



A New Strategy for Developing African Bond Markets

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Key insights from policy discussions at OECD

- **Liquid local bond markets are crucial for emerging markets to attain:**
 - **Enhanced financial stability**
 - **More efficient financial intermediation, including low public borrowing costs**
 - **More successful participation in global financial landscape**
- **Modern public debt management and developing liquid domestic bond markets are mutually reinforcing strategies**
- **Government bond markets support development of corporate bond markets**

Work on sovereign debt and bond markets at OECD (1)

- **OECD Working Party on Public Debt Management**
- **Members: senior debt managers of 30 OECD countries, plus IMF and World Bank as observers**
- **Discussion of OECD policies on public debt management and government securities markets**
- **Policy dialogue with emerging markets in Global Debt and Global Bond Market Forums organised by OECD in co-operation with IMF and World Bank**

Work on sovereign debt and bond markets at OECD (2)

- **OECD Forum on African Public Debt Management (since 2006)**
- **Practical policy dialogue between African debt managers and OECD Working Party**
- **Main purpose of Forum: acquaint African debt managers (and other financial officials involved in public debt markets) with OECD best practices, techniques and market operations**

Outline of presentation

- **Key characteristics of public debt management and bond markets in Africa and link between debt management and bond market development**
- **Outline of new strategy for developing liquid bond markets in Africa**
- **Major challenges**

Chart 1: Characteristics of bond markets in Africa (mix of local- and foreign-currency debt)

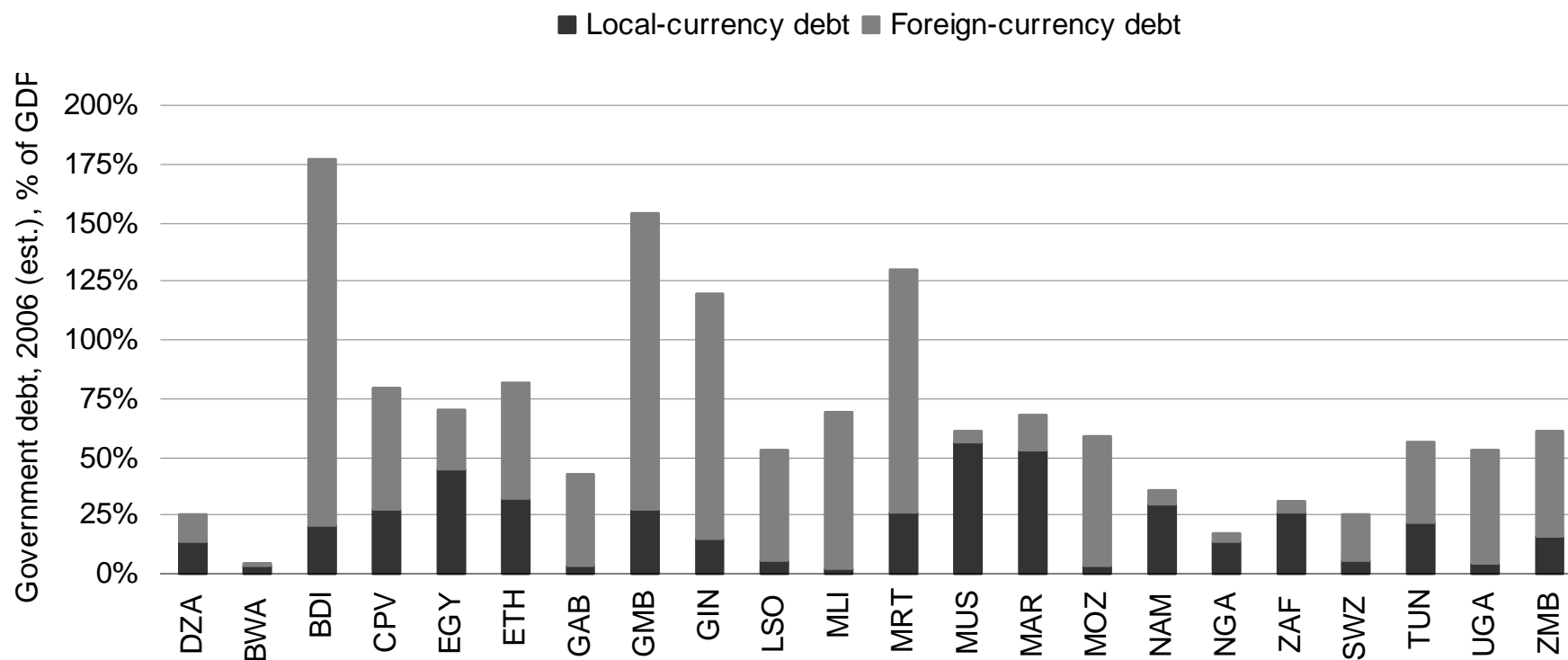


Chart 2: Characteristics of bond markets in Africa (domestic debt maturing under 1 year)

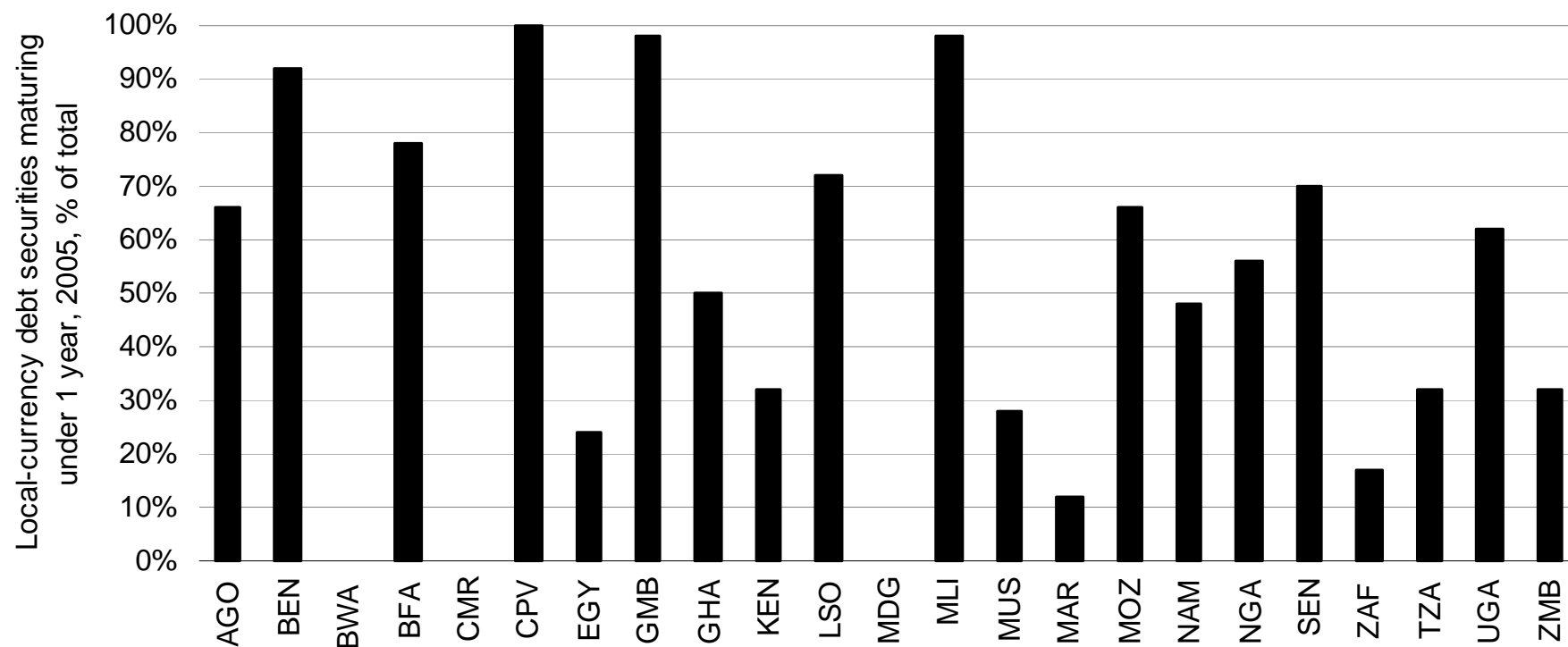


Chart 3: Relative burden of debt servicing (local- and foreign-currency debt)

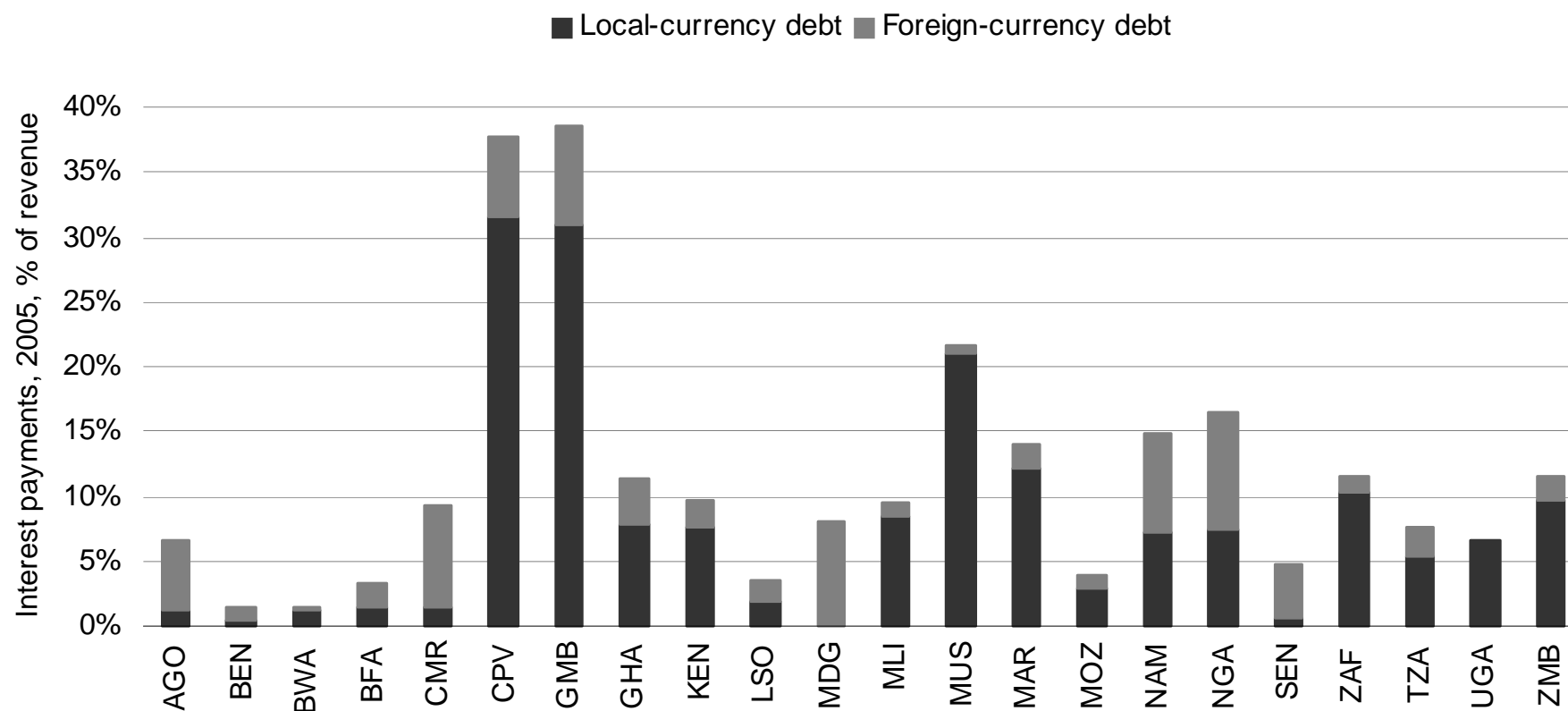
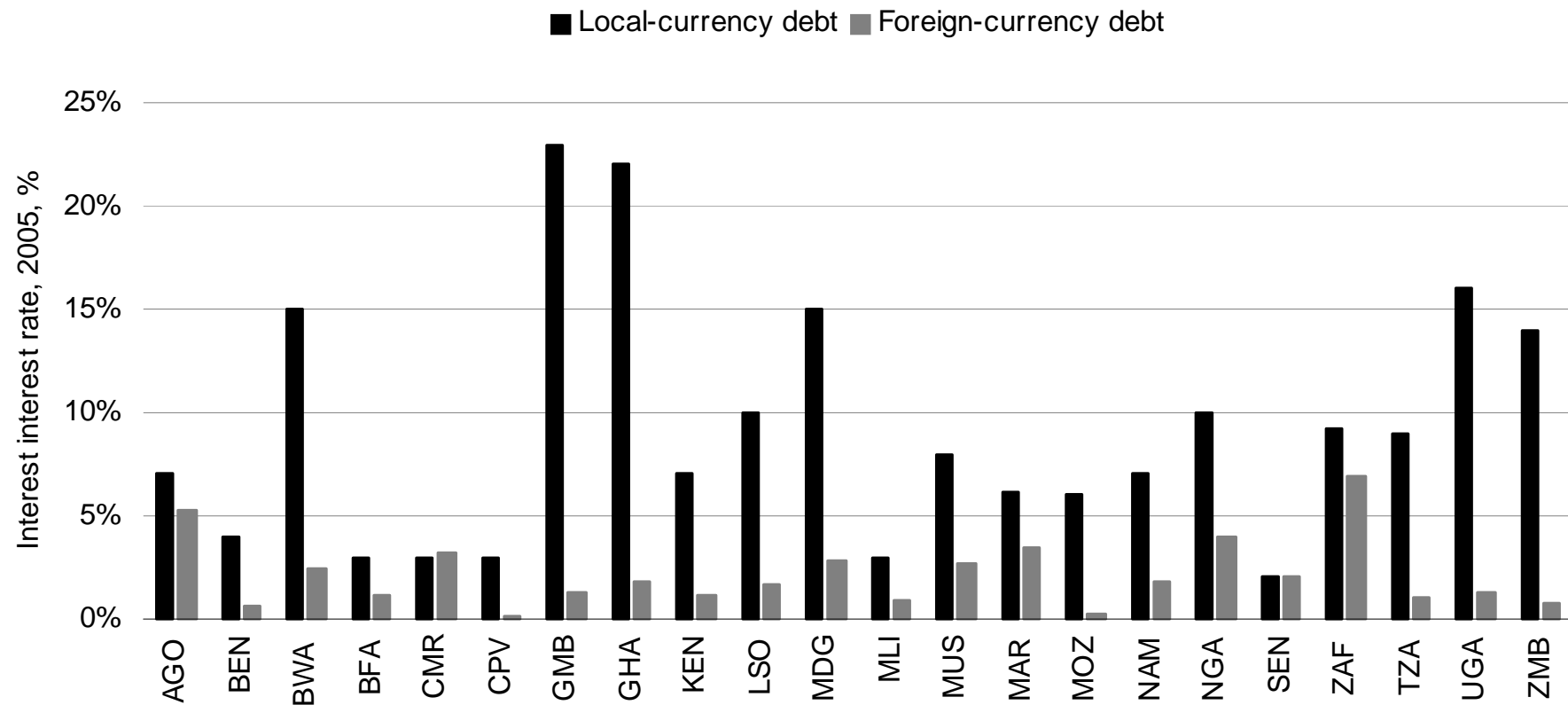


Chart 4: Relative interest rates (local- and foreign-currency debt)



Weaknesses in public debt management

- **Many African countries do not use best practices for debt management. As a result:**
 - **An operational medium-term debt strategy is missing**
 - **Various liabilities (including off-balance sheet liabilities such as guarantees) are not integrated into a single portfolio**
 - **Costs and risk of different instruments are not properly assessed**

Weaknesses in African bond markets (1)

- **Links between debt management practices and bond market development:**
 - **Modern public debt management practices are used by only a handful of countries**
 - **As a result, government securities markets in Africa generally remain rudimentary compared with markets in middle-income and more developed economies**

Weaknesses in African bond markets (2)

- **Many countries continue to suffer from original sin**
- **Predominance of foreign-currency debt reflects availability of, and continued reliance on, concessional multilateral and bilateral funding (Chart 1)**
- **Issuance of debt in domestic market often remains erratic and in small volumes, leading to problems in developing liquid instruments and benchmarks**

Weaknesses in African bond markets (3)

- **Many yield curves do not extend beyond five years at longest**
- **In many markets, liquidity tends to be concentrated at short end of yield curve (Chart 2)**
- **Narrow investor base with local commercial banks as largest holders of government securities, often in excess of 50% of outstandings**
- **Lack of a wider institutional investor base reduces demand for longer-term securities**

New strategy for developing liquid African bond markets

- **Starting point: formulation of risk-based public debt management strategy**
- **Implications:**
 - **Important tool for achieving strategic debt targets based on benchmarks**
 - **Management of integrated portfolio, including domestic and foreign debt and guarantees**
 - **Assessment of costs and risk, providing information for optimal debt portfolio and sustainable debt position**

Implications for primary public bond markets

- **Market-based issuance of (nominal and inflation-linked) bonds at optimal maturities with optimal mix of local and foreign currencies**
- **Creation of liquid benchmarks**
- **Development of wide (diversified) institutional investor base**
- **Use of primary dealer system**

Implications for secondary public bond markets

- **Liquid government bonds along yield curve (also at longer maturities)**
- **Market characterised by interest rate, liquidity and currency benchmarks**
- **Liquidity boosted by dominance of relatively few benchmarks and diversified investor base**

Implications for bond markets in general

- **Establishment of interest rate, liquidity and currency benchmarks will help improve transparency, predictability and liquidity of fixed income debt markets more in general**
- **Government bonds as pricing benchmark and tool for interest rate risk management**
- **Support to financial infrastructure (clearing and settlement, disclosure requirements, trading platforms)**

Major challenges in implementing new strategy (1)

- **Structure of outstanding debt is much more complex**
- **Volatility in macro environment is usually much higher**
- **Emerging market economies lack natural stabilising structural characteristics that allow use of effective counter-cyclical policies**

Major challenges in implementing new strategy (2)

- **Emerging debt managers are facing original sin**
- **Many emerging markets are not in position to benefit from international risk-sharing**
- **Emerging debt managers, therefore, face greater and more complex risks in managing their public debt portfolios and executing their funding strategies**

Recommendations regarding technical assistance (1)

- **Agreement on public debt management strategy among IMF, OECD, World Bank, AfDB and other agencies (including NEPAD, MEFMI, WAIFEM and BCEAO/BEAC) is essential**
- **OECD Forum on African Public Debt Management brings all relevant agencies together for a policy dialogue about key strategic issues**

Recommendations regarding technical assistance (2)

- **OECD Forum also functions as a clearing house to share and exchange information on programmes of work of all relevant multilateral and bilateral agencies**
- **In parallel to its annual Forum on African Public Debt Management, OECD also organises annual Regional Workshops on African Public Debt Management and Bond Markets**

Recommendations regarding technical assistance (3)

- **Main objective of Regional Workshops: focus on operational and technical aspects of interacting with, and developing, local bond markets**
- **Agendas of Regional Workshops are determined in consultation with African debt managers, as well as African agencies (including AfDB)**

Recommendations regarding technical assistance (4)

- **Results of Regional Workshops (and Forum meetings) are being widely distributed so as to inform and support technical assistance programmes of IFIs (including IMF, World Bank, and AfDB), regional organisations, and bilateral agencies**

OECD background material

- **H.J. Blommestein and J. Santiso, “New Strategies for Emerging Domestic Bond Markets in the Global Financial Landscape”, *OECD Development Centre Working Paper 260*, April 2007**
- **H.J. Blommestein (2005), ed., *Advances in Risk Management of Government Debt*, Paris, OECD**
- **H.J. Blommestein and G. Horman, *Public Debt Management and Bond Markets in Africa*, OECD, Paris (forthcoming)**