

And what about Africa's original sins?

Sub-Saharan African governments have made significant progress in developing domestic local currency bond markets over the last decade. While this bodes well for their countries' economic resilience and facilitates necessary investments, many challenges remain.

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Recent commentaries and opinion pieces have argued, and rightly so, that the problem of “original sin”, countries' inability to borrow long-term in their local currency, has been largely overcome by world's leading emerging market economies, including Brazil, China, Mexico, Russia and South Korea (see e.g., Wigglesworth 2013). In fact, the vast majority of government borrowing in these countries now happens through domestic, local currency bond markets. On the whole, this is good news; both for emerging markets, many of which suffered destructive currency crises because of - or at least intensified by - original sin and for the stability of the global economy, which could benefit from a more diversified supply of non-dollar assets for investors.

Where most commentators reporting on original sin are silent, however, including Professors Barry Eichengreen and Ricardo Hausmann who coined the term at the end of the 1990s and have followed up on the phenomenon ever since, is on the progress being made by developing countries beyond the BRICs and their likes, in Sub-Saharan Africa in particular. One important reason for this has been the dearth of reliable, comprehensive data on African bonds.

As of recent, international organisations such as the IMF, African Development Bank and the OECD have started to collect African bond market information more systematically (see OECD 2012), allowing for a closer look at where these countries stand in “washing away” original sin. This is exactly what we have tried to do ourselves in a recent working paper, which brings together these different sources (Essers and Cassimon 2012). And we find much to be optimistic about.

In the paper we show that in Sub-Saharan Africa overall government debt has declined substantially, from around 100% of GDP on average during the 1990s to just over 40% in 2010, in large part due to the large-scale external debt cancellations many low-income African countries benefitted from under the 1996 Heavily Indebted Poor Countries Initiative (HIPC) and its 2006 successor, the Multilateral Debt Relief

Initiative. In addition, domestic debt now occupies a much greater share of total government debt - approximately 40% in 2010. To the extent that this reduces Africa's reliance on cheap, but increasingly scarce external funds and demonstrates a growing capacity to mobilise domestic savings to self-fund their development (with the potential to enhance governments' accountability to their own citizenries), we should applaud such a shift.

True, not all of this domestic debt is long-term and some of it may be even denominated in dollars rather than local currency (as is the case in Liberia and, to a lesser extent, in Angola). But while one needs to remain cautious in generalising trends, further analysis reveals that in quite a number of African countries, governments have successfully issued fixed-rate local currency bonds with tenors of at least ten years. Next to South Africa, also Kenya, Nigeria, Namibia and Mauritius are tapping their domestic bond markets for securities with maturities of twenty years or more. Perhaps even more striking, “ex-HIPCs” including Malawi, Mozambique, Rwanda, Tanzania, Uganda and Zambia now issue ten(+)-year bonds locally. Typically (but again not always) bond issuance covers a variety of tenors and takes place on a regular basis in these countries. Just-published IMF research suggests that improved institutions and macroeconomic policy have had a hand in the development of African bond markets (Mu et al. 2013).

It thus is clear and, we believe, deserves mentioning that not only the largest and most vibrant of emerging markets have made strides in combating original sin. Especially given where they started their journey, several smaller and lower-income African economies too have taken major steps on the path towards original sin redemption. Larger and deeper domestic, local currency bond markets are a welcome addition to Africa's traditionally shallow financial systems. That said, a number of important provisos apply.

First of all, the advances made by African countries are primarily on the domestic front of original sin. International



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original sin, i.e. the inability to borrow in local currency *from abroad*, has proven a much more intractable issue. Whereas many of the countries mentioned have started (or plan) to issue bonds on international financial markets, mainly in the US and Europe, these are all denominated in dollars. Such eurobond sales could undo the efforts made in expanding and deepening domestic local currency bond markets. Moreover, participation of foreign investors in local bond markets (in which case these bonds become part of *external* local currency debt) remains very limited in Sub-Saharan Africa, with the exception of South African, Nigerian and a couple of other markets.

One potentially interesting class of international investors is the African diaspora. World Bank researchers have looked into the potential of so-called “diaspora bonds”, drawing on the experiences of India and Israel with such instruments (Ketkar and Ratha 2010). It is argued that because the diaspora is better informed and has a direct interest in its home country’s development, the issuing government may enjoy a “patriotic discount” on the prices of bonds marketed to nationals living overseas. And since diaspora investors also tend to have liabilities in their country of origin they are said to be less averse to accruing local currency assets. Ethiopia’s disappointing trials with diaspora bonds to fund grand infrastructure projects however suggests the practical execution of this innovative idea is not without its own problems.

A second qualification is that African bond holdings are still dominated by local, commercial banks, which holds risks in the event of a domestic banking crisis and may crowd out credit to the private sector. Contrary to popular beliefs, the assets of African non-bank financial institutions - pension funds, insurance companies and mutual funds - have grown tremendously in recent years, thanks to regulatory reforms. On average, these assets now compare comfortably to those in emerging Asia and Latin America in percentages of GDP, according to another IMF study (Adelegan and Radzewicz-Bak 2009). In need of appropriate assets to match their liabilities, pension funds in particular are natural candidates to hold longer-term local currency government bonds.

Third, in most African economies secondary markets for government bonds are relatively underdeveloped, as are corporate bond markets. The lack of liquidity in these segments leads to higher prices, lowers predictability, and hampers the development of more advanced risk management products. International financial organisations could and are indeed helping Sub-Saharan Africa in building and strengthening their local currency bond markets, thereby reducing original

sin and its inherent risks. Next to the data assembly and analysis already mentioned, organisations such as the African Development Bank and the World Bank are acting as “market makers” in a growing number of African countries. Through the African Domestic Bond Fund the former is to invest in longer-dated local currency government bonds that meet certain eligibility criteria, in the hope to jumpstart further market development. Since 2005 the African Development Bank has also issued offshore bonds denominated in or linked to African local currencies, including Ghanaian cedi, Zambian kwacha and Ugandan shilling. This should over time provide benchmarks for potentially interested non-resident investors. Together with its private lending arm, the International Finance Cooperation, the World Bank operates the Efficient Securities Markets Institutional Development (ESMID) programme in East Africa, which aims to facilitate cross-border listing and investment in the region by means of technical assistance and support with demonstration issues.

Ultimately, however, to wash away original sin, it are African nations themselves that will have to prove to domestic and international investors that they are capable of borrowing responsibly and using the obtained funds to exploit growth-enhancing opportunities.

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