 million). Ten out of the fifteen countries are among those whose debts were forgiven, i.e. previously run into financial difficulties.

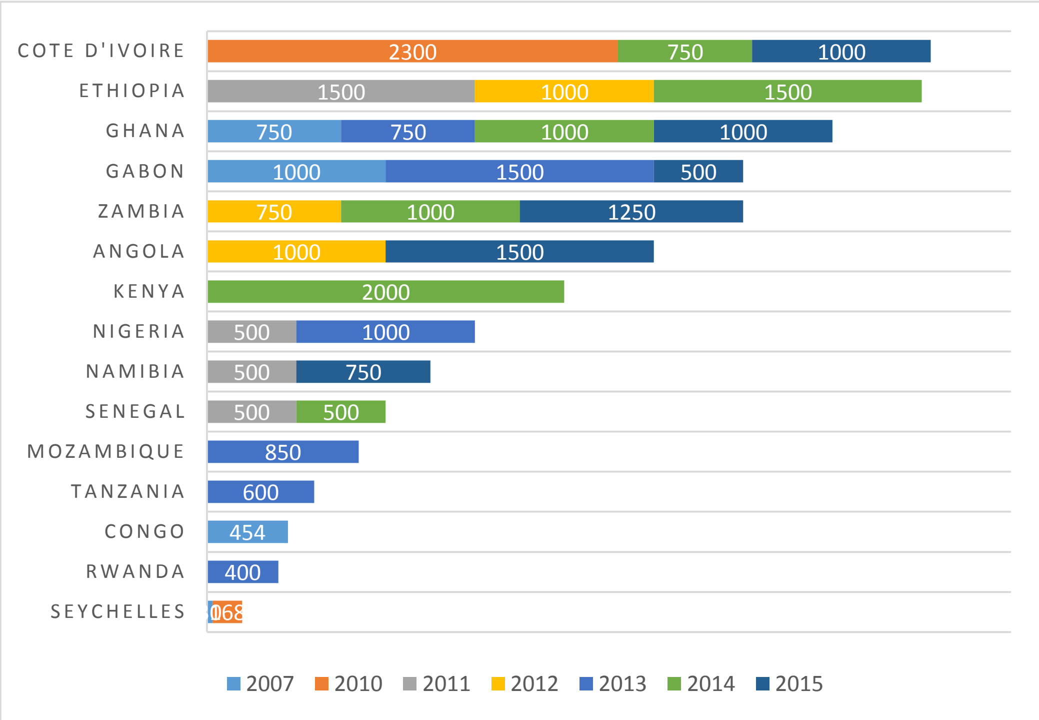
While bond issuances provide development opportunities that reflect the sovereign choices of African governments, there are a number of risks that countries face. These new opportunities may not result in accelerated development and we highlight four potential problems that pose problems for debt repayment:

1. **Exchange Rate Risks:** Since the debt is issued in dollars, African countries face an exchange rate risk. The inflow of capital should lead to an appreciation of their exchange rate which would help the countries to repay their debt, but in many sub-Saharan African countries this has not been the case, their currencies have actually depreciated. For example the Nigerian Naira depreciated by 20 per cent in 2015.
2. **Macroeconomic Risks:** Large scale capital inflows can lead to volatility, credit booms and inflation. This requires careful macroeconomic management and sterilization. In their absence capital flows, including those related to bonds, will result in financial instability. The fluctuations and trends in the international commodity markets also pose a considerable risk to

the ability of repaying the debt. Commodity prices for the primary exports in this region are falling and this is projected to continue. This affects oil and metal exporters like Nigeria, Angola, Gabon, Côte d'Ivoire, Ghana and Zambia.

3. **Project Overruns and Delays**: The result of project overruns and delays are higher project costs and decreased returns and thus make repayment more difficult. Project delays and cost overruns are common in many sub-Saharan African countries. Corruption, weak institutions, a poor regulatory environment and low capacity to evaluate and monitor projects are the main causes of overruns and delays.
4. **Diversion of Funds:** In some cases funds are diverted from their intended use. If the funds are used for unproductive purposes repayment is jeopardized. One example is the bond issue in Mozambique in 2012 which raised $850million with the aim to invest in a tuna fishing fleet. However, the funds have allegedly been used to build speedboats for the navy. Consequently, the "tuna bond" maturing in 2023 collapsed from 81.2 cents on the dollar to a low of 66.6 cents, which is equal to an annual yield of over 20 per cent. It is feared that Mozambique might renege on its debts.

Figure 1: Sovereign Bond issuances in SSA Excluding South Africa (2007-2015)



Source: International Debt Statistics and author's research

POLICY IMPLICATIONS

Governments face international and domestic risks. International risks include changes in the currency and commodity price markets which small sub-Saharan African countries cannot influence. However, the ability to absorb exogenous shocks and make their economies more resilient is shaped by domestic policy choices. Other risks are entirely due to domestic causes, these include: Corruption, poor project planning and oversight and the misuse of funds for purposes other than the intended use.

In order to gain from the additional funds governments need to develop a clear plan on how the funds are going to be used and tackle legal, institutional and capacity bottlenecks before the funds arrive. Better cost benefit analysis could guide governments in their choice of infrastructure investment. Botswana’s procedures could serve as a useful benchmark. Setting up independent debt management offices, advising the government on how much to borrow, how to invest and how the debt can be repaid sustainably, could decrease the risk of defaults. Donors could support such efforts by providing technical assistance.

To take advantage of these additional funds for development countries have to further develop their financial markets and support them with macro-prudential policies. In particular, commodity exporters have to make their economies more resilient, this includes diversification and an increase of tax revenue. All countries have to implement systems to manage and supervise the projects in order to avoid project overruns and the corrupt diversion of funds. If countries are not able to improve their macro policies and the management of their projects, this will ultimately lead to unsustainable levels of debt. This will then result in debt restructuring with support from the IMF. This has already happened in the cases of Angola, Ghana and Mozambique. This assistance was granted on the condition of a number of reforms and policy improvements. This is where the story comes full circle. Even though government bonds provide opportunities to pursue sovereign development choices, the markets’ demands on government behaviour are very similar to those demanded by the IMF. Without sound macroeconomic policies, strong institutions and anti-corruption measures none of the loans, whether concessional or non-concessional, will result in economic growth and development.

RESEARCH PARAMETERS

Since bond issuances in sub-Saharan Africa are a recent phenomenon, there are relatively little data and we decided against an econometric analysis. Typically, there are a lot of missing observations on explanatory variables when concatenating data sets on African countries, further reducing the number of observations. We thus we decided to conduct a qualitative analysis, supporting our narrative with descriptive data. We updated the information on African bond issuances from IMF and ODI working papers by scoping media reports, mainly Bloomberg news, the Wall Street Journal and the Financial Times. The data sources used for country aggregates were the World Development Indicators and the International Debt Statistics. Both data sources are provided by the World Bank.

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FURTHER READINGS

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PROJECT IDENTITY

PROJECT NAME	NOPOOR – Enhancing Knowledge for Renewed Policies against Poverty
COORDINATOR	Institut de Recherche pour le Développement, Paris, France
CONSORTIUM	CDD The Ghana Center for Democratic Development – Accra, Ghana CDE Centre for Development Economics – Delhi, India CNRS (India Unit) Centre de Sciences Humaines – New Delhi, India CRES Consortium pour la Recherche Èconomique et Sociale – Dakar, Senegal GIGA German Institute of Global and Area Studies – Hamburg, Germany GRADE Grupo de Análisis para el Desarrollo – Lima, Peru IfW Kiel Institute for the World Economy – Kiel, Germany IRD Institut de Recherche pour le Développement – Paris, France ITESM Instituto Tecnológico y de Estudios Superiores de Monterrey – Monterrey, Mexico LISER Luxemburg Institute of Socio-Economic Research – Esch-sur-Alzette, Luxemburg OIKODROM - The Vienna Institute for Urban Sustainability – Vienna, Austria UA-CEE Université d'Antananarivo – Antananarivo, Madagascar UAM Universidad Autónoma de Madrid – Madrid, Spain UCHILE Universidad de Chile – Santiago de Chile, Chile UCT–SALDRU University of Cape Town – Cape Town, South Africa UFRJ Universidade Federal do Rio de Janeiro – Rio de Janeiro, Brazil UNAMUR Université de Namur – Namur, Belgium UOXF-CSAE University of Oxford, Centre for the Study of African Economies – Oxford, United Kingdom VASS Vietnamese Academy of Social Sciences – Hanoi, Vietnam
FUNDING SCHEME	FP7 Framework Programme for Research of the European Union –SSH.2011.4.1-1: Tackling poverty in a development context, Collaborative project/Specific International Cooperation Action. Grant Agreement No. 290752
DURATION	April 2012 – September 2017 (66 months)
BUDGET	EU contribution: 8 000 000 €
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The views expressed in this paper are those of the authors and do not necessarily represent the views of the European Commission.