**PRESENTATION TO CABRI**

**Is there a role for Debt Managers in Developing Local-Currency Debt Markets**

**By Phakamani Hadebe**

*'It is important to remember how fortunate we are as country to have a **currency** and **a bond market** that is seen in every way as a source of strength and it's a huge responsibility for us to keep it that way'. (Lawrence Summers)*

Good morning Ladies and Gentlemen, I am honoured to stand in front of you today on this important topic. Lawrence Summers' quote above, while also talking about currency, does highlight the important role played by the domestic bond market. This, as stated above, is a huge responsibility. The **creation, development and sustainability of the domestic bond markets** is an absolutely necessity, essential and extremely important tool for developing the country's economy. If we want to build a bigger pool of investors, we need to build our domestic bond markets. To build a sustainable developed bond market demands **integrity, openness and transparency**. It is only after such a journey has been travelled that the domestic capital market begins to influence the country's economic literature, and experience shows that deep liquid bond markets ensure access to long term local currency debt. This contributes to long term investments such as infrastructure development needs. The IFC paper on Developing the Domestic Capital Markets (2016) emphasizes that the domestic markets have an important role to play in mobilizing private capital to finance domestic developments – By giving companies the ability to borrow domestically in local currencies, domestic capital market can also reduce currency mismatches for borrowers, thus reducing systemic risks. At the same time, government bond markets create tools to manage macroeconomic and fiscal risks and provide important pricing benchmarks.

I am not going to be long here as I know that we are familiar with the domestic capital markets literature and the possible impact of a developed bond markets. **I am more interested in talking about the development of the Continental (Africa) capital markets since late 1990s and the lessons learned and the role of debt managers.**

By late 1990s there were no more than 5 countries that could issue five year fixed income domestic bonds in Africa (this includes Northern Africa). Most of the countries were going through the HIPC (Highly Indebted Poor Countries) Initiative of the Bretton Woods Institutions. According to CNBC Africa, the 1996 HIPC Initiative, supplemented by the 2005 Multilateral Debt Relief Initiative (MDRI), cancelled about US$100 billion of debt in 30 African countries in exchange for economic reform.

Our discussions, in the late 1990s, on creating domestic capital markets in the Continent were very elementary. The concentration then was how to extend the issuance from 3 months treasury bills into 6 – 9 – 12 months bills. We were also talking about how can we introduce short term fixed interest instruments which were issued by very few countries. There was also a great appetite for introducing primary dealers as we were aware of the liquidity impact of such a move. After more than 20 years, the Continental Domestic Capital Markets are in a better shape than they were then. Notwithstanding, we cannot deny that we have not achieved the growth pace we were anticipating in the 1990s. The era where we saw a lot of progress is between 2000 and 2007: We were holding a number of debt development gatherings, like today's CABRI Workshop and we seemed to have found a plan on how to develop our domestic capital markets. We had a vision and we began to influence our partners as to how this vision could be realized. For example, we used to hold two meetings annually with the OECD talking about the continental capital markets. One meeting was held in South Africa and the other in Amsterdam, a day before the OECD bond market meetings. We also attended the IMF/World Bank Public Borrowers Forum and we were given a space to talk Africa. The IMF/World Bank teams that were visiting countries in the continent with a view to helping them develop their capital markets began to include experts from the Continent to assist these countries. The Secretary-General of the OECD and the then Minister of Finance, Mr Trevor Manuel, agreed to a need to establish an OECD/Africa Debt Management Office that was supposed to operate from the Development Bank of Southern Africa. Johan Krynauw was supposed to run that office. UNCTAD also wanted to be part of the Team. They had very good debt statistics and they were willing to work with us. South Africa hosted a number of countries from around the world on debt management, though the majority was from the Continent. The OECD, IMF/World Bank Public Borrower Forum and African Capital Markets were attended by similar people and this ensured continuity. As we began to know each other better, we communicated better and progress was visible to all of us. There were also monthly telephonic discussions where if you

had some challenges, you could call and the African experts would assist. We could see that the quality of presentations was improving. Our expectations of future African capital markets were growing.

Then, 2008 happened and the Global World went into recession. During this time, there was a change in priorities from some of our Partners. OECD which was supposed to co-finance the African Debt Office with South African Government had other priorities; There was a change in the South African political landscape. The global appetite for domestic currency bonds was only left to those emerging markets with developed bond markets**. But it was the quantitative easing / monetary easing of the developed world that changed the capital market landscape in the developing world[1].** The world had cheaper money and there was a great demand for yield pick-ups. The domestic bond markets that were at the nascent stage could not attract any foreign appetite. Governments soon learn that it was easy to borrow the cheap money from the global capital markets and they were taking advantage of the high commodity prices. The spree of borrowing was such that between 2014 and 2015, sub-Sahara countries hit a record, issuing a US$16 billion debt. Noises of whether Africa is on the brink of another debt crisis started circulating. The plunge in commodity prices has exasperated the situation. On 30 October 2017, a paper written by Trevor Hambayi in Quartz Africa had a heading; 'African countries are having a risky affair with Eurobond debt and it could end very badly'. In 2016 October, the UN had warned that Africa risks fresh debt crisis as levels of borrowing rise sharply. **Amidst all these, we have ignored prioritizing the domestic currency markets.**

The problems that we are now facing were bound to happened. The former Federal Reserve Chairman, Ben Bernanke in his speech in 2013 stated; "Among advanced economies, the mutual benefits of monetary easing are clear. The case of emerging market economies is more duplicated ……..Because many emerging market economies have financial sectors that are small or less developed by global standards but open to foreign investors, they may perceive themselves to be vulnerable to asset bubbles and financial imbalances caused by heavy and volatile capital inflows, including those arising from low interest rates in the advanced economies".

[1] See the paper written by Saroj Bhattarai (University of Texas) and Arpita Chatterjee (University of New South Wales*); **Effects of US Quantitative Easing on Emerging Economies.***

Africa can therefore not rely on foreign domestic markets because of currency risks and neither can she rely on domestic services, as they are too small to sustain growing economies. Relying on commodities is risky because of their volatile nature.

***Where does this leave the debt managers in Africa?***

The Africa Infrastructure Country Diagnostic (AICD) estimated that Africa needs about US$100 billion per annum to catch up with the rest of the world on infrastructure. With such volatility in commodities and foreign debt markets and low savings ratios, such will not be achieved if Africa ***does not create, develop and sustain the domestic capital markets.*** As bond managers, you are more important than you think. You are the people who can contribute in pulling Africa forward and grow her economies. You have the means to build markets that will ensure that Africa has access to long term local currency debt that will support our infrastructure development needs. Your role is seen globally as paramount – James Carvilla, the ex-advisor of Bill Clinton once commented; 'Bonds have so much power over economy – I used to think if there was incarnation, I wanted to come back as the president, or the Pope……But now I want to come back as the bond market. You can intimidate everyone'.

**Do Bond Managers really have power to influence Economy – A South African Case Study**

In 1999, we felt that the South African bond market needed to move to a higher level. Encouraged by a document written by IMF Officials, we created the South African Comprehensive Debt Management. The following were some of the impact of the Comprehensive Debt Management:

- **We already had a 30 year maturity bond** – our research indicated that we needed to improve our issuance in a 30-year maturity area, the R186: **Economic Impact** – Pension Funds and Institutional Investors, including long term investors such as Property Investors were now able to match their long term assets to long term liabilities. South Africa grew this bond to be the longest liquid fixed income instrument in the emerging markets and it was used globally as a global benchmark for emerging markets. The matching of Assets and Liabilities at the long-end of the curve changed both the South African and emerging market financial markets. This had a great impact on the South African financial markets as it became a hedge for long-term loans and investments.

- **We consolidated all the bonds into fewer benchmark bonds, improving liquidity of the bond market**. We also **bought back 'dog bonds'**: **Economic Impact** – This, together with Primary Dealers, enhanced the liquidity of the bond market from R3 trillion to R9 trillion within a space of 5 years. South Africa was rated 6th most liquid bond market in the world by the OECD. The market had a very efficient 1 to 30 year benchmark for different kinds of financial instruments. We managed to build a bigger pool of investors, while saving government money.
- Introduce **inflation linked bonds**: **Economic Impact** – Diversified the market and brought global investors to South Africa. Enhance the financial market as there are so many financial instruments linked to inflation. Life Cover Sector benefitted a great deal as they need to match their liabilities with long term inflationary linked assets.
- Retail Bonds: **Economic Impact** - Because we are not charging service fees, forced banks to reduce their bank fees and also increase the return as Retail Bonds are priced off the Government yield curve. This has helped improve the savings culture in RSA, although this can still improve.
- Some of **Public Private Partnership Projects (PPP)** projects priced off the yield curve.
- There is a **viable corporate bond market**.
- We used domestic debt market to contribute in eliminating the **country's external vulnerability** and improve the Country's reserves.
- Multilateral institutions are happy to issue the rand loans which is less volatile for the continent.

**The above initiatives were not only good to fund the government deficit, but were essential to grow the country's economy. This is what Africa needs and this is a role that should be played by managers of domestic currency debt markets.**

**In conclusion,**

**Carvilla is correct, Bonds do have power over the economy. This demands a lot of work and credibility.**

The IMF Working Paper on; ***'The Role of Domestic Debt Markets in Economic Growth: An Empirical Investigation for Low-income Countries and Emerging Markets'***; (prepared by S.M. Ali Abbas and Jakob E. Christensen) is able to statistically show the positive impact between domestic debt market and economic growth. Abbas and Christensen developed a new public domestic debt (DD) database covering 93 low-income countries and emerging markets over the 1975 – 2004 period to estimate the growth impact of DD and concluded that DD exerts a positive overall impact on economic growth.

**The role of Debt Managers is far bigger than just funding the government deficit, it has potential in influencing the economy.**