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CABRI – Collaborative Africa Budget Reform Initiative

NEWSLETTER
for Public Debt Managers in Africa

Borrowing in global uncertainty

Dear reader,

Welcome to the first edition of CABRI's bi-monthly newsletter targeting public debt managers in Africa. Covering notable developments at the international, regional, and national level, this newsletter seeks to provide public debt managers with the latest information on various economic and financial topics as well as provide an outlet through which African debt managers can share their own experiences, concerns and lessons learnt.

Public debt in Africa – both external and domestic – has been rising steadily over past decade. This is mainly due to the strong drive on infrastructure development projects, bail outs and capital injections to state-owned entities in financial distress and the severe impact of COVID–19 on the economy and national budgets. It is foreseen that borrowing requirements will remain high and the risks in the debt portfolios will continue to increase.

Against rising debt levels, this issue will cover –

- Favourable market conditions but potential mispricing of sovereign risks amongst African issuers
- Developing and strengthening domestic bond markets in Africa
- Taking stock of international debt relief initiatives
- Country spotlight: Effective public debt management in Benin
- CABRI's 2021 workplan on public debt in Africa

Favourable market conditions but potential mispricing of sovereign risks amongst African issuers

After a pause in early 2020 due to the economic disruption caused by the Covid-19 crisis and its broader international repercussions, **international capital markets have reopened for some sub-Saharan African countries**.

Côte d'Ivoire issued a 12-year €1 billion Eurobond with a 5 percent yield in November 2020 and raised €850 million in February 2021, consisting of €600 million at an interest rate of 4.3 percent with a maturity of 11 years and €250 million at an interest rate of 5.75 percent with a maturity of 27 years.

Benin issued €1 billion bond in January 2021: €700 million at an interest rate of 4.8 percent with a maturity of 11 years and the remaining €300 million at an interest rate of 6.8 percent and a maturity of 31 years.

Ghana issued more than US$3 billion at 6–9 percent in March 2021: $525 million for the 4-year zero-coupon, $1 billion for 7-year bond, $1 billion for 12-year bond and $500 million for 20-year bond. Ghana is the first Emerging Market Sovereign to add a zero-coupon bullet tranche to its bond financing portfolio.

Like many emerging economies, some advanced economies are also facing significant rollover risks due to shorter maturities in a period of high uncertainty. To manage these risks, advanced economies are lengthening maturity profiles as well as diversifying funding instruments. Similarly, Côte d'Ivoire, Benin and Ghana have sought to improve their redemption profiles by using a portion of these bond proceeds to buy back existing Eurobonds. Although international bond issuance in SSA may remain lower than in previous years, markets expect sub-Saharan African sovereign issuance to rebound to about $15 billion in 2021, led by countries such as Ghana, Nigeria, and South Africa.

However, are African countries paying too much? The evidence is mixed. The global hunt for yield because of massive monetary easing in advanced economies has helped bring down the cost of debt. Bond spreads narrowed significantly in many countries in 2020Q4. **Cote d'Ivoire's bond was also priced at a record-low yield of 5%** and was still five times oversubscribed. However, its lower yields compared to most of its African peers reflects higher credit ratings, more stable macroeconomic fundamentals, and favourable growth prospects. Weaker credits may still face higher risk premia than before the coronavirus pandemic, which could discourage their return to markets.

There is also **evidence of mispricing of African sovereign risk**.[1] Over the past decade, changes in market sentiment unrelated to macroeconomic fundamentals have has a significant impact on sovereign risk pricing in Africa's debt markets. This is due to herding by international investors and their tendency to lump all African bonds in one asset class, making them highly susceptible to shifts in market sentiment.

To counteract this potentially discriminatory behaviour by international investors as well as reduce debt vulnerabilities, African governments with market access should:

- enhance communication with international stakeholders to raise awareness about their country-specific fundamentals and economic reform progress,
- carefully monitor their foreign exchange risks and exposure to large creditors,
- lengthen the maturity structure of their debt assets to reduce rollover risks,
- diversify international lenders/investors to reduce exposure to sudden wake-up call risks,
- jointly support and contribute to existing proposals to reform rating agencies and establish lines of accountability.[2]

Developing and strengthening domestic bonds markets in Africa

African countries have tapped into domestic bond markets to fund the increases in budget deficits amidst the pandemic. Moreover, considering both global and domestic market environment and related vulnerabilities, several African countries (for example, Benin, Ghana, Nigeria and South Africa) are seeking to increase the domestic portion of public debt over the medium term.

In addition to providing a stable source of funding in normal times, the turmoil in financial markets caused by the COVID-19 pandemic have shown that efficient local currency bond markets can increase financial resilience by mitigating currency risk. However, the potential inherent in Africa's capital markets remains largely untapped with significant scope for improvement in several areas.

Public debt managers play an important role in driving the development of local debt currency markets through frequent communication with investors and fostering transparent debt practices. **WAEMU countries are among the top performers in a** new World Bank assessment tracking how transparent countries are when issuing domestic debt. This is due to having clearly specified and enforced rules for issuing and reporting domestic government securities.

Several African countries are seeking to increase the domestic portion of public debt over the medium term

1 For further details, see Morsy, H., and E. Moustafa. 2020. "Mispricing of Sovereign Risk and Investor Herding in African Debt Markets." Working Paper Series 331, African Development Bank, Abidjan, Côte d'Ivoire.

2 For further details, see Human Rights Council. 2021. "The role of credit rating agencies in debt relief, debt crisis prevention and human rights" A/HRC/46/29, Available at https://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/CreditRatingAgencies.aspx

Taking stock of international debt relief initiatives

- **G20 Debt Service Suspension Initiative (DSSI):** Since the DSSI took effect on May 1st, 2020, 31 out of 38 eligible African countries have benefitted from the initiative. Originally set to end on December 31, 2020, G20 bilateral official creditors agreed to a final extension of the DSSI by 6 months through end-December 2021. DSSI eligible countries that need debt relief beyond the DSSI, are encouraged to seek such relief under the G20 Common Framework (see the following section for more details).

  Despite initial concerns about the potential impact of DSSI participation on borrowing costs or sovereign credit ratings, recent analysis suggests that DSSI participation did not adversely affect borrowing costs of African frontier markets.[3,4] However, DSSI savings have fallen short of what was originally estimated for African countries.[5]
- **Common Framework for Debt Treatments beyond the DSSI** introduced in November 2020 remains work in progress. The framework seeks to coordinate broader efforts between Paris Club and non-Paris Club creditors (particularly China) to address unsustainable debt burdens across the 73 DSSI-eligible countries. Though it improves the international debt architecture by including more official creditors, the terms of engagement have been criticised for being too vague to shape a new regime or ground market expectations.

  Chad, Ethiopia, and Zambia are the first countries to request debt treatment under the Common Framework. As the Common Framework requests debtor countries to seek the involvement of private sector creditors, Ethiopia has already been downgraded by major rating agencies. Zambia has not seen any further rating action, as it is already in default, and Chad (which has no outstanding Eurobonds) is not rated by major rating agencies. Looking ahead, countries that have already participated in the DSSI and have large imminent debt service needs, may be more likely to turn to the Common Framework.
- **A new special drawing rights (SDR) general allocation of about SDR 450 billion ($650 billion)** is gaining momentum. IMF shareholders gave the green light for the Managing Director formally to pursue an SDR allocation of US$650 billion with IMF executive board approval expected in June, leading to SDR allocation in August. This would provide $33.6 billion to Africa—a sizable amount compared with anticipated IMF program support of $4–5 billion in 2021. By swiftly boosting the reserves of all members in a transparent and accountable manner, an SDR allocation would strengthen the region's crisis response.

  However, when allocated, countries will receive SDRs based on their IMF quotas. Because of this, **the top seven African recipients will receive over half of the amount for the region**. A further mechanism to allow advanced economies to on-lend part of their SDRs to lower-income countries is also being considered, potentially expanding the available pool of concessional resources significantly.[6]

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3 IMF. 2021. "Regional Economic Outlook for Sub-Saharan Africa, April 2021". https://www.imf.org/en/Publications/REO/SSA/Issues/2021/04/15/regional-economic-outlook-for-sub-saharan-africa-april-2021

4 For further details, see the forthcoming IMF publication: "Has the DSSI helped lower Sovereign Spreads of Eligible Participating Countries?" IMF Special Series on COVID-19, Washington, DC.

5 IMF. 2021. "Regional Economic Outlook for Sub-Saharan Africa, April 2021".

6 For further details see: G30. 2021. "Sovereign Debt and Financing for Recovery after the COVID-19 Shock: Preliminary Report and Recommendations". https://group30.org/publications/detail/4799

Country spotlight: Effective public debt management in Benin

Benin has emerged a model of effective debt management for other countries to emulate. Since 2016, the Government of Benin has implemented a series of debt management reforms that have enabled it to borrow responsibly, based on international and regional standards and practices. Underlying Benin's debt management strategy are 6 pillars: **proactivity, diversification, innovation, selective choice, monitoring and transparency** – a more detailed discussion of Benin's experience will follow during our next public debt managers in Africa meeting on June 7th, 2021.

In responding to the Covid-19 crisis, Benin has relied on official creditors and local markets. After carefully assessing the costs and benefits, **Benin declined to participate in the DSSI** in 2020 and 2021. The expected benefit was relatively small (0.1% of GDP) compared to the higher costs of implementing the DSSI (i.e., negotiations with creditors and reviewing of existing arrangements to avoid potential defaults and cross-acceleration). This decision is aligned with Benin's commitment to strengthen the quality of its credit profile, by consolidating public finances and establishing a stronger relationship with private investors.

As noted above, **Benin has regained access to international capital markets** with a successful bond issuance of €1 billion in January 2021. Following this issuance, Benin has benefitted from two recent positive rating actions by Fitch and Moody's due its economic resilience, robust growth prospects and solid track record of fiscal consolidation.

Going forward, Benin's funding strategies for 2021 is anchored around the following guidelines:

- Prioritize concessional financing to reduce refinancing and interest rate risks.
- Potential reprofiling operations to extend the debt maturity profile and reduce portfolio costs.
- Further take advantage of favourable market conditions in international and regional capital markets (as was done in January 2021).
- Use financing from local banks and West Africa Development Bank for project financing.

CABRI's 2021 workplan on public debt in Africa

CABRI strives to achieve its vision across Africa, that public financial resources are managed with integrity, transparency and accountability for efficient and effective service delivery, sustainable economic growth and development. To help realise this vision, CABRI believes that African countries need access to affordable public debt that is guided by a credible and sustainable debt and cash-management strategy.

The objective of CABRI's workplan on public debt is to strengthen collaboration among public debt managers in Africa. The key components include:

- Developing a network of debt managers through bi-monthly newsletters and regular engagements,
- Coordinating policy engagement on key African debt issues through policy dialogues, training, and in-country work,
- Producing technical briefs on relevant topics to inform the decision-making process of public debt managers.

Our upcoming events for public debt managers

1. **7 June 2021:** Virtual engagement of public debt managers
2. **July 2021 and October 2021:** Two policy dialogues.

Proposed topics, as informed by previous engagements, are:

- Raising and managing public debt in a volatile post-COVID world
- Negotiating and renegotiating debt contracts with creditors

To facilitate a powerful process of co-operation and co-ordination amongst public debt managers in Africa, Debt Readers are strongly encouraged to suggest topics to be included in the next newsletter of July 2021 as well as share their feedback more generally by emailing: Johan.Krynauw@cabri-sbo.org