First Borrow

A growing number of countries in sub-Saharan Africa are tapping international capital markets

Amadou N.R. Sy

MOST sub-Saharan African countries long have had to rely on foreign assistance or loans from international financial institutions to supply part of their foreign currency needs. But now for the first time many of them are able to borrow in international financial markets, selling so-called Eurobonds, which are usually denominated in dollars or euros.

This sudden surge in borrowing by countries in a region that contains some of the world's poorest nations is due to a variety of factors—including rapid growth and better economic policies in the region, low global interest rates, and continued economic stress in many major advanced economies, especially in Europe. In several cases, African countries have been able to sell bonds at lower interest rates than troubled European economies such as Greece and Portugal could.

Whether the rash of borrowing by sub-Saharan governments (as well as a handful of corporate entities in the region) is sustainable over the medium-to-long term, however, is open to question. The low interest rate environment is likely to change at some point—both raising borrowing costs for the countries and reducing investor interest—and heady economic growth may not continue, which would make it harder for countries to service their loans. Moreover, political instability in some countries could also make it more difficult for borrowers and lenders alike.

Joining the crowd

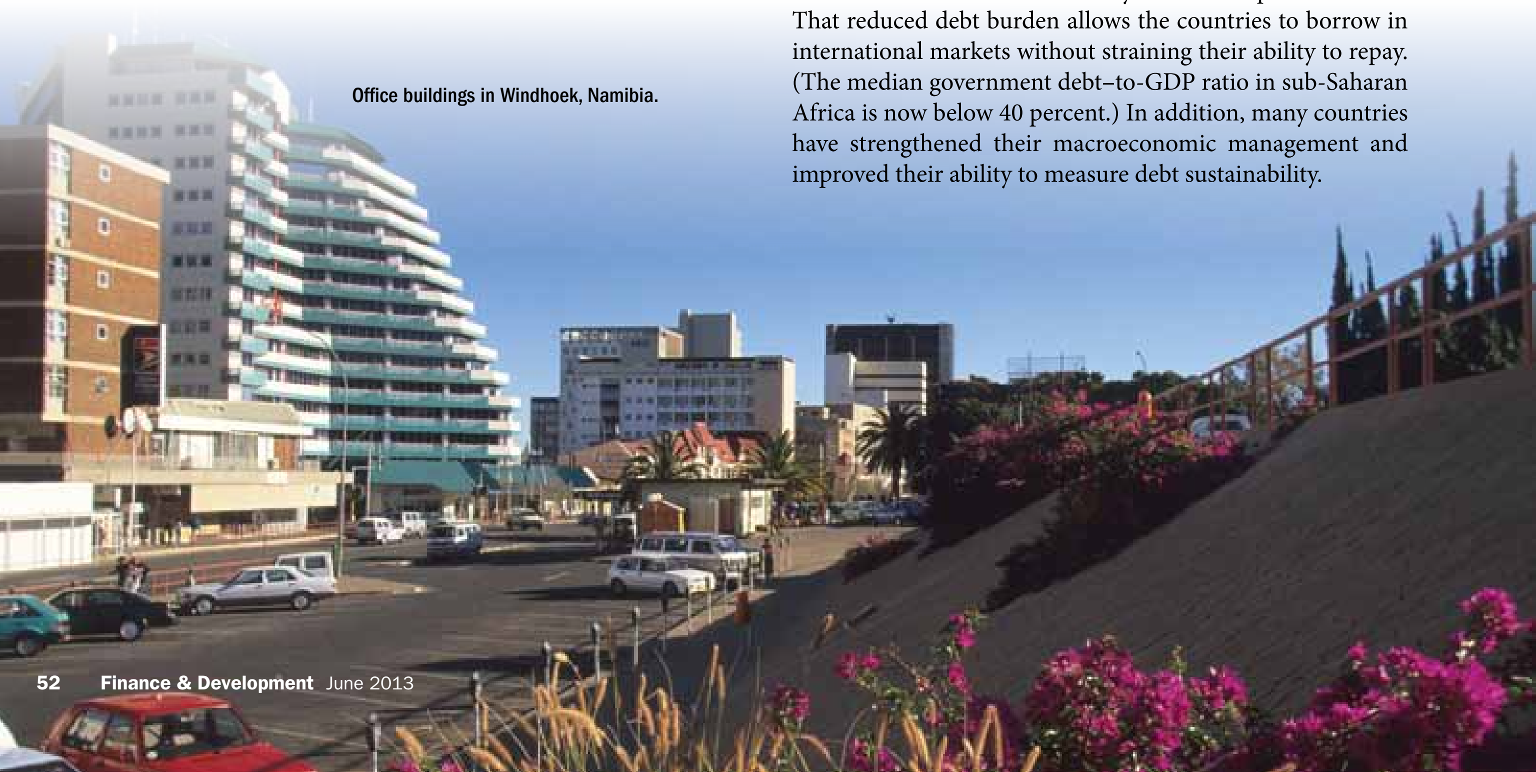
South Africa has issued Eurobonds for a number of years. But more recently, such countries as Angola, Côte d'Ivoire, Gabon, Ghana, Namibia, Nigeria, Rwanda, Senegal, Seychelles, and Zambia have been able to raise funds in international debt markets (see Chart 1). Kenya, Tanzania, and Uganda are expected to issue Eurobonds in the near future. In total, more than 20 percent of the 48 countries in sub-Saharan Africa have sold Eurobonds.

Moreover, a few corporate entities in sub-Saharan Africa have also successfully issued Eurobonds (Guarantee Trust Bank in Nigeria raised $500 million in a five-year bond offering in 2011, and Ghana Telecom issued $300 million in five-year bonds in 2007).

Among the factors propelling the sales are the following:

• ***Changes in the institutional environment:*** Since 2009, the IMF limit on borrowing at unsubsidized (nonconcessional) rates for low-income countries under IMF programs has become more flexible. It is based on a country's capacity and the extent of its debt vulnerabilities. As of December 2011, there were only seven sub-Saharan African countries with limited or no room for nonconcessional borrowing.

• ***Reduced debt burdens:*** The IMF revised its policy after many donor countries and major multilateral financial institutions canceled debts of many less-developed countries. That reduced debt burden allows the countries to borrow in international markets without straining their ability to repay. (The median government debt–to-GDP ratio in sub-Saharan Africa is now below 40 percent.) In addition, many countries have strengthened their macroeconomic management and improved their ability to measure debt sustainability.



Office buildings in Windhoek, Namibia.

• ***Large borrowing needs:*** Many sub-Saharan African countries have significant infrastructure requirements—such as electricity generation and distribution, roads, airports, ports, and railroads. Eurobond proceeds can be crucial to financing infrastructure projects, which often require resources that exceed aid flows and domestic savings.

• ***Low borrowing costs:*** In recent years, sub-Saharan African countries have been able to borrow at historically low yields—at times even lower than those of euro area crisis countries—and under favorable conditions, such as longer repayment periods (see Chart 2). Although borrowing costs are historically low, yields of Eurobonds from sub-Saharan Africa are high enough to attract foreign investors.

Sub-Saharan African countries are not the only ones taking advantage of the prevailing low yields to issue Eurobonds for the first time; some Latin American countries are, too. Bolivia recently tapped international markets for the first time in 90 years. Paraguay recently made an initial offering, and Honduras sold Eurobonds in early March 2013.

Can it continue?

To assess whether the favorable climate for bond issuance is likely to persist, it is useful to focus on factors that drive the cost of borrowing and determine the direction of capital flows. So-called *push* factors affect the general climate for bond sales to international investors; *pull* factors are country-specific and depend to a degree on a country's policies. Gueye and Sy (2010 and 2013) studied these factors in 120 countries between 2000 and 2009.

Among the important push factors were the federal funds rate (the overnight interest rate U.S. banks charge each other to borrow excess reserves); liquidity measured by reserve money (currency in circulation and commercial bank deposits at the central banks for the euro area, Japan, the United Kingdom, and the United States); the price of oil; measures of investors' risk appetite; the ratio of U.S. short-term interest rates to long-term rates (the slope of the yield curve); and U.S. high-yield corporate spreads.

The factors that pull in funds include a country's GDP per capita; the sustainability of its external financial operations, including the current account (which measures what a country spends abroad offset by what foreigners spend in that country) and the ratio of external debt to exports; and macroeconomic stability (mainly measured by inflation performance). Sovereign credit ratings, which are a good proxy for the creditworthiness of a country, capture most of these pull factors.

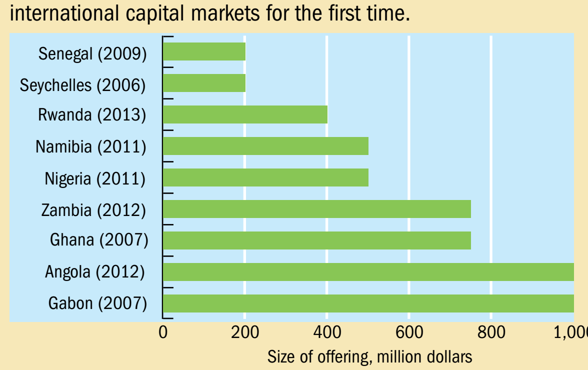
Push factors indicate that the capital inflows driving the purchase of Eurobonds issued by sub-Saharan African countries are sustainable only in the short term. One reason is that the record-low interest rates that prevail in the United States are likely to increase in the medium term. The other is a change in the risk appetite of foreign investors, which has been increasing as they search for higher yields than they can get in the United States and other safe havens. That favors Eurobonds from sub-Saharan Africa. But when global interest rates increase and concerns about the global financial crisis abate, governments in sub-Saharan Africa will have to compete with other issuers for funding.

Pull factors also indicate that capital inflows are sustainable in the short run. Whether they will pull in capital over the long run depends on the ability of policymakers in sub-Saharan Africa to strengthen them. According to IMF projections, the near-term outlook for the region remains broadly positive, and growth is projected to be 5.4 percent in 2013 (IMF, 2013). But downside risks have intensified, mostly stemming from the uncertain global economic environment, which would affect mostly several middle-income countries with trade links to Europe, including South Africa (IMF, 2012). The strength of projected growth in the region is helped in part by supply-side factors, including expanding natural resource sectors. But low-income countries in sub-Saharan Africa have also been

Chart 1

Joining the party

A number of countries in sub-Saharan Africa have sold bonds in international capital markets for the first time.

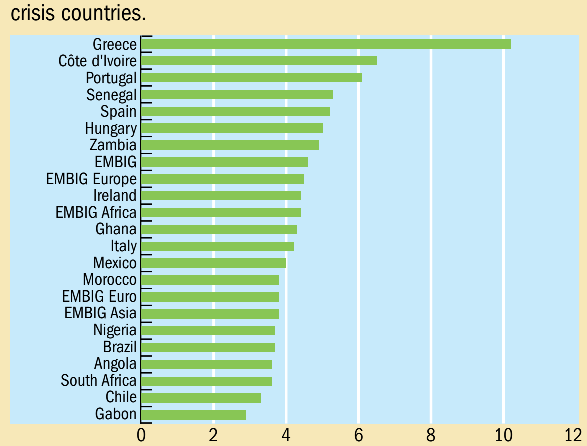


Source: Author's calculations.
Note: Data are through the end of January 2013. Year in parentheses is date of first sale.

Chart 2

Bargain rates

Yields on Eurobonds issued by sub-Saharan African countries are historically low—at times even lower than those of euro area crisis countries.



Source: Bloomberg L.P.
Note: Bond yields as of Jan. 30, 2013, in the secondary market. Eurobonds are bonds issued in a foreign currency, usually dollars or euros. EMBIG is the J.P. Morgan Emerging Market Bond Index Global.

helped by stronger policy frameworks, improved governance, favorable commodity price trends, and sharply reduced external debt burdens (at least for now). Natural resource wealth presents challenges that must be addressed, including how to ensure the efficiency of public spending that arises from such wealth (see Arezki, Gylfason, and Sy, 2011).

Conventional policies

Recent sovereign defaults in sub-Saharan Africa illustrate the importance of strengthening pull factors. The Seychelles defaulted on a $230 million Eurobond in October 2008, following a sharp fall in tourism revenues during the global financial crisis as well as years of excess government spending. The default led to debt restructuring and government spending cuts. Following election disputes, Côte d'Ivoire missed a $29 million interest payment, which led to a default in 2011 on a bond that was issued in 2010.

In several cases, African countries have been able to sell bonds at lower interest rates than troubled European economies.

Other questions about a country's policies arise when external debt is cheaper than domestic debt. Ghana's experience is a case in point. In January 2013, its government could pay about 4.3 percent on a 10-year borrowing in dollars (reflected in secondary market yields on the offering). However, when the government borrows in local currency domestically, the interest rate is at least 23 percent on three-month treasury bills. After inflation differentials are taken into account, the difference between the U.S. dollar and local currency borrowing costs reaches 10.6 percentage points (5.4 percentage points, taking into account currency depreciation). This difference is due in part to changes in the policy environment—monetary policy was tightened in 2012 and the fiscal deficit increased to about 10 to 11 percent of GDP. But the difference is also due to a low external cost that reflects foreign investors' search for yield, their confidence in Ghana's willingness to repay its debt obligations, and its ability to do so because of its positive growth prospects (it is an oil-producing economy). The difference also reflects underdeveloped domestic debt markets with an investor base dominated by banks—which raises domestic borrowing costs—and probably the effects of restricting foreign investors from buying domestic government securities with a maturity of less than three years.

The spate of international borrowing by sub-Saharan African countries at rates sometimes below what many euro area countries are paying is probably unsustainable in the long run unless these countries are able to generate high and sustainable economic growth and further reduce macroeconomic volatility.

Policy actions are therefore important. Short-term policy actions must continue to focus on achieving macroeconomic stability, maintaining debt sustainability, ensuring adequate use of proceeds from financing and investing in projects with high economic "multipliers," avoiding the buildup of balance sheet vulnerabilities from currency and maturity mismatches, and managing the risk of significant slowdown or reversal. Long-term policy actions should focus on developing domestic capital markets and institutions and adequately sequencing the liberalization of the capital account.

Unconventional policies

But countries also must consider the net benefits of unconventional policies because conventional policies will take time to develop and implement.

For example, developing a well-functioning domestic bond market to attract domestic and foreign savings—especially over the long term—is not easy. To that end, conventional advice is that countries must improve macroeconomic policies; debt management; and the regulatory, legal, and market infrastructure—as well as develop an investor base. Money markets are the cornerstone of capital markets and a natural place to start reforms. Commercial banks are typically the largest investors, and a well-functioning interbank market is key. Ensuring the liquidity of domestic markets should also be a priority.

But implementing these conventional policies takes time. Taking examples from a variety of countries, African policymakers could aim for successful second-best policies and then progress to the best ones. For instance, Malaysia has been able to develop the third-largest bond market in Asia (after Japan and Korea) by developing its Islamic capital markets. By strengthening common institutions, the governments in the West African Economic and Monetary Union are increasingly able to mobilize domestic savings from banks and other investors in the eight countries of the union and separately issue treasury bills and bonds. Ethiopia, Ghana, and India have tapped savings from nonresident nationals by issuing diaspora bonds. Finally, the Canadian province of Quebec and Morocco have relied on French-inspired public financial institutions called *Caisses de Dépôts* to develop their domestic capital markets. Learning from experiences of other countries could be a useful way forward in sub-Saharan Africa. ■

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