



# Unresolved issues and challenges of bond markets in Africa

***G7 High Level Workshop 2007  
-Developing Bond Markets  
in Emerging Market Economies-***

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# Overview

- Objectives for developing bond markets in low income countries (LICs) remain different from those in emerging market economies (EMEs):
  - One key objective: improving government financing modalities
  - Additional objectives
  
- Bond market development in Africa requires specific solutions:
  - Specific constraints faced by Sub-Saharan African countries
  - Targeted initiatives are needed

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# Objectives for developing bond markets in Africa

- One key objective: improving government financing modalities
  - Bond issuance as an efficient way of diversifying sources of government funding
  - In a context characterised by a general shift away from the monetary financing of governments
    - progress in several countries (e.g. Burundi, Gambia, Mauritania and the CAEMC)
    - gradual elimination of central bank's advances taking place in WAEMU countries

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# Objectives for developing bond markets in Africa

- One key objective: improving government financing modalities
  - Several advantages to be expected from market finance compared to external or concessional financing :
    - In terms of control over access to resources
    - Predictability
    - Transparency
    - Governance: incentives for greater transparency in managing public finance and for stricter fiscal policies

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# Objectives for developing bond markets in Africa

- Paving the way for government financing through domestic bond markets needs some fundamental prerequisites:
  - Minimum budget transparency
  - Budget financing from the central bank forbidden or strictly limited
  - Liberalisation of interest rates and banks' access to central bank financing
  - Efficient instruments for the monetary policy to manage the level of liquidity and eliminate interest rate distortions

# Objectives for developing bond markets in Africa

- Some recent developments in African domestic government debt markets

<b>Government Securities Markets in Sub-Saharan Africa</b>			
<i>(in % of GDP)</i>			
	1980-1989	1990-1994	1995-2000
Burundi	3	2	6
The Gambia	3	13	23
Ghana	12	8	24
Kenya	21	23	22
Namibia	0	8	19
Nigeria	28	29	16
South Africa	30	37	45
Zimbabwe	35	29	37
Sub-Saharan Africa (excl. CFA Zone)	11	12	15
<i>HIPC countries</i>	9	6	8
<i>non HIPC countries</i>	14	18	23
<small>source: IMF, J. Christensen, 2005</small>			

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# Objectives for developing bond markets in Africa

- Four additional objectives should be stressed :
  - Providing long-term financing to the private sector since:
    - long-term financing needs of developing economies are insufficiently met
    - equity markets are underdeveloped
  - Reducing overall exchange rate risk
  - Stimulating local savings
  - Contributing to more efficient monetary policy

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# Developing bond markets in Africa: specific challenges and solutions

- Major constraints faced by LICs in developing local bond markets:
  - Not only the default risk of issuers is high but it is difficult to assess :
    - information needed to evaluate the risk often lacking
    - transfer risk (for non-resident investors)
  - Partially inadequate institutional, legal and regulatory framework
  - Weak local demand
  - Weaknesses of the technical environment:
    - rudimentary technical infrastructures in some cases
    - lack of tools for managing interest rate risk
    - public debt management

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# Developing bond markets in Africa: specific challenges and solutions

- Targeted initiatives are needed:
  - Giving priority to sub-regional bond markets in monetary unions, to achieve critical mass by removing obstacles to intra-regional capital flows
  - Encouraging subsidiaries of multinational groups and also international and regional financial institutions to issue bonds on local markets
  - Encouraging the use of best practices (certification of accounts, transparent and reliable financial reports, sound bankruptcy laws and anti money laundering regulation...)
  - Considering the use of ODA flows as collateral for state-issued bonds in extreme circumstances (even though the question of ODA flows' predictability appears to be a practical constraint)
  - Focusing G7 technical assistance on active public debt management

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# Developing bond markets in Africa: specific challenges and solutions

## → Conclusions:

- Compared to EMEs, bond markets in LICs are lagging at an earlier stage of development
- Developing local currency bond markets is worth considering given favourable macroeconomic conditions (debt relief initiatives, improved growth rates) and expected benefits
- Provided debt sustainability objectives are met and prudent fiscal policies are kept in place, to avoid renewed debt crises