Analytical Chapters

Regional Economic Outlook for Sub-Saharan Africa

IMF, African Department

May 2013

Outline of Presentation

Key theme: ***How to facilitate building growth momentum in a multi-speed and uncertain world by creating the policy space to address shocks and address longer-term development needs.***

Chapter 2:
Strengthening Fiscal Policy Space

Chapter 3:
Issuing International Sovereign Bonds under Easy Global Financial Conditions

Chapter 4:
Energy Subsidy Reform in Sub-Saharan Africa

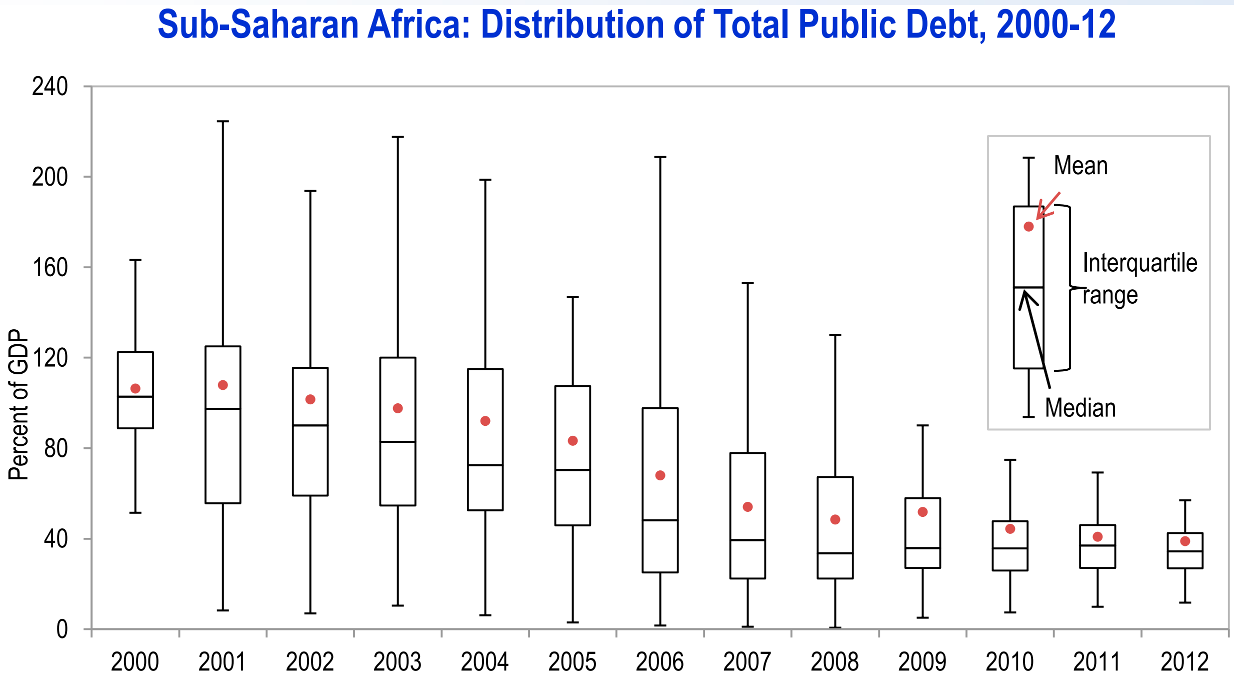
Chapter 2:
Strengthening Fiscal Policy Space

Introduction

- **Fiscal policy space**:
  - Capacity to finance larger deficits during economic slowdowns
  - Ability to avoid a pro-cyclical fiscal policy response in a downturn, or
  - to adopt a counter-cyclical (or neutral) fiscal policy in the event of a downturn

- **General conclusion**: while the majority of countries in the region are not burdened by their debt levels, many could find it difficult to finance larger deficits in a downturn.

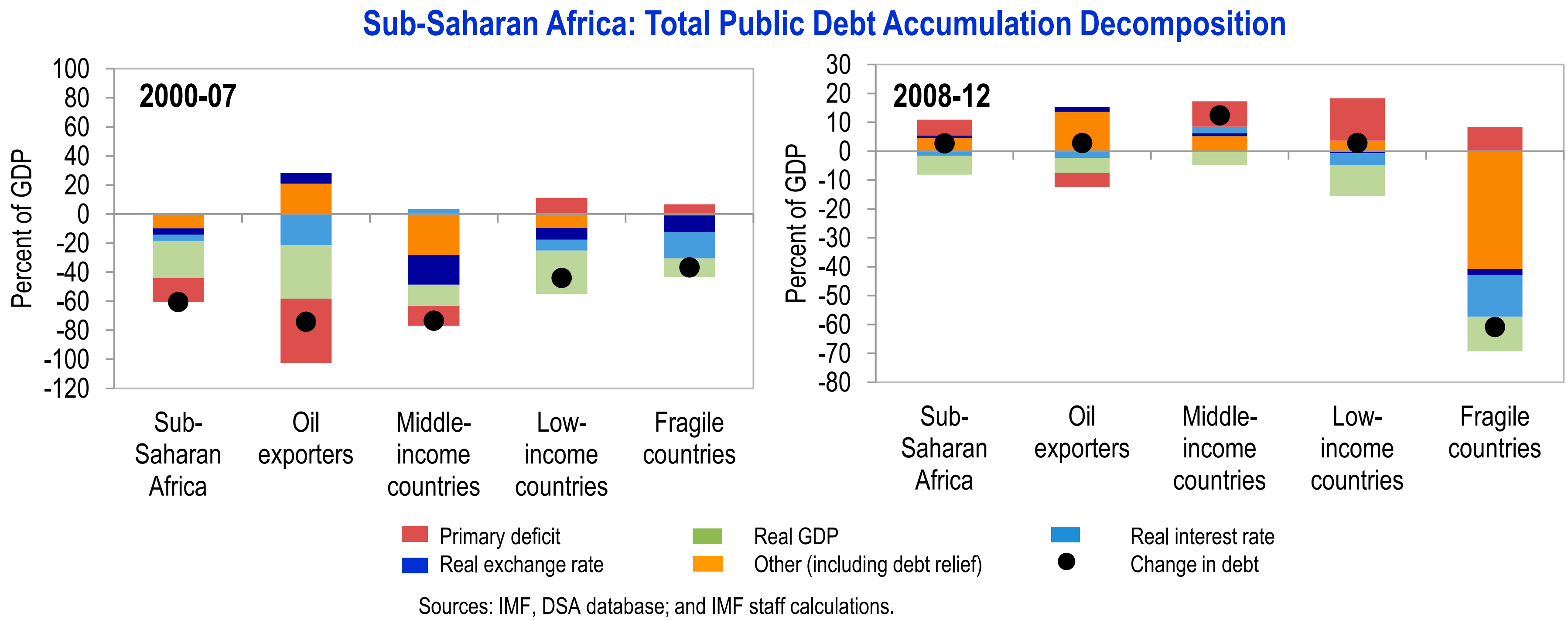
The Evolution of Public Debt Levels since 2000



Sources: IMF, DSA database; and IMF staff calculations.
Note: The "box and whiskers" plot summarizes the distribution of debt-to-GDP ratios across sub-Saharan African countries.

- Public debt-to-GDP ratios have fallen sharply since 2000.
- The steady decline in debt levels was halted by the onset of the global recession.

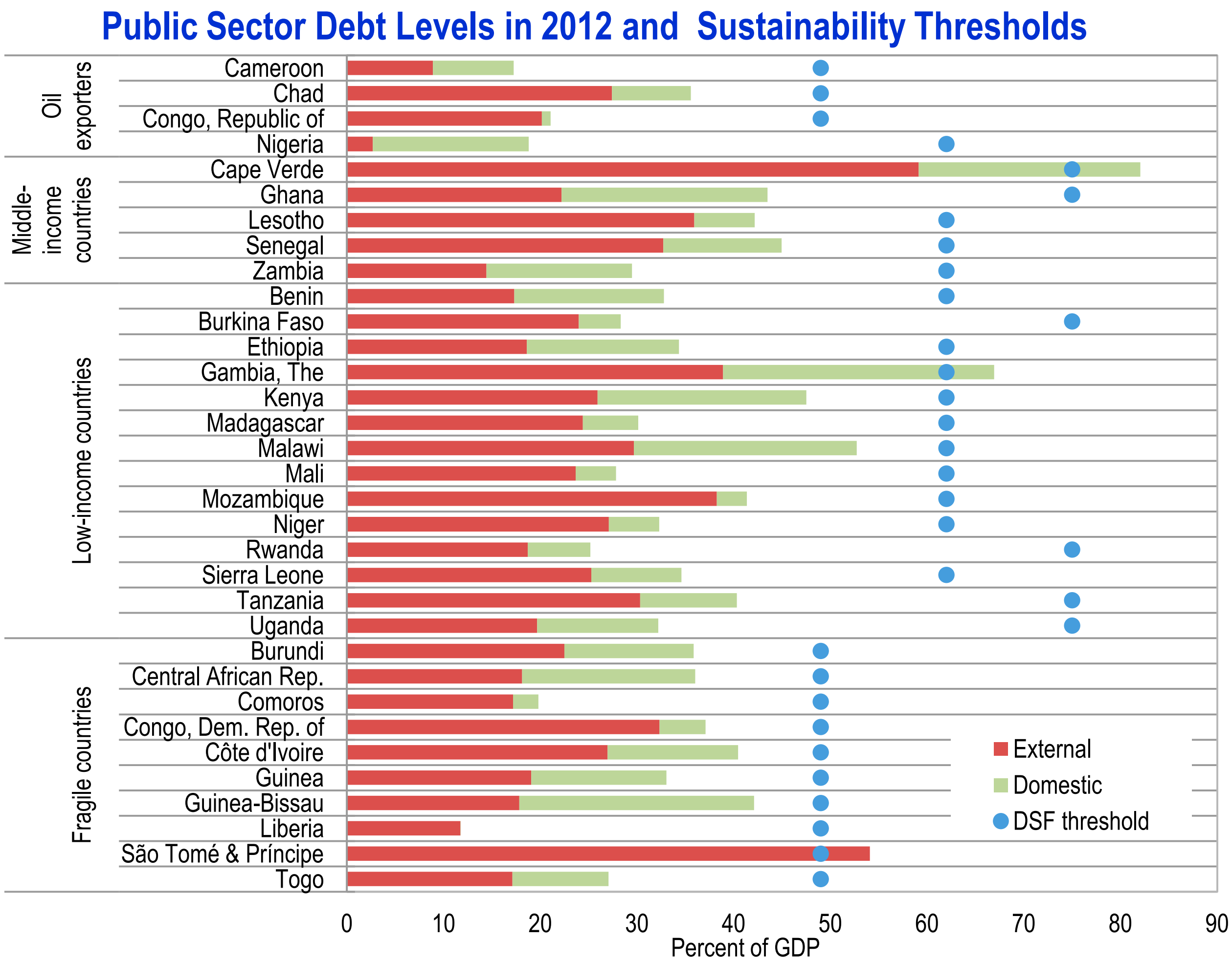
The Drivers of Debt Reduction Since 2000



- 2000-07: improved fiscal balances, strong economic growth, some real exchange rate appreciation, and, in many cases, debt relief.
- 2008-12: diverging trends, with debt relief a key factor for fragile countries.

First Look: Are Current Debt Levels High?

PRGT-Eligible Countries



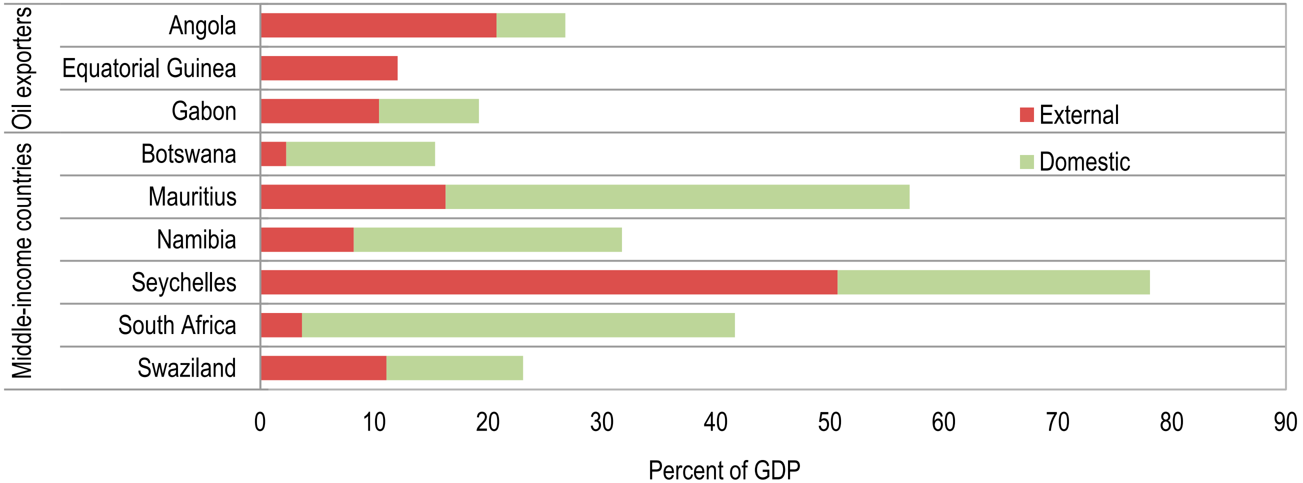
Sources: IMF, DSA database; and IMF staff calculations.

Note: Excludes Eritrea and Zimbabwe. Debt to GDP ratios pertain to public sector debt as defined in the Debt Sustainability Framework.

First Look: Are Current Debt Levels High?

Other (Middle Income) Countries

Public Sector Debt Levels in 2012, Non-PRGT-Eligible Countries

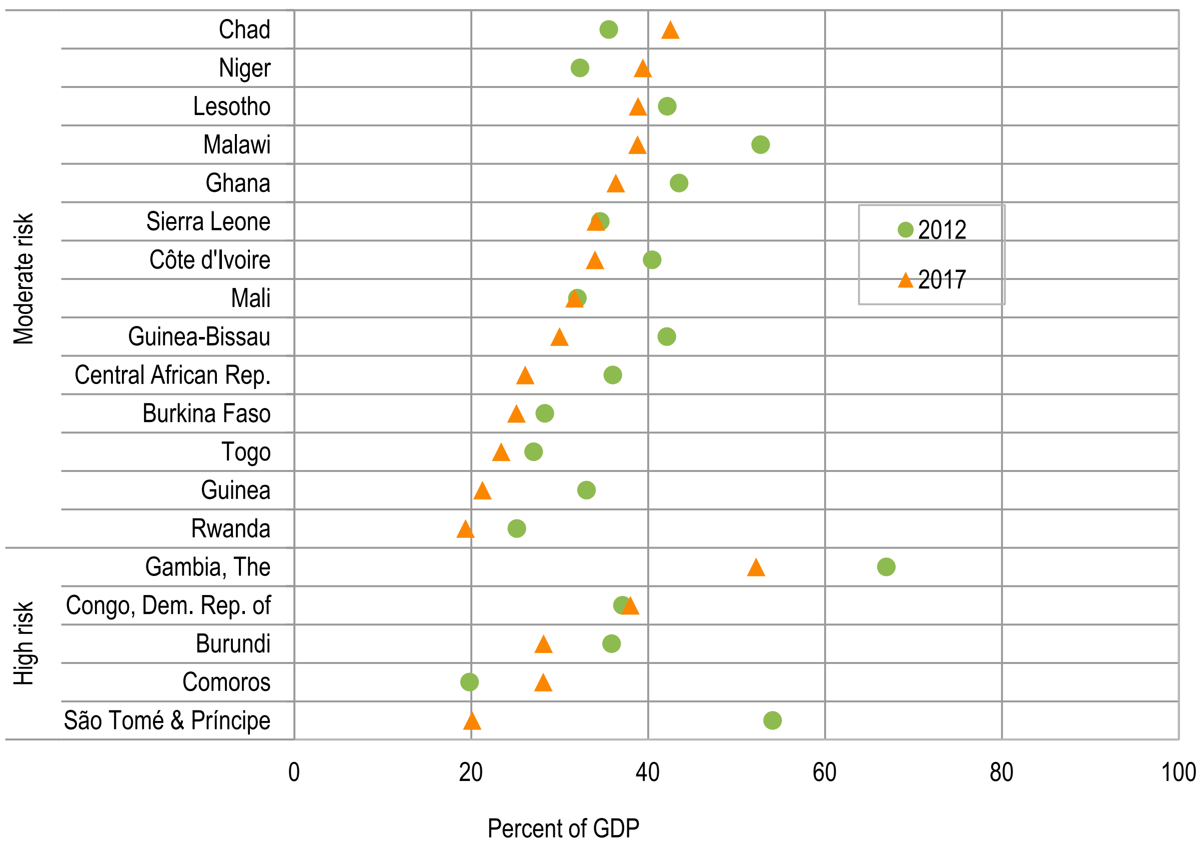


Sources: IMF, DSA database; and IMF staff calculations.
Note: Debt to GDP ratios pertain to public sector debt as defined in the Debt Sustainability Framework.

Second Look: Is the Debt Outlook a Cause for Concern?

PRGT-Eligible Countries

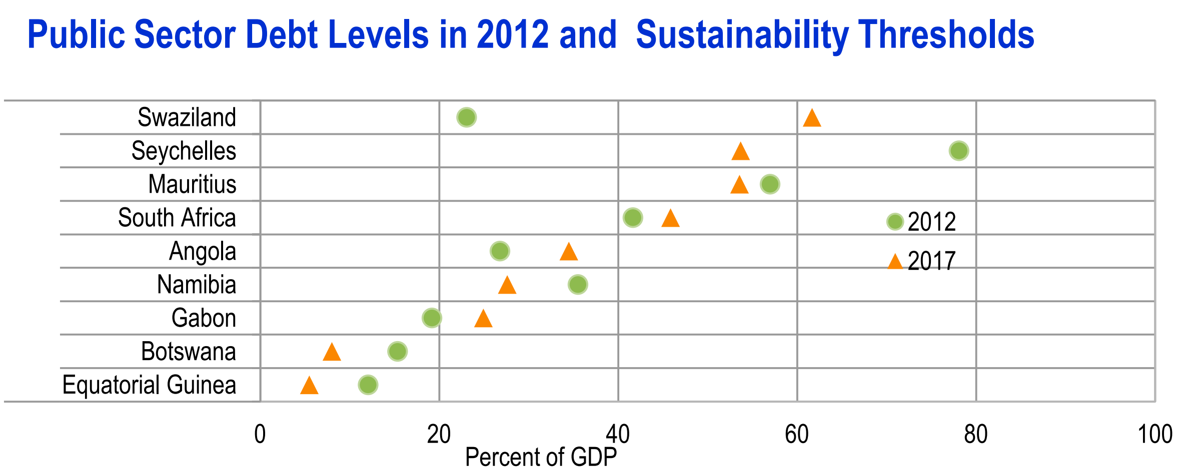
Public Sector Debt Levels in 2012 and Sustainability Thresholds



Sources: IMF, DSA database; and IMF staff calculations.

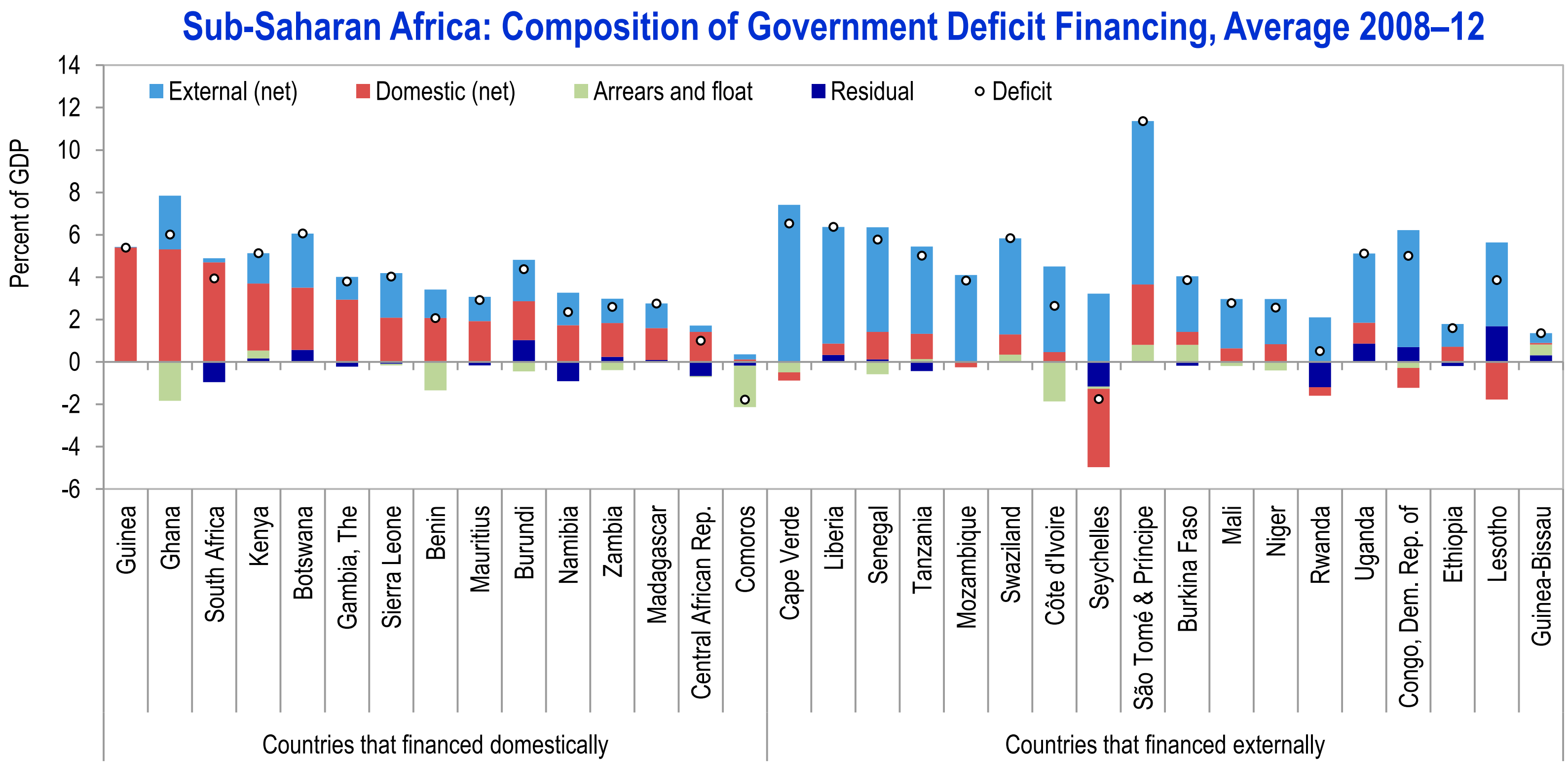
Second Look: Is the Debt Outlook a Cause for Concern?

Other (Middle Income) Countries



Sources: IMF, DSA database; and IMF staff calculations.

Financing Budget Deficits during 2008-12

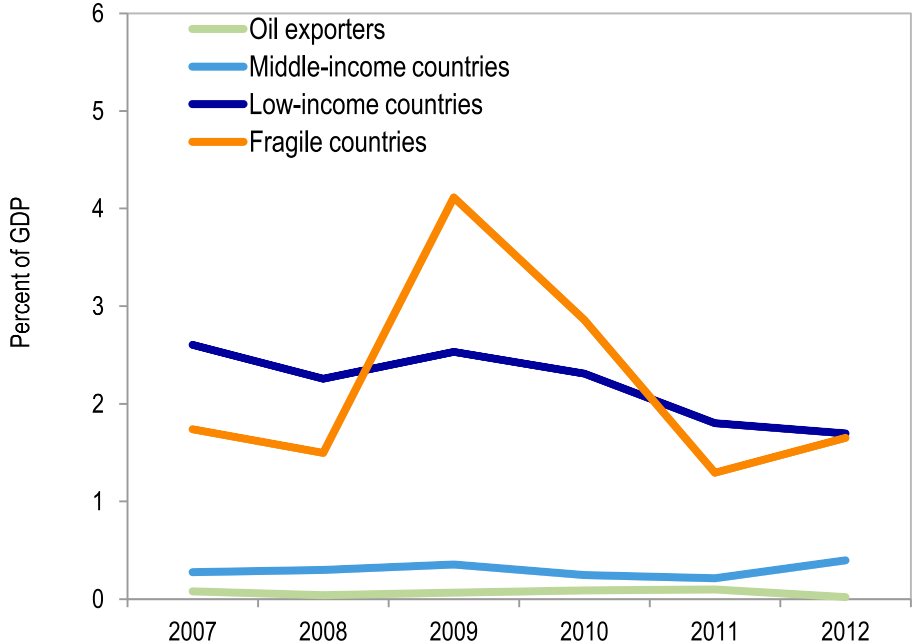


Sources: IMF, *World Economic Outlook*; and African Department database.
Note: External financing and deficit exclude debt-relief operations.

- Countries with well-developed bond markets relied mainly on domestic bond issuance.
- Poorer or smaller countries have typically relied on external financing.

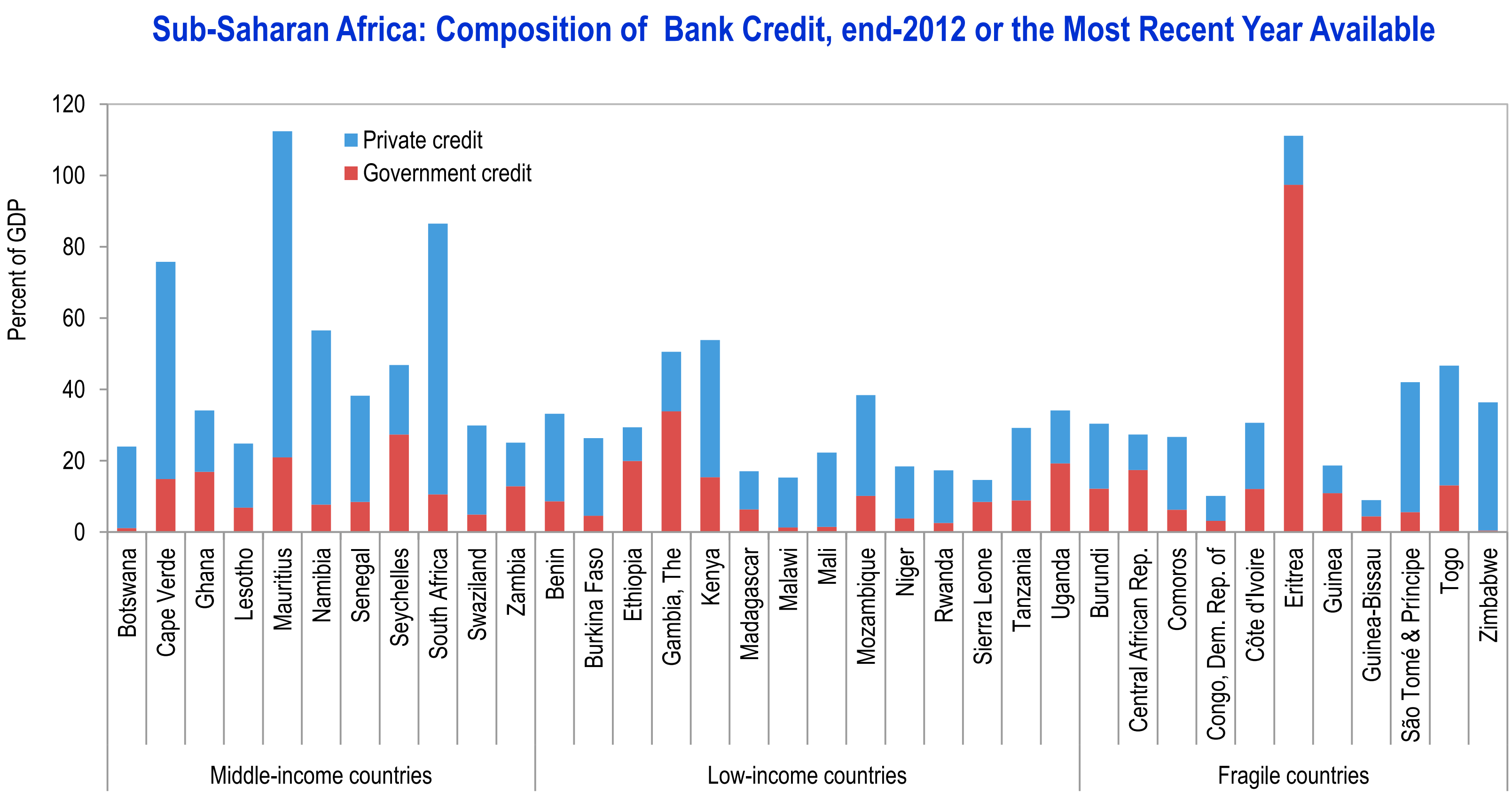
Financing Budget Deficits: The Role of External Budget Support

Sub-Saharan Africa: External Budget Support, 2007–12



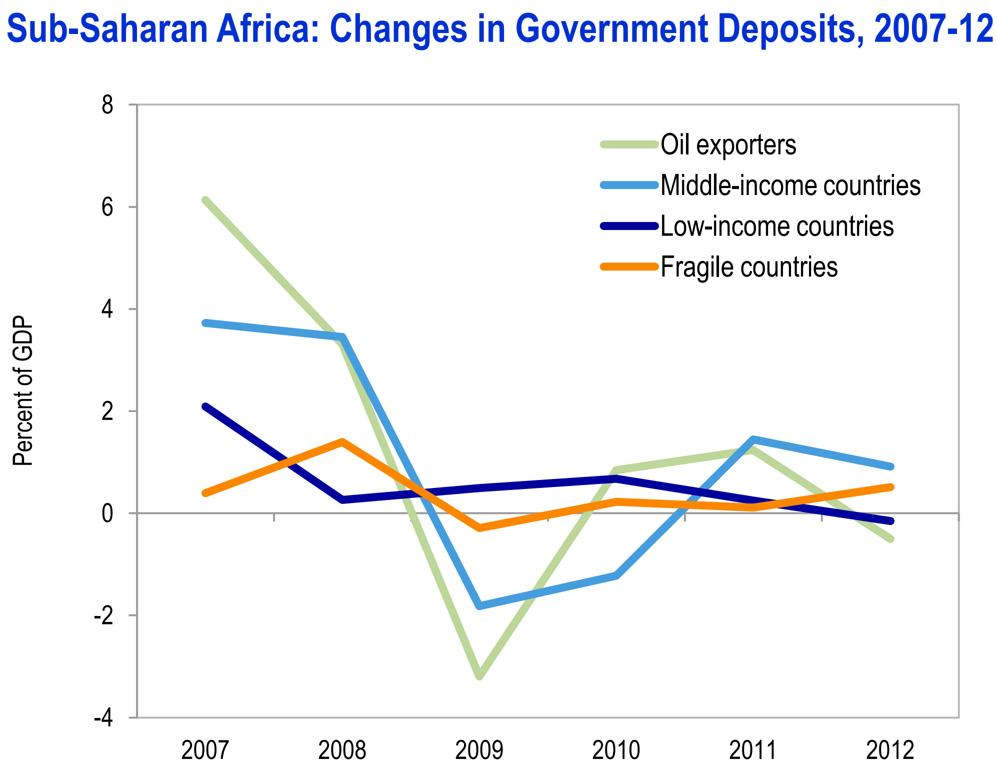
Sources: IMF, *World Economic Outlook*; and African Department database.
Note: External financing and deficit exclude debt-relief operations.

Domestic Borrowing Capacity: Current Credit Allocation

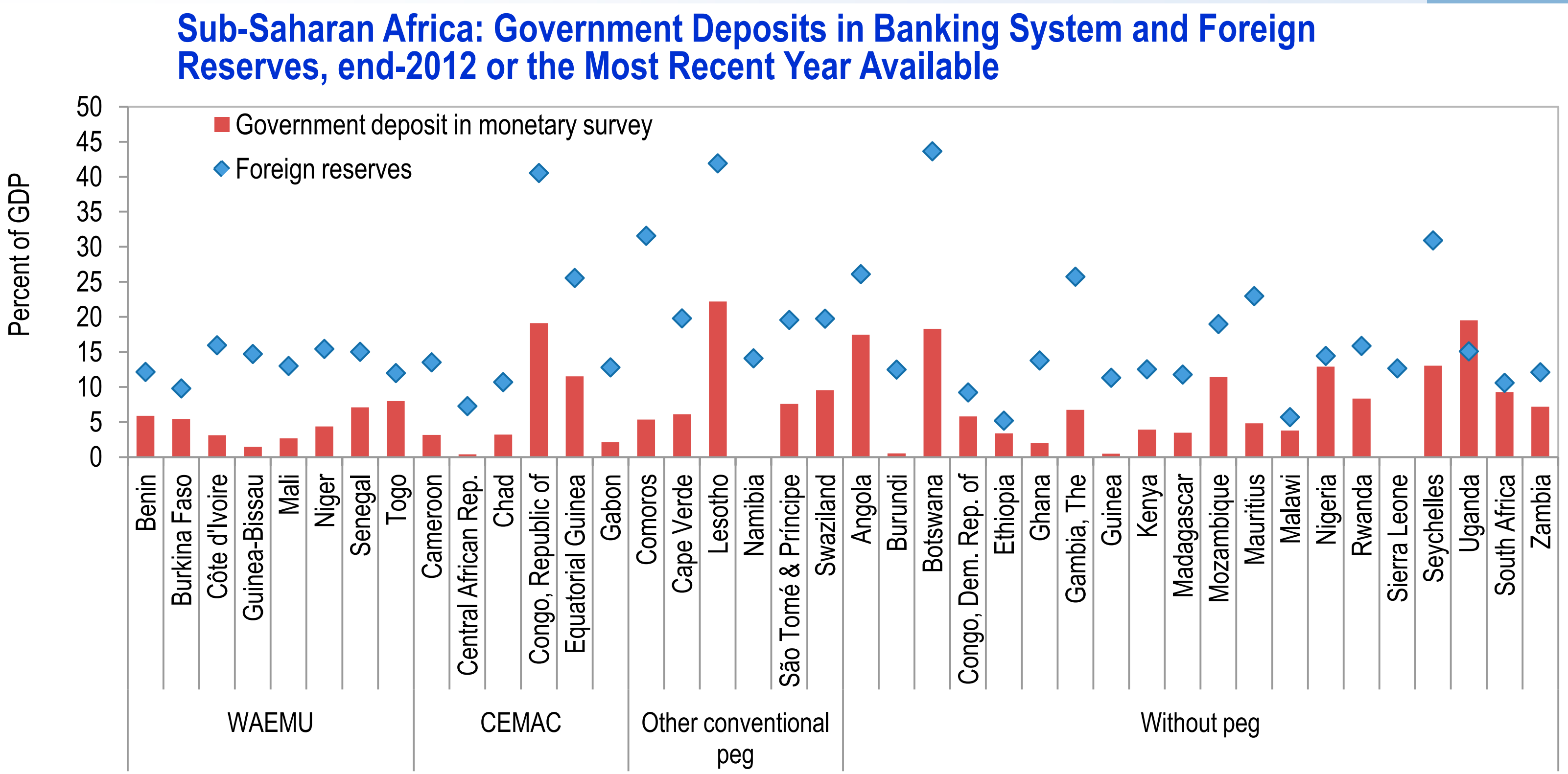


International Monetary Fund, Regional Economic Outlook for sub-Saharan Africa, May 2013

Government Deposits as a Fiscal Buffer



The Current Availability of Government Deposits



- Generally resource-rich countries have large fiscal buffers in the form of deposits.
- Important for countries where exports and budgetary receipts are volatile.

International Monetary Fund, Regional Economic Outlook for sub-Saharan Africa, May 2013

Expanding Fiscal Policy Space: How Can It Be Done?

- Near-term:
  - Reducing domestic borrowing needs
  - Building government deposits
- Longer-term:
  - Strengthening fiscal position
  - Domestic bond market development

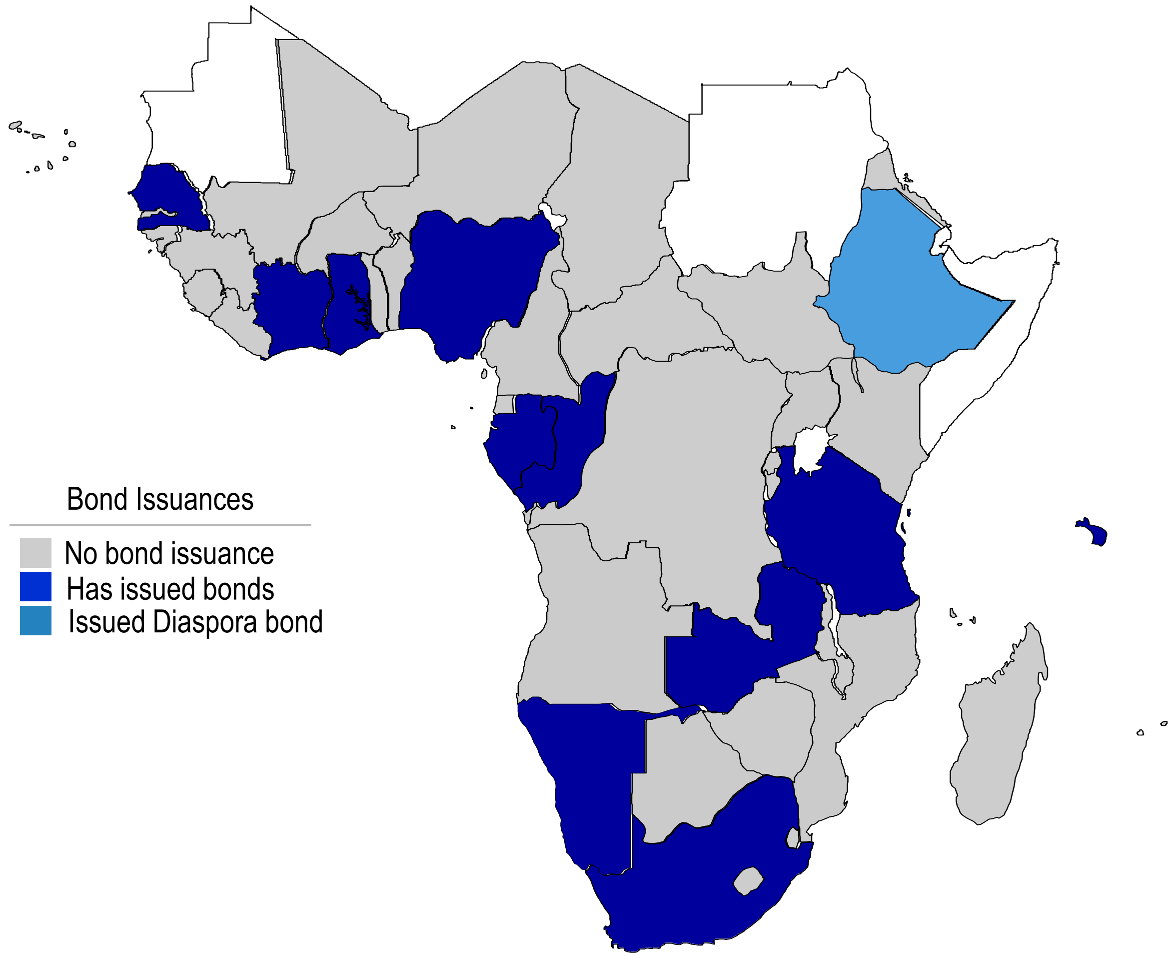
- Can this be done?
  - IMF country teams' assessments: about two-thirds of the countries in the region have the capacity to raise revenue and for sizable consolidation by 2015

Expanding Fiscal Policy Space: The Tradeoffs

- Should focus be on fiscal buffers or longer-term development needs?
- Elevated public debt levels are a constraint, but most countries now have relatively modest levels of public debt.
- While there is no "off-the-shelf" answer, some general points can be made:
  - Going into debt distress should be avoided as it is usually an exceptionally costly, and can halt development.
  - Building strong domestic bond markets provide governments with an important additional policy option.
  - For aid-eligible countries, obtaining exceptional support from multilateral and bilateral donors provides an important additional degree of freedom.
  - In situations where the global outlook is cloudy, more weight needs to be given to building fiscal policy space to handle a downturn.

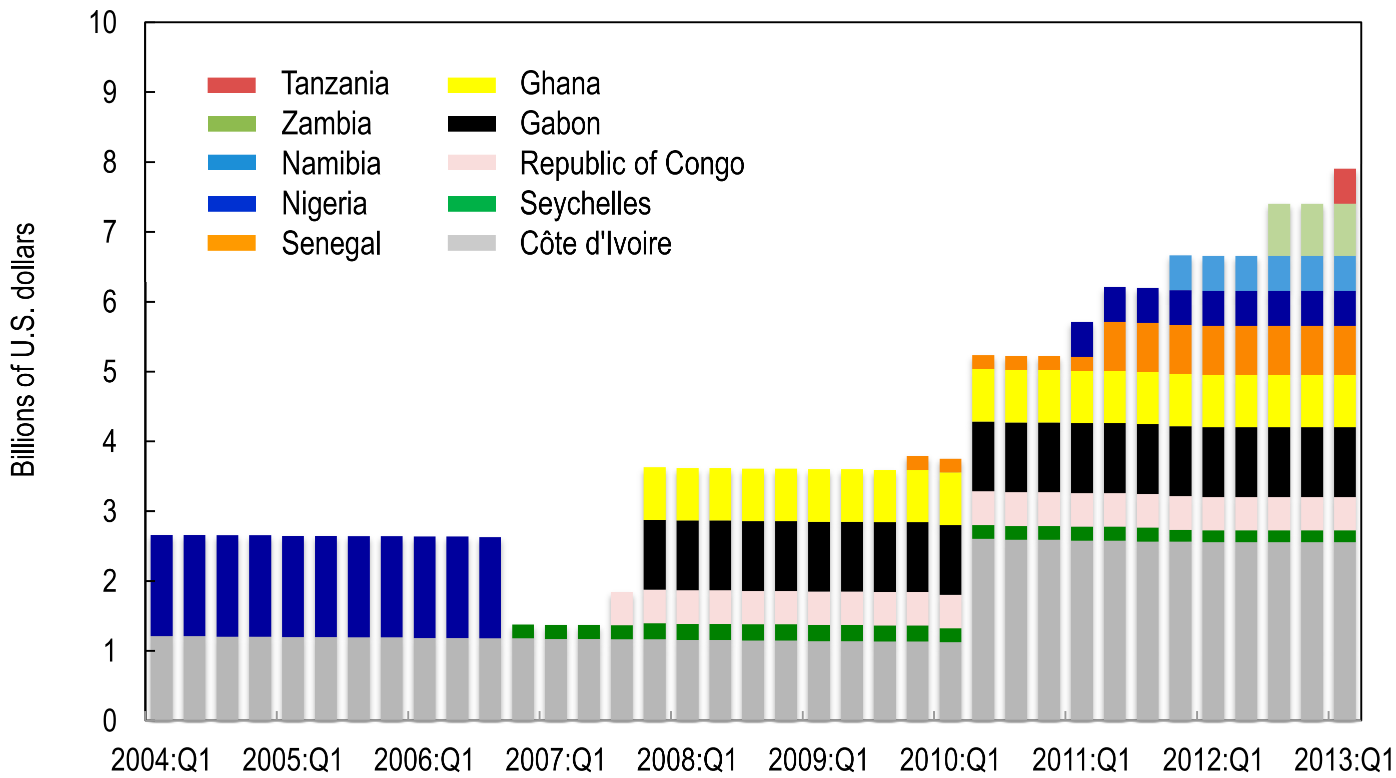
Chapter 3:
Issuing International Sovereign Bonds under Easy Global Financial Conditions: A Sub-Saharan Africa Perspective

Twelve sub-Saharan African countries have sovereign bonds outstanding,…



Under easy global financial conditions, search for yield has reached frontier markets…

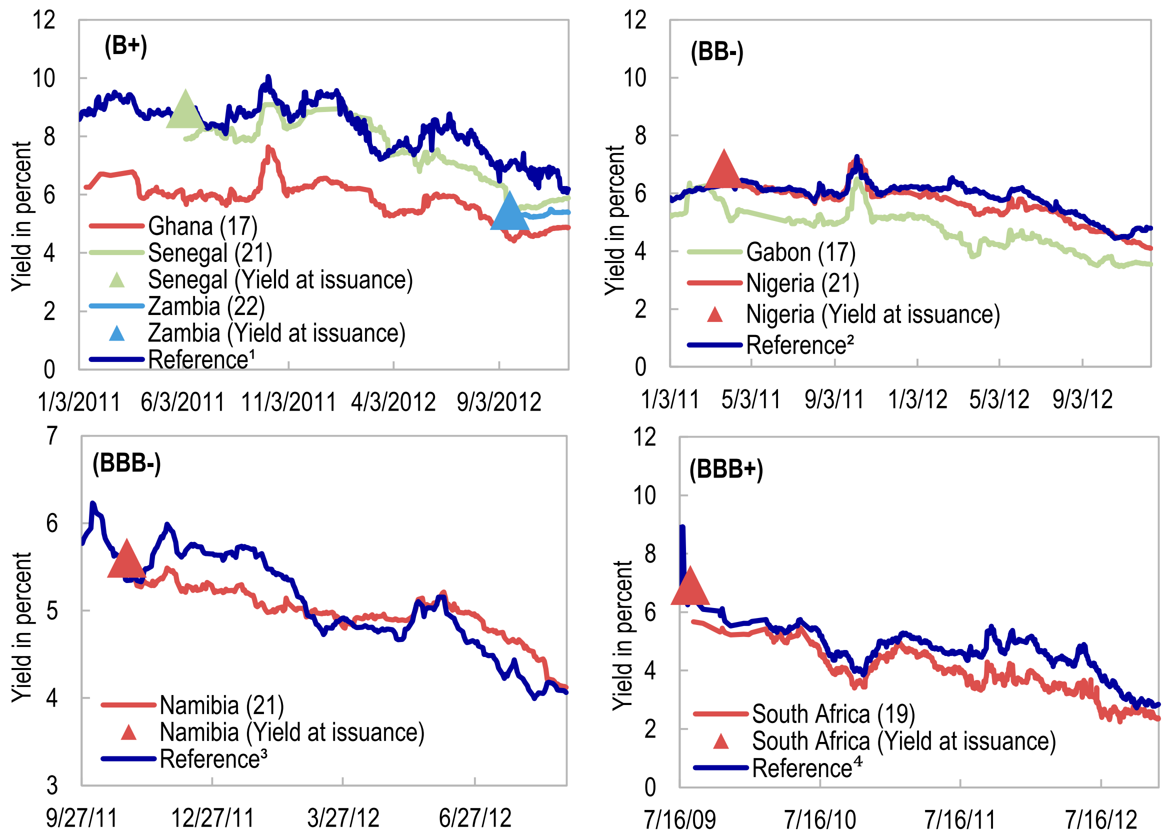
Sub-Saharan Africa: Recent Sovereign Issuances (Excl. South Africa)



Sources: Bank for International Settlement Quarterly Review; Bloomberg; and EPFR Global.

Sub-Saharan African international sovereign bonds are priced relatively favorably,…

Sub-Saharan Africa: Sovereign Bond Issuance Terms



Sources: Bloomberg; and IMF staff calculations.

[1] Reference is the average of Vietnam, Venezuela, and Egypt.

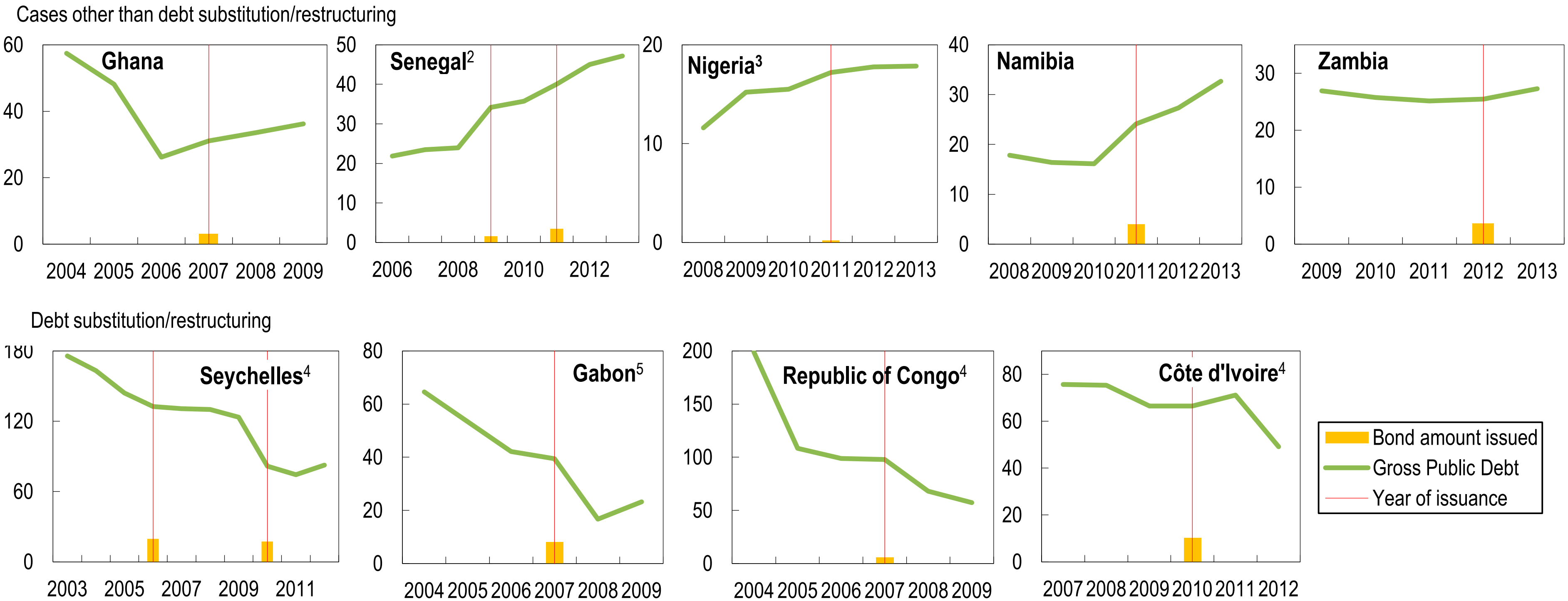
[2] Reference is the average of Sri Lanka, Georgia, and El Salvador

[3] Reference is the average of Lithuania, Russia, and Bahrain.

[4] Reference is the average of Turkey, Indonesia, Croatia, and Colombia.

Bonds did not increase debt levels when part of restructuring, but in other cases they did.

Public Debt as Percent of GDP: Before and After Sovereign Bond Issuance[1]



Source: IMF, African Department Database; and IMF staff estimates and projections.

[1] Seychelles and Cote d'Ivoire issued small amounts of bonds in 2007 and 2012, respectively, which are not presented in the figure. South Africa is not included.

[2] Part of the proceeds from the bond issued in 2011 was used to exchange and repurchase the bond issued in 2009.

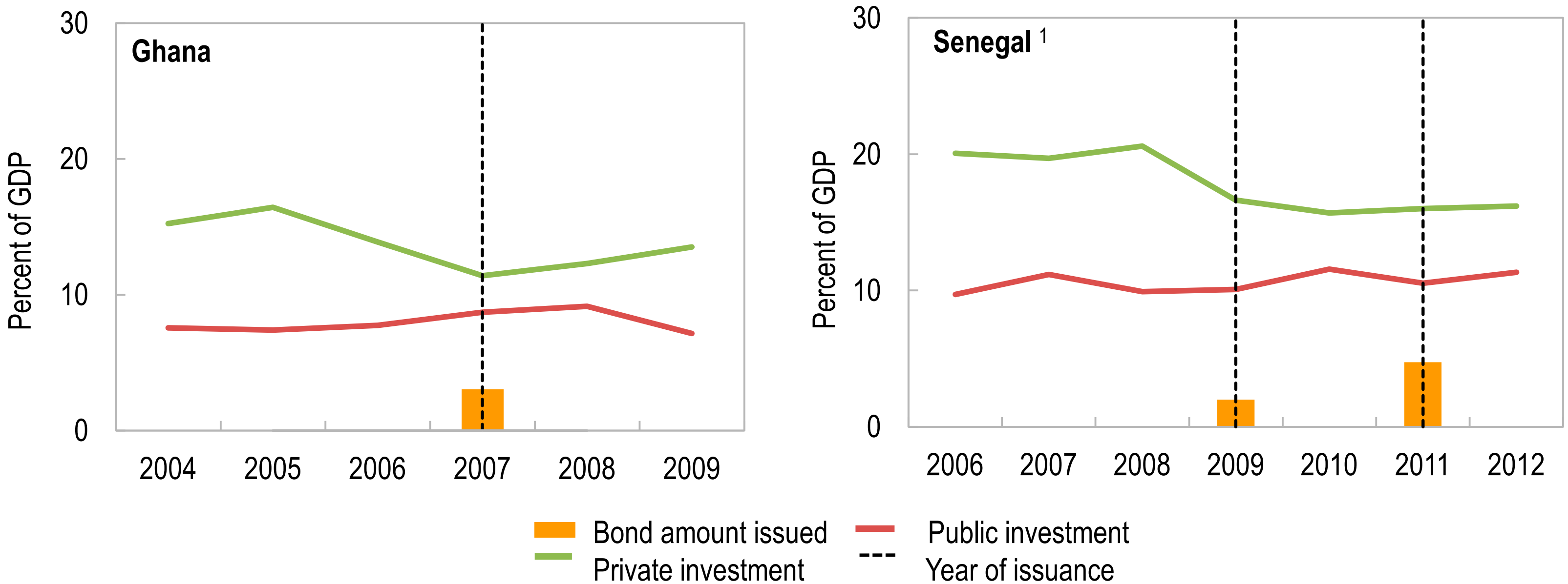
[3] Nigeria's bond amount issued in 2011 is 0.2 percent of GDP.

[4]n the case of Seychelles in 2006, the proceeds were used to clear external arrears to some multilateral and commercial creditors and to repay a collateralized loan. In the other cases, bonds were issued as exchange offers on their defaulted debts.

[5] The proceeds were used to repay outstanding debt to the Paris Club.

Nevertheless, bond issuance has generally not translated into an increase in public investment.

Sub-Saharan Africa: Public Investment after Bond Issuance



Source: IMF, World Economic Outlook database.
[1] Part of the proceeds from the bond issued in 2011 was used to exchange and repurchase the bond issued in 2009.

Issuing sovereign bonds creates both opportunities and risks

- Opportunities:
  - ✓ Access to long-term funding for large investment projects
  - ✓ Improve debt profile with lower debt servicing cost
  - ✓ Can provide a benchmark for pricing corporate bonds in international markets
  - ✓ Strengthen transparency and macro discipline
- Risks:
  - ✗ Encourages excess spending, affecting efficiency of public investment expenditure
  - ✗ Carry costs
  - ✗ Increased vulnerabilities, e.g., FX risk.
  - ✗ Potential repercussion for monetary and exchange rate policy

Recommendations for sub-Saharan African sovereign issuers

- Maintain prudent fiscal policies consistent with debt sustainability.
- Think in terms of an overall medium term debt strategy: e.g., lock in low interest rates with modest amortization over long maturities, while smoothing the maturity profile of the entire portfolio.
- Review capacity and secure appropriate technical assistance.
- Follow best practices to get the best possible access terms.
  - ✓ Assess advisability of issuing a bond within the medium-term debt strategy framework

  If advisable:

  - ✓ Select legal and financial advisers and lead managers
  - ✓ Receive a sovereign rating before issuance
  - ✓ Conduct road shows

Chapter 4:
Energy Subsidy Reform in Sub-Saharan Africa: Lessons and Implications

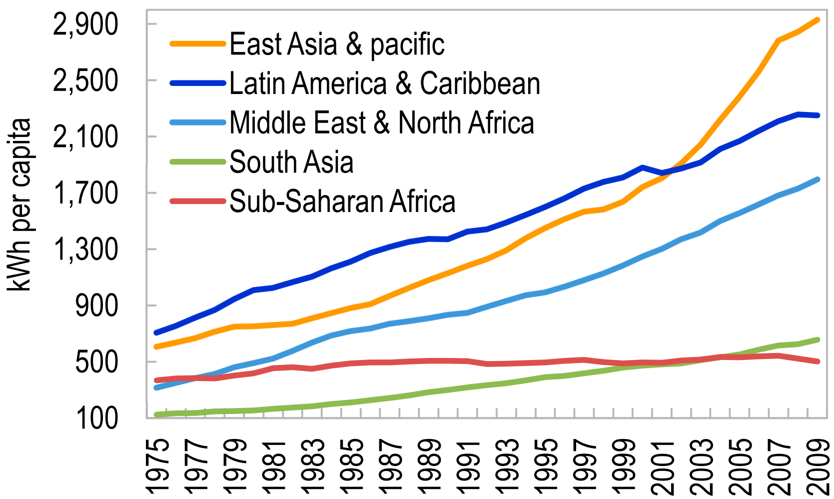
Energy subsidies in Sub-Saharan Africa are costly and poorly targeted

- Energy subsidies are costly— nearly 3 percent of GDP
  - ✓ Direct subsidies and foregone taxes: 1.4 percent of the region's GDP in 2012;
  - ✓ Quasi-fiscal deficits of state-owned electricity companies: 1.4 percent of GDP in 2009–10 : Subsidies to inefficiency!
- Subsidies are poorly targeted
  - ✓ The bottom 40 percent of households receive only 20 percent of the fuel subsidy— i.e., under a universal subsidy policy, the government has to spend 5 dollars in order to give 1 dollar benefit to poorer 40 of households.
  - ✓ Similarly, electricity subsidy in SSA countries is skewed to richer households— among the poorest 40 percent of households, access to electricity is below 10 percent.

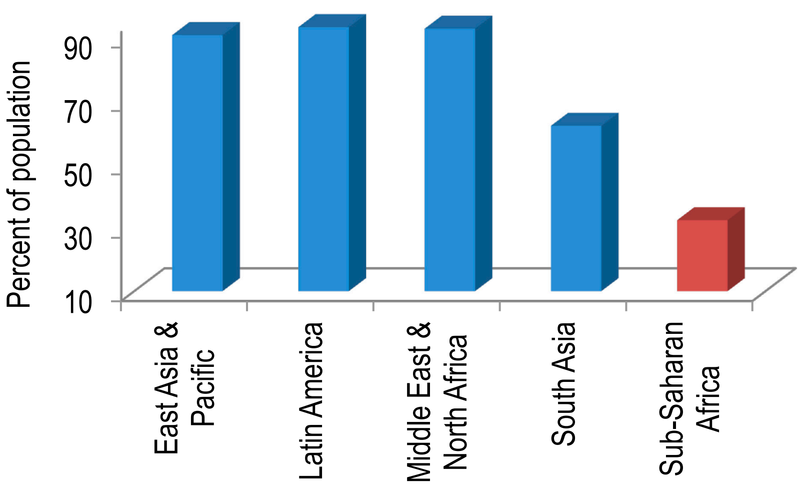
Adverse consequences of energy subsidies go well beyond fiscal costs

- Reinforce inequality, as most benefits accrue to richer households
- Depress growth
  - ✓ reduce investment in the energy sector
  - ✓ crowd-out critical public spending
  - ✓ over-allocate resources to energy intensive sectors
- Exert pressure on balance of payments of energy importers
- Create negative externalities (for example, global warming)

Selected Regions: Electricity Production, 1975–2009



Selected Regions: Access to electricity, 2009



Six key ingredients for energy reform

1. A comprehensive reform plan (e.g., Kenya, Ghana and Uganda)
   - ✓ clear long-term objectives
   - ✓ assessment of the impact of reforms
   - ✓ consultation with stakeholders
   - ✓ promote private sector participation

2. A far-reaching communications strategy (e.g., Namibia, Ghana and Uganda)
   - ✓ inform the public of the size of all energy subsidies and benefits of reform
   - ✓ strengthen transparency in reporting subsidies

3. Appropriately phased and sequenced energy price increases (e.g., Namibia)
   - ✓ Gradually raise prices to allow households and enterprises time to adjust and governments to build social safety nets
   - ✓ sequence increases differently across products

Six key ingredients for energy reform

4. Improvements in the efficiency of state-owned enterprises (SOEs) to reduce their fiscal burden (e.g., Kenya and Uganda)
   - ✓ Improve reporting on SOE costs, set performance targets and incentives, and introduce competition
   - ✓ improve collection of energy bills
5. Targeted mitigating measures to protect the poor (e.g., Kenya, Niger, Ghana)
   - ✓ targeted cash transfers where possible
   - ✓ when cash transfers are not feasible, other mechanisms can be utilized as administrative capacity is developed
   - ✓ SOE restructuring may also require targeted measures (e.g., job training)
6. Depoliticize price setting (e.g., Kenya, Namibia, Tanzania)
   - ✓ implement automatic price mechanism (with price smoothing)
   - ✓ establish an autonomous body to oversee price setting

Reforms pay off over time: findings from Kenya and Uganda

- **Power supply increased**. Post reform, average annual increase in power supply in Kenya was over 5 percent and in Uganda over 9 percent.
- **Distributional efficiency improved.** Distribution losses have steadily fallen and electricity bill collection rates improved
- **Access to grid-supplied power expanded**. After limited progress early on, the number of customers with access to grid-supplied power in Uganda increased by 40 percent during 2006-12. In Kenya, access increased by nearly 140 percent during 2005-11.
- **Progress on reducing quasi-fiscal costs was mixed**.
    - ✓ In Kenya, the automatic price adjustment mechanism helped reduce quasi-fiscal deficit from 1.5 percent of GDP in 2001 to almost zero by 2009.
    - ✓ In Uganda, notwithstanding efficiency gains, the quasi-fiscal deficit increased steadily until 2011 because of higher fuel costs and lack of adjustments in power tariffs.

Thank You