#04 / NOVEMBER 2021

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NEWSLETTER
for Public Debt Managers in Africa

Managing higher borrowing cost

Dear reader,

Welcome to the fourth edition of CABRI's bi-monthly newsletter for public debt managers in Africa and the broader public finance community. As with the previous editions, this edition, dated 30 November 2021, will cover notable developments in the international space that may impact borrowing costs in 2022 and key policy considerations to include in your future relationship and communication strategies with investors/creditors. This edition of the newsletter:

- addresses inflationary pressure in developed economies;
- shares key messages from CABRI's recent Policy Dialogue on negotiating fair and balanced contracts with investors/creditors in Africa;
- takes a closer look on the work of the African Legal Support Facility (ALSF);
- shows how countries could improve their credit rating scores; and
- spotlights Liberia.

Do higher commodity and other recent price increases mean higher inflation in developed economies and therefore, higher cost of borrowing for African countries?

Recent comments made by Mr Jim Caron, Senior Portfolio Manager on the global fixed income team of Morgan Stanley Investment Management, indicates that for the next 18 months, we (portfolio managers) are going to be talking about inflation – although the latest statistics **published on the consumer price index in the US, showed that the pace of price gains is cooling off[1].**

There are, however, sectors in the US economy that are sensitive to supply bottlenecks, following the recent reopening of the economy. Businesses are no longer prepared to absorb higher prices but are now passing on higher costs to the consumer by raising prices. Projections are that the US CPI could hover above 4%, in the next year, before moderating to roughly 3% at the end of 2022 and 2023. According to data published by the New York branch of the Federal Reserve Bank, their expectations are that inflation could reach 5.2%, before tampering off to around 4%.

Regardless of who you believe, both these projections are at record levels. The risks of inflation prove much more persistent, than what the financial market expected. Indications are that the Fed will start tightening monetary policy far earlier. Analysts are now expecting at least three policy interest rate adjustments by the end of 2023. This will be particularly painful to many current bond holders and bond issuers. Inflation pressures in the developed economies are real and not just a small probability anymore.

What does rising inflation mean to emerging and developing economies? For many years, pre-COVID and during COVID, African countries were able to issue bonds in the international debt capital markets on very favourable term.

1 FTfm: Fixed Income | Financial Times. Fixed Income and Sovereign Bonds research and news coverage. https://www.ft.com/ftfm-fixed-income

Table 1: List of some of the countries in Africa tapping international markets in 2021.

Issued date	Issuer	Amount	Coupon	Yield	Maturity
17 Nov 2021	Gabon	$800 million	7%	7%	24/11/2031
21 Sept 2021	Nigeria	$1 250 million	6.125%	6.125%	28 /09/2028
17 June 2021	Kenya	$1 000 million	6.3%	6.3%	23/01/2034
29 March 2021	Ghana	$1 000 million	8.625%	8.75%	07/04/2034

According to current inflation pressures and tightening of policy rates by central banks in developed economies, indications are that the favourable borrowing environment for African countries in the international space, might have come to an end. With higher policy rates, international benchmarked rates (US treasuries and Mid Swap), will increase, meaning that the interest rates on foreign borrowing transactions, that are priced-off these international benchmark rates, could raise soon.

One might ask - how could governments still reduce or maintain its borrowing cost, despite international inflation threats? The answer could be in our own hands. As mentioned above, interest rates, internationally or even domestically, are normally priced from a base or benchmarked rate, such as US Treasuries, Mid Swap rates or local CPI rates. In determining an interest rate, at which governments are borrowing, a real rate of return (CPI + spread), country risks or new issuance spread etc., are added to the 'base rate' and priced in. Under normal circumstances these spreads could vary from 200 to 300 basis points etc., but in most Africa countries, these spreads are high and varies between 500 and 1000 basis points. A good strategy to consider, may be, for public debt managers in Africa, is to analyse these spreads and determine the underlying causes of high spreads in our countries. As they say, any inefficiency or perceived uncertainty, or risk, have a price.

Most of the causes of high spreads are things that we (debt managers), although sometimes challenging, could manage ourselves. There is still value in a stable, predictable, transparent, and accountable public debt office. Therefore, building strong, reliable, and capable debt offices, implementing prudent public debt management strategies and policies, developing practices and processes within a respected regulatory framework, introduce solid internal controls and building trust through the timely sharing of reliable and accurate information, are those things that debt managers have control over and that will eventually convince investors/creditors to buy our bonds at fair prices.

CABRI's virtual events for public debt managers in Africa

CABRI hosted a Policy Dialogue on negotiating fair and balanced contracts with creditors/investors in Africa on 5 and 6 October 2021

The dialogue was attended by participants from 26 African countries as well as legal experts, investment banks, creditors, investors, regional representatives, research institutions, and other relevant stakeholders. The event provided a platform for African public debt managers to share their experiences in negotiating with different creditor groups, highlighting common pitfalls, and identifying practical steps through which African governments may improve negotiation outcomes. Special focus was placed on Chinese lenders and their approach towards lending and restructuring of public debt in Africa. The four areas of focus were:

- Improving the transparency of sovereign debt negotiations;
- Enhancing the government's negotiations position through rigorous financial analysis;
- Understanding key legal concepts and room to manoeuvre;
- Assessing the options and opportunities for restructuring sovereign debt.

The 8 key take-aways emerging from the Policy Dialogue are highlighted below.

Key message 1: Effectively negotiating debt contracts requires a variety of technical skills

It is important that governments surround them with necessary legal and financial expertise, while at the same time building in-house capacity in these areas.

Key message 2: The negotiation process should be guided by a robust institutional and legal framework

The negotiation process, and the roles and responsibilities of each stakeholder in the debt cycle, should be clearly defined (for example, these should be clearly stipulated in a debt management procedure manual), well understood, communicated to all, and respected.

Key message 3: Transparency and mutual communication inform decision-making and building trust among creditors/ investor and sovereign borrowers

The provision of comprehensive and accurate data on the existing debt stock is critical for making informed borrowing and lending decisions. Transparency, however, covers both sides of the coin. Commercial banks should, therefore, disclose all costs or fees, to enable governments to properly assess the full costs of financing and compare to alternative funding options.

Key message 4: Rigorous financial analysis is a critical component of the debt negotiation process

DMOs should evaluate key financial terms before the start of the negotiations process, in preparing themselves to assess the cost effectiveness and other terms.

Key message 5: Legal terms and provisions are not set in stone and must be carefully examined and negotiated

All the provisions in a debt contract, even those based on common market practices, are open to negotiation and should not be automatically accepted in the form presented by the creditor without proper examination.

Key message 6: China is not a homogenous entity but is made up of different lending institutions facing different incentive structures

Chinese lending is fragmented across several different institutions and will vary by the type of loan and the creditor involved. No commercial bank in China can forgive a loan without the approval of the State Council which constitutes the highest administrative authority in China. They are likely to be opened to rescheduling payments, waiving certain contractual requirements, and extending the drawdown period to avoid a default on the principal.

Key message 7: Understand your negotiation power and ways for increasing this power

A borrower's negotiating power/bargaining power is likely to be affected by its credit rating; those with a higher credit rating will have more room to dictate or resist the terms as presented.

Key message 8: Governments must not neglect crisis prevention measures

While shocks and other factors beyond the government's direct control may require a government to restructure its debt obligations, **it is also important that governments respect legal contracts that they have agreed to and implement ex-ante measure to reduce the risk of debt distress and the need for restructuring.**

In conclusion, as was discussed, it is only by the continuous strengthening of the DMOs capabilities, by being better prepared and through tough negotiations, that the ever-increasing cost of borrowing will not undermine social outcomes, value for money and the affordability of our fiscal frameworks.

More information on the discussions during the dialogue - conference materials (post-event report, recordings, presentations, case studies, background papers and others) can be accessed **here**.

Underlining key legal concepts in loan agreements and negotiations

It is often said that public debt managers are not necessarily lawyers, and lawyers are not necessarily financial experts. One of the key takeaways from the Policy Dialogue on negotiating fair and balanced contracts, as mentioned above, is for public debt managers or government to hire reputable legal and financial experts, while at the same time building in-house capacity in these areas.

The African Legal Support Facility (ALSF) has been actively supporting and assisting African countries on legal matters and requirements. Below is an extract on the work and services of the ALSF-

The African Legal Support Facility (ALSF) is an international organisation hosted by the African Development Bank (AfDB). The ALSF provides a range of advisory, capacity building and technical assistance to its regional member countries (RMCs) to support them with, and enhance their capacities in, the negotiation and structuring of complex commercial transactions. The ALSF centres its support on the extractives and natural resources, infrastructure/public-private partnerships, power and debt sectors.

The ALSF was created to assist African governments to avoid the pitfalls of excessive debt accumulation and the threat of vulture fund litigation. Sovereign debt, therefore, is central to the ALSF's work. The ALSF is mandated to support governments in their quest to achieve debt sustainability, which ultimately will provide them with the fiscal space to make cogent choices free of the burden of oppressive debt servicing obligations.

Asymmetry in negotiation prowess in respect of debt-related contracts and the mismanagement of public debt were identified as the main drivers of debt issues on the continent. Consequently, the ALSF's services to RMCs in the debt sector focus on facilitating fair and balanced contracts with creditors and empowering governments to achieve effective debt management.

To this end, the ALSF's support to RMCs in the debt sector includes:

- Regional and bespoke capacity building training to enhance knowledge and understanding of key provisions in debt documentation;
- Developing comprehensive debt management strategies;
- Conducting debt reconciliation exercises;
- Developing debt restructuring and creditor engagement strategies;
- Restructuring external and domestic commercial debt;
- Supporting creditor engagement and negotiations related to debt relief with commercial creditors, non-Paris Club and Paris Club creditors;
- Defending against claims brought by vulture funds;
- Conducting commercial creditor litigation risk assessments;
- Developing commercial creditor dispute resolution strategies;
- Supporting restructuring negotiations in the context of dispute settlement arrangements;
- Advising on Eurobond issuances and related hedging arrangements; and
- Developing accounting approaches to contingent liabilities for sovereign guarantees.

Through ALSF advisory support, RMCs benefit from a hands-on learning process that develops capacity and fosters knowledge retention, thereby contributing to more sustainable debt management in RMCs.

Specific examples of the Facility's work includes: assisting the Government of Guinea Bissau in negotiating significant private debt forgiveness, which reduced the country's debt obligations to the relevant creditor from US$50 million to US$5 million; supporting the Government of The Gambia in restructuring its commercial creditor debt, conducting a DSA and developing an MTDS; assisting the Government of Somalia with its Paris Club negotiations, which resulted in debt relief in the amount of US$1.4 billion and moved Somalia closer to the HIPC Completion Point; and supported the Government of Sudan to successfully reach the Decision Point under the HIPC Initiative. This historic milestone enabled the Government of Sudan to obtain interim debt relief from the Paris Club, consolidating debt of approximately US$23.5 billion, cancelling a total of US$14.1 billion of debt and rescheduling approximately US$9.4 billion of debt.

Moreover, the ALSF has developed and disseminated knowledge tools to further empower African governments to understand and effectively manage their debt, including:

- A continent-focused handbook entitled "Understanding Sovereign Debt: Options and Opportunities for Africa," to guide public debt managers and others involved in the public financial management of African countries; and
- The ALSF Academy, a three-level capacity-building and certification program for African government officials and lawyers, which offers several courses, including on sovereign debt.

The ALSF's mission and mandate are supported by donors, including, ***inter alia***, the AfDB, the United Kingdom's Foreign Commonwealth and Development Office and the Gates and Melinda Gates Foundation. The ALSF additionally leverages its relationships with key development partners including the Collaborative Africa Budget Reform Initiative (CABRI), the International Monetary Fund, the International Senior Lawyers Project, the Macroeconomic and Financial Management Institute of Eastern and Southern Africa, the Overseas Development Institute, the Sovereign Debt Forum, the United Nations Economic Commission for Africa, the West African Institute for Financial and Economic Management and the World Bank's Debt Management Facility.

One of the principal reasons for establishing the ALSF was to level the playing field between African governments and their international investor counterparts. Key to eliminating the asymmetry in negotiations between these two parties is ensuring that African governments understand debt documents before signing or signing off on them, are aware of all associated risks and know where they have the room to negotiate.

Through the provision of advisory services, capacity building and the development and dissemination of knowledge products covering the public debts sector, the ALSF plays a pivotal role in ensuring that governments are empowered to make sound decisions related to debt.

For any further information on the ALSF, welcome to contact Ms Eve Ehoura - **e.ehoura@afdb.org**; Ms Nicole Kearse - **n.kearse@afdb.org** or Ms Toyin Ojo- **o.ojo@afdb.org**

Please also note the background paper on key legal concepts prepared by the ALSF, under discussion papers prepared for the **Policy Dialogue on negotiating fair and balanced contracts** above**.**

Credit ratings and key issues to consider improving countries credit score in Africa

Rating Action in Africa

Country credit ratings in Africa have been negatively impacted and is on average at historic low levels, mainly due to pandemic related effects on reserve adequacy, fiscal fundamentals, and growth - of the 30 countries being downgraded over the past year, 17 are from Africa.

According to a EMEA Emerging Markets Sovereign Rating Trends - Midyear 2021 review by Standard and Poors (S&P Global Ratings), smaller less-diversified economies have been hit the hardest, particularly those with large tourism sectors, during the pandemic. The macroeconomic performance of the biggest oil producers, Angola and Nigeria, has been far weaker than larger domestic and more diversified export baskets. Despite their considerable fiscal challenges, Ghana and particularly Egypt appeared to have resisted the worst of the pandemic impact on growth.

The pandemic has also taken a greater toll on sovereigns with limited monetary flexibility. Developed economies were able to provide sufficient stimulus support to their economies, due to the credibility of the central banks. While developing economies relied mostly on foreign currency borrowing and non-residents capital inflows into local debt markets to finance gaps between tax collection and expenditure. This has put additional pressure on foreign currency exposures, which in turn has increased countries' vulnerability to external and balance sheet shocks.

Most of the rating outlook, however, according to S&P Global Ratings remains stable, as many developing countries have benefitted from capital inflows, favourable funding conditions and accelerating global economic recovery, particularly in the commodity sector. At the same time, the following risk factors were highlighted for developing countries – the FED responses to higher inflation expectations, the uncertainty around the COVID pandemic, fiscal challenges, to a lesser extend balance of payment or reserve challenges, social and political issues, economic growth, high debt levels and restructuring of public debt.

With credit ratings at its lowest in developing countries and the loss of investment grade status for some countries, a study was conducted by the 3 major rating agencies, namely Moody's, S&P and Fitch on 14 countries (Bulgaria, Colombia, Hungary, India, Indonesia, Ireland, Kazakhstan, Panama, Philippines, Romania, Slovenia, South Korea, Thailand, and Uruguay) on how long it took to regain their investment grade status. According to the study, it took on average 7 years, with the shortest period of 1 year for South Korea and Indonesia the longest at 19 years.

The factors highlighted for losing investment grade were low economic growth, currency and financial instability, unfavourable debt restructuring, fiscal weaknesses, political and policy uncertainty, slow pace of structural reforms and macroeconomic vulnerabilities.

This article emphasised the importance of credit ratings for public debt management in Africa and noted that it should always be part of or a priority for the national agenda. Managing the communication with rating agencies are and should be included in the annual investor/creditor and communication strategies of the DMOs. DMOs have a key role in managing rating agencies, to co-ordinate and facilitate credit rating interactions in your country.

Any positive credit rating action will have an immediate impact on more favourable borrowing costs and terms for governments. In dealing with rating agencies and investors/creditors might require, in future, a different, more comprehensive, and holistic approach.

To assist public debt managers in Africa, in stabilising and better their credit rating scores, or even for countries that still consider a credit rating, the following could be useful guidelines to develop your own annual investor and credit rating agencies relationship and communication programme

- Create awareness and obtain buy-in from decision and policy makers on the importance of managing and engaging with rating agencies as part of the national agenda;
- Include monetary and fiscal policies in your strategy;
- Include financing solutions with a strong focus and commitment towards environmental, social and governance (ESG) priorities as part of your sustainable development plan;
- Redefine annual investor relationship and communication strategies, targeting not only current investors or creditors, but also potential investors/creditors;
- Conduct comprehensive research on investor behaviour and demand and supply dynamics prior to funding annual borrowing requirements;
- Interact more regular with investors/creditors, using virtual options, to share country experiences, challenges as well as policy directions and decisions taken;
- Investor relationship management are, however, a two-way process, where investors/creditors to disclose all costs and fees;
- Countries should undertake their own analyses and research done on reasons of downgrades and/or recent rating actions;
- Any investor programme or communication strategy should include the major rating agencies;
- Any information sharing should be timely, reliable, and accurate;
- Even during times of crisis, uncertainties, and vulnerabilities – DMOs should provide regular updates on current policy directions, and spending priorities – and address all investors/creditors concerns; and
- Investors/creditors and credit rating agencies should understand that they are regarded as valuable counterparts in the government sustainable development plans.

Public debt managers in Africa need to rethink current investor/creditor/rating agencies relationship management strategies and practices and make them part of the normal day-to-day operations in the respective public debt offices.

Dialogue on managing investor/creditor/credit rating agencies will continue and be included in the workplan and our engagements for 2022.

Country spotlight: Strengthening the Debt Management Office of the Government of Liberia

The Government of Liberia (GoL) is fully committed to structural reforms, following a prolonged period of economic stagnation. One such reform involves the establishment of a strong and capable public debt management office that will manage the public debt of Liberia in a cost-effective and sustainable manner. Although Liberia continues to be considered as having a sustainable debt burden, the borrowing space is insufficient to support sustainable growth and the pressure on high borrowing costs, in the short- to medium-term, is ever increasing.

The Debt Management Unit (DMU) currently mostly performs back-office functions (debt recording and initiating debt service payments) while other critical functions are fragmented across several units within the Ministry of Finance and Development Planning and the Central of Bank of Liberia and based on largely informal/undocumented procedures. The GoL is therefore seeking to strengthen its institutional framework around public debt management, by adopting prudent public debt management policies and implementing sound practices and processes.

The main achievements to date include:

1. Developing of a comprehensive **Public Debt Management Procedure Manual** that is published online and will be updated on a regular basis;
2. Developing of a **Medium-Term Debt Management Strategy (MTDS), 2021-2023**, which will be updated in 2022;
3. Developing of a debt management reform strategy and action plans.

The five priority areas in this reform base strategy, are as follows:

1. **Strengthening the legal framework for public debt management.** Although the PFM Act was amended in 2019, to include *the objectives for borrowing*, there are still some important gaps that need to be addressed by means of amendments to the PFM Act and regulations.
2. **Functional restructuring of the DMU to ensure clear separation and segregation of duties.** The proposed reorganization will focus on functionalities and will be split between front, middle and back office responsibilities, for better work flow, separation of duties and co-ordinating and sharing of information amongst stakeholders.
3. **Strengthening management practices within the unit** to enhance staff efficiency and effectiveness.
4. **Transitioning from the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) to the Commonwealth Meridian debt recording system** to improve the recording, analysing and reporting of public sector debt.
5. **Better coordinating public debt management with fiscal and monetary policy.**

To date Liberia has received support from various development partners to strengthen public debt management capabilities. The DMU is committed in ensuring that the support received are well embedded in policies and strategies in accessing the most favourable borrowing options as well as terms and conditions. Going forward, Liberia will proactively seek assistance from the appropriate external partners and will also prioritise learning and adopting good practices from other debt management offices in the region. Several countries in the region have made significant progress in establishing strong and capable debt management offices, from which valuable lessons could be learned.

For more information on the latest developments in the DMU of Liberia, please contact Mr Frederick B. Krah at **fkrah@mfdp.gov.lr**

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 28 February 2022 as well as share their feedback more generally by emailing: **Johan.Krynauw@cabri-sbo.org.**

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