Concept Note

7th Network Engagement of Public Debt Managers in Africa

Virtual Meeting - 13 April 2023

Focus:

Given the elevated financing costs driven by global inflationary pressures and the ongoing war in Ukraine, the 7th Network Engagement of Public Debt Managers in Africa will explore how Public Debt Managers are addressing the pending roll-over risk, debt refinancing and fiscal risks owing to massive Eurobond issuances coming due for redemption or refinancing over the next 8 to 9 years - particularly in 2024, 2025, 2027, 2028 and 2032. This happens as most African governments have to deal with increasing contingent liabilities and other hidden liabilities.

Debt managers will share lessons on the application of various active debt and risk management strategies such as debt exchanges (or non-credit event debt restructuring or reprofiling) or debt buy-backs in managing and/or reducing government refinancing risk. Attention will also be given to the indicators (and/or risk benchmarks) countries are using to monitor and report on government's refinancing risk, which can impact positively on debt sustainability analysis, sovereign risk and rating analysis. Lessons could also be shared on when and how governments need to act on these indicators.

1. Background and Introduction

In the early 2010's, African Governments took advantage of low policy rates and accommodating fiscal and monetary conditions to issue massive Eurobonds in the international capital markets, which then was a sign of investor confidence in the African credit markets and risks. After the cancellation of debt through the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief (MDR) Initiative, which saw multilateral debt and official bilateral debt decreasing by 43% and 46% between 2004 and 2006, respectively, African countries began a new wave of borrowing from the diversified sources of funding[1].

Not only has the Sub-Saharan African countries debt increased to slightly below US$400 billion at the end of 2019, it has tripled from the low point reached in 2006 after the debt cancellation, see Hooper et al. (2022). Moreover, the composition of creditors has radically changed as well. According to the report, while the share of multilateral creditors saw a smaller decrease from 37% in 2009 to 31% in 2019, the share of debt owed to private sector creditors increased from 29% to 43% over the same period as a result of the larger share of bond debt.

Of the countries eligible for support from the International Development Association (IDA), which is a concessional loan facility of the World Bank, Ghana led first-time Eurobond Issuers in 2007, meanwhile 12 other countries benefiting from the IDA facility also issued Eurobonds or accessed other sources of private-sector financing. It is further noted that debt service has more than tripled in the Sub-Saharan African countries between 2010 and 2019. Meanwhile interest rates also increased reflecting a rise in the bond debt as the higher interest rates continue to be paid to private sector creditors. The ratio of debt service to public revenue has equally increased and this is an

[1] Hooper, E., Le Clainche, V. et Seitz, C. (2022). L'endettement de l'Afrique subsaharienne. Ministère de l'Économie, des Finances et de la Relance. Direction générale du Trésor, Trésor-Économie, No.299, janvier 2022.

illustration of increased vulnerabilities as the number of countries with a high risk of debt distress increase according to the International Monetary Fund (IMF).

COVID-19 has resulted in materialization of most risks, led to a steep rise in spreads across capital markets with the most hardest hit being Emerging Market Countries and those in Sub-Saharan Africa following multiple downgrades by the three main international credit rating agencies. Some of these countries have endured spreads of more than 1000 basis points compared to pre-pandemic levels of around 470 basis points. While the spreads have compressed again to around 320 basis points at the end of 2020, which allowed African Issuers to re-enter the international capital markets in early 2021, a shift from concessional to non-concessional and competitive financing sources has come at a higher cost of borrowing, even though there are other benefits that countries derive such as improved liquidity especially as sovereign credit ratings also improve.

But improved liquidity of a country's external currency debt does not imply the same cost and risk benefits as the improved liquidity of its local currency debt as greater reliance on market financing especially from external debt does not only lead to refinancing risk but exchange rate risk as well. With Eurobond refinancing challenges already imminent as early as in 2024 and 2025, unfortunately conditions for favourable refinancing or rollover of debt have worsened.

Discussing post-crisis global trends in public debt management in the G20 High Level Seminar[2] on Public Debt Management, which led to the revision (later in 2014) of IMF-WB 2001, 2003 Guidelines for Public Debt Management, it was acknowledged that in as much as the 2007-09 global financial crisis has left a number of legacy problems for all sovereign debt portfolios, many large sovereigns have been burdened with high debt levels, while several others were facing near-term refinancing risk. Other factors considered important on sovereign borrowing included the shrinking universe of safe assets, the internationally agreed tightening of financial regulation and the rapidly increasing role of Local Currency Bond Markets (LCBMs).

Further, the seminar observed that extremely low interest rate environment prevailing then stimulated rapid debt accumulation in many advanced, emerging as well as developing economies. The future of Local Currency Bond Markets, will strongly depend on the greater use of modern financial instruments and techniques already widely employed by sovereign borrowers from advanced economies. These techniques included Indexed Instruments, Buybacks and Debt Exchanges.

Even under these circumstances, given the potential for sizeable economic losses if a government cannot refinance its debt, refinancing risk should be given particular emphasis. Clearly, the government can reduce refinancing risk and borrowing costs by issuing in maturity segments that are attractive to a wide range of investors, while the most conventional way to measure/assess refinancing risk is through indicators such as average term to maturity and the share of debt maturing within one year.

2. Context and Discussion

A comparative case study[3] on the impact of Eurobond issuance in Africa, note that while South Africa was first to issue a Eurobond in the international capital markets back in 1995, followed closely by Mauritius and few others in 1996, in early 2000s more African countries followed suite by debuting

[2] Chair Summary (2013). The G20 High-Level Seminar on Public Debt Management under Non-Conventional Conditions on Debt Markets held in Moscow Russia.
[3] Chuku, C. and M. Y. Yenice (2021), Eurobonds, Debt Sustainability and Macroeconomic Performance in Africa: Synthetic Control Experiments, Working Paper Series No 356, African Development Bank, Abijan, Cote d'Ivoire.

in the international capital markets through their first issuances. In a matter of two decades (from 2000 to 2019) about 21 African sovereigns issued Eurobond instruments valued at over $155 billion.

The comparative case study further notes that regardless of the problems stated with regard to Africa's sovereign bond issuances, especially concerns related to mispricing of African risk, these Eurobond issuances remain an important channel for raising external financing and accelerating growth and development. Given that Africa's sovereign bond covenants are rapidly evolving from plain-vanilla type instruments to more sophisticated instruments with hedging enhancements by creditors that come in various forms including collateralization with natural capital assets, risk-free papers and put options – it is important that countries have active debt management frameworks that make for impactful use in the proceeds from Eurobond issuances (Chuku and Yenice, 2021).

Advancing the argument for an active debt management approach to mitigate refinancing risk and reduce debt, through which the cash management, debt management (including investor relations) and risk management sections within Debt Management Offices are encouraged to operate jointly in achieving short-term funding objectives or medium-term debt strategy objectives and indirectly, the much longer-term debt sustainability analysis objectives, the question remains whether the techniques underlying active debt management are or should be applied uniformly to both local and external refinancing challenges.

Some of the main debt portfolio drivers often precipitating refinancing challenges and even debt crises are having excessive short-term debt and/or excessive foreign currency denominated debt, respectively. Managing the structure of the debt portfolio, for instance by imposing limits on the two, is in most cases within the control of Debt Management Offices.

A case study[4] commissioned by CABRI shared interesting insights on the management of refinancing risks in West African Economic and Monetary Union (WAEMU) comprising of countries such as Benin, Burkina Faso, Cote d'Ivoire, Mali, Niger, Senegal and Togo. Countries in the WAEMU region were able to diversify their funding options by adding new instruments in their debt portfolio – such as Eurobonds (external), Public Private Partnership (PPPs), Islamic Finance and other related bonds – and by raising funds in the regional market as part of their domestic funding. The maturity, currency and interest rate composition of their debt profile has changed since 2013.

The first country – Togo showed a consistent higher share of domestic debt, but a lower domestic debt average term to maturity signifying the dominance of short-term debt. Meanwhile the share of external debt was consistently lower but with a higher average term to maturity. In Burkina Faso, which present a unique case – the share of external vs domestic debt changed from 78 percent and 22 percent in 2013 to 51 percent external debt and 49 percent domestic debt in 2020. More of the domestic debt was issued in the short end of the curve, which also is an indication of refinancing risk pressures. Cote d'Ivoire on the other hand changed the debt composition from 50 percent external debt and 50 percent domestic debt in 2013 to 64 percent external debt and 36 percent domestic debt in 2020.

Looking at the average debt maturing within one year a higher proportion (23.4 percent) is domestic debt, while external debt comprises only 3.5 percent. Of the seven countries in the region, four have over 20 percent of their domestic debt maturing within 1 year and only 6 percent of external debt maturing within 1 year. It is apparent that the source of refinancing risk is domestic debt. Countries such as Benin started restructuring in 2018 and government was able to repay debt maturing within

[4] CABRI Case Study (2021). Managing Refinancing Risk in a Volatile and Uncertain Environment Within the West African Economic and Monetary Union (WAEMU). Available at www.cabri-sbo.org

2 years to local banks and further replaced its short-term debt with a Euro denominated loan guaranteed by the World Bank at a lower interest rate over 12 years.

Improvement in Benin's credit ratings made the restructuring transaction possible with better terms and conditions. While the lessons learnt from WAEMU regarding factors that increase refinancing risk are highly noted, some of the challenges and shortcomings identified in the region include: the need to develop appropriate indicators to identify risks, monitor those risks and take timely action; debt restructuring should extend the yield curve and introduce longer-term maturities; reforms to improve sovereign ratings should be prioritized and buy-in obtained from all decision makers.

African countries should be lauded for taking the necessary steps to instill investor confidence and improve their sovereign creditworthiness by tapping the international capital markets. However, it appears that not enough lessons were learnt from past episodes of debt restructuring and the debt relief mechanisms instituted to restore their debt situations back to the path of sustainability. A large number of African sovereign continue to contract too much long-term external debt, while domestic debt is short-term in nature – thus precipitating more refinancing risk and bringing back the wave of debt crises that damaged growth prospects and negatively impacted on development.