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CABRI – Collaborative Africa Budget Reform Initiative

NEWSLETTER
for Public Debt Managers in Africa

Strengthening public debt management capabilities and developing local debt capital markets

Dear reader,

Welcome to the second edition of CABRI's bi-monthly newsletter targeting public debt managers in Africa. As with the 1st edition, issued 31 May 2021, this edition will cover notable developments in the international and at national levels, pertaining to public debt managers in Africa. Public debt managers are still facing many uncertainties. With high public debt levels and with borrowing requirements to remain high, for the near future, the focus of most debt managers in the region is on identifying and managing the risks in the public debt portfolios while meeting pressing financing needs at the lowest cost possible. Given these risks and concerns, this edition will cover the following:

- Concerns about uneven global economic recovery.
- CABRI's virtual events for public debt managers in Africa, June–July 2021.
- Borrowing with purpose through Environmental, Social and Governance (ESG) bonds.
- Building public debt management capabilities in Africa – Why Cash Management?
- Country spotlight: Morocco's public debt remains sustainable amid COVID-19 crisis.
- Additional readings and references.

Concerns about uneven global recovery though inflation surge may be temporary

The good news is that the global recovery from the COVID-19 pandemic is progressing broadly in line with the International Monetary Fund's (IMF) April projections of 6% growth this year. The bad news is that this recovery is uneven, with many countries in danger of falling further behind advanced economies and some emerging economies (IMF, 2021c).

This economic divergence is largely being driven by dramatic differences in vaccine availability, infection rates, and the ability of governments to provide policy support. Sub-Saharan African countries are currently experiencing a surge in infections with less than 1 adult in 100 fully vaccinated, compared to an average of over 30% in more advanced economies (Georgieva, K., 2021). The IMF has therefore called for urgent action by policy makers across the globe to end the pandemic and increase support to vulnerable economies (Georgieva, 2021).

An important part of the solution is the IMF's new general Special Drawing Right (SDR) allocation equivalent to US$650 billion. This is the largest allocation in the IMF's history and will be critical in boosting the liquidity and reserves of all its member countries. The IMF Executive Board has recently backed the proposal which will be presented to the IMF's Board of Governors for their consideration and approval. If approved, it is expected that the SDR allocation will be completed by the end of August. In recognition of the uneven distribution of SDRs across regions and income groups, the IMF is currently exploring options for voluntary channelling SDRs from wealthier members to poorer countries through the Poverty Reduction and Growth Trust (PRGT) and possibly a new Resilience and Sustainability Trust (RST) to provide financing for green policies and reforms.

Another potential risk amid this two-track recovery is rising inflation in major economies, particularly in the U.S, but this may not be problematic if it is transitory. There is a risk of a more sustained rise in inflation or inflation expectations that could potentially require an earlier-than-expected tightening of U.S. monetary policy. Higher interest rates in the U.S. could lead to a sharp tightening of global financial conditions and increase the cost of borrowing in South Africa, Egypt and other countries with large refinancing needs. It could also lead to significant capital outflows from emerging and developing economies. However, the consensus among most experts is that this year's rise in inflation is due to supply bottlenecks, and thus, transitory (Fitch, 2021; Jones, 2021). Consequently, emerging economies' interest rates may not have to rise far. It is essential that Central Banks in major economies carefully communicate their policy plans to keep inflation expectations well anchored and avoid overreacting to transitory increases in inflation.

CABRI's virtual events for public debt managers in Africa, June–July 2021

CABRI has hosted two virtual events with public debt managers in Africa on 7 June and 6–7 July 2021. Debt managers from 20 countries in Africa attended the first event which provided a forum for them to discuss current issues and trends in domestic and international debt markets. Nigeria and Egypt shared their experience in developing their domestic bond market and strengthening the capabilities of their respective debt management offices. Zambia provided an update on its ongoing sovereign debt restructuring under the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI). The next meeting of African debt managers is scheduled for November 2021.

The second virtual event in July was a Policy Dialogue on Raising and Managing Debt for post-COVID recovery. Public debt managers from 22 African countries as well as financial and legal experts from the private sector and research organisations participated in the event, jointly discussing the four most pressing challenges currently facing public debt managers in Africa:

- Managing refinancing risks,
- Mobilizing additional financing,
- Maintaining and improving investors relations and confidence,
- Restructuring unsustainable debt portfolios.

All conference materials (videos, presentations and background papers) can be accessed here.
The next Policy Dialogue will be held in October 2021.

The key messages are as follows:

1. The path of the pandemic remains uncertain in the region, as several African countries currently struggle with more virulent variants, and the prospects for broad-based vaccination remain uncertain.
2. Although refinancing risks have increased in West Africa, some countries have effectively reduced this risk through reprofiling actions and by adopting a proactive approach to debt management.
3. In meeting governments' financing needs, public debt managers need to carefully evaluate the costs and risks of innovative financing options such as financing with an Environmental, Social and Governance (ESG) focus as well as financing from Export Credit Agencies (ECAs). Debt managers must also proactively take steps to ensure they get the most favourable terms and conditions available.
4. Building and maintaining relationships of trust with investors is a priority of debt managers during good and bad times. African governments must control their narrative, as leaving an information vacuum increases the likelihood of subjective assessment by investors, rating agencies or data providers.
5. Sovereign debt restructuring should not be postponed since history has shown that delaying restructuring increases the likelihood of protracted negotiations, and larger haircuts to the detriment of all stakeholders. Once a country decides to restructure its debt, it is imperative that it communicates its intentions in a transparent manner, providing regular updates to key stakeholders.

Borrowing with purpose through Environmental, Social and Governance (ESG) bonds

Most Africa countries need debt for their post-COVID recovery, and they need to find ways to put it to the best use given elevated debt levels and risks. This is because how debt is used is one of the determinants of future repayment capacity, and thus the expected probability of debt sustainability. Thematic bonds with an Environmental, Social, and Governance (ESG) focus such as green and social bonds are a way to ensure that countries with market access borrow with purpose by allocating to projects or assets with environmental or social benefits.

A recent CABRI paper, 'Exploring environmental, social and governance (ESG) and sustainable finance solutions for African sovereigns', notes investor appetite for these types of bonds is expected to grow, and some African countries can potentially benefit from this increasing demand. Although the paper finds no conclusive empirical evidence that these thematic bonds provide a cheaper source of financing, they do offer other potential benefits to the sovereign issuer that make them an attractive source of financing compared to vanilla bonds. These benefits include attracting a new class of investors as well as improving investors' understanding of a country's development strategy and goals.

Recognising the untapped potential of this market, the Government of Benin issued Africa's first sovereign social bond on international capital markets in July 2021, mobilising 500 million euros (328 billion FCFA). Ghana is expected to follow soon, recently announcing its interest in selling social bonds (Dontoh, 2021). The funds mobilised by Benin will be used exclusively to finance various social and environmental projects contributing to Benin's commitments to achieve the United Nations's Sustainable Development Goals (SDGs). This Eurobond was issued at a coupon of 4.95%, reflecting investor confidence in Benin, with a maturity of 2035. A negative new issue premium of 0.20 percentage point was obtained, reflecting the significant appetite of investors for this innovative instrument.

Notably, the Government of Benin has created a comprehensive website in English and French that provides all the relevant documents including the SDG bond framework. Benin has also partnered with the Sustainable Development Solutions Network (SDSN) - an organisation under the United Nations - which will monitor the progress made by the issuer towards SDGs, further increasing transparency and accountability.

Thematic bonds may not be appropriate for every African country given their stage of market development, level of political commitment and general macroeconomic conditions. However, where feasible, it can be an important step in increasing the likelihood that governments borrow with purpose and, in doing so, boost investors' confidence in a country.

Building public debt management capabilities in Africa – Why Cash Management?

Cash has real value – and if managed well, can bring about significant savings and efficiencies to Government's scarce resources. The recent COVID-19 pandemic has shown that efficient management of government's liquidity is crucial to respond to unanticipated revenue losses and increases in expenditures.

There is often a misconception that cash management is an isolated function within the Ministry of Finance that purely attempts to respond to cash requirements during the execution of the budget. Whilst ultimately, the function aims to ensure that there is enough cash, at the right time and the right place to fulfil government's payment obligations, the function is also concerned with optimising its value – or actively managing cash. To do this, cash managers need to juggle the mismatches between the timing of payments and the availability of cash during the fiscal year, whilst at the same time also ensuring that resources are made available at the best possible cost. This requires credible consolidated spending and cash plans of the various spending agencies to be laid against projected revenue flows. However, optimising cash or minimising borrowing costs is not necessarily a concern for spending agencies since their interest have already been considered in the budget. This is one of the factors that complicates cash management reforms.

CABRI has hosted numerous Policy Dialogues and training events on cash management in different regions across Africa. Through these interactions, countries have identified shortcomings, challenges and learnt from each other' experiences with managing cash resources. These exchanges flag that, in most instances, information sharing (expenditure flows and revenue projections) between cash management units, Ministries, Departments and Agencies of Government

(MDAs) and revenue authorities is incomplete and inaccurate, undermining the accuracy of cash flow projections. Therefore, making timely payments becomes an important challenge in most countries which tend to resort to cash rationing. Because the allocation of cash is unpredictable, ministries find it difficult to plan activities in their sector, with potentially negative impacts on the delivery of public services.

Although there is no specific solution which fits all countries, solutions often require better positioning of cash management in the government's planning and resource management cycle and strengthening linkages with debt management. Clear definition of responsibilities and workflows within and among the entities in charge of cash management is critical.

To start addressing the above issues, CABRI has launched its Building Public Finance Capabilities (BPFC) programme, working with country-teams to practically work towards addressing cash and liquidity management problems.

Country spotlight: Morocco's public debt remains sustainable amid COVID-19 crisis

Public debt in Morocco has increased significantly from 65.2% of Gross Domestic Product (GDP) in 2019 to 77.6% in 2020 due to the COVID-19 crisis. Although this is well above the risk benchmark of 70% of GDP for emerging markets, the IMF assessment is that Morocco's public sector debt remains sustainable (IMF, 2021a).

Effective debt management in Morocco has helped to limit potential debt vulnerabilities by achieving the following characteristics of the debt profile: i) relatively long maturity (weighted average maturity of about 7.5 years), ii) relatively low share denominated in foreign currency (about 25%) and iii) investment base made mostly of local investors, many of whom are long-term investors (IMF, 2021a). Due to these features, as well as to its solid track record and favourable ratings, Morocco's government has maintained steady access to international capital markets at favourable terms over the last 10 years, and more recently during the health crisis.

In responding to the COVID-19 crisis, Morocco diverted from its debt management strategy and increased external funding in 2020. Greater access to external borrowing, including the full drawing of the IMF Precautionary and Liquidity Line (PLL) arrangement, helped to maintain international reserves at adequate levels in 2020. However, this is seen as a temporary diversion, with domestic markets remaining the main source of funding for the government. The total borrowing requirement in 2021 will be split between 24% of external debt and 76% in domestic debt.

Morocco's domestic market is well developed and forms the base of the country's financial system. In maintaining and improving the depth and liquidity in the market, the Treasury is a major player and through its annual auction programme, ensures a regular supply of government securities and presence in the market. Moreover, while some countries have relied heavily on shorter-term domestic financing, reflecting borrowing cost considerations and nascent domestic markets for long-term instruments (for example, Egypt), Morocco issued long-term domestic bonds (IMF, 2021b).

Although there are concerns of rising COVID-19 cases in the region, the risks are limited for Morocco as its vaccination programme has made good progress with a significant share of the population expected to be inoculated by the end of 2021.

For any further information, contact Mr El Hassan Eddez, Deputy Director of Debt, Department of Treasury and External Finance (DTFE) in the Ministry of Economy, Finance and Administration Reforms, Morocco at e.eddez@tresor.finances.gov.ma.

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 September 2021 as well as share their feedback more generally by emailing: Johan.Krynauw@cabri-sbo.org.

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