MEFMI

Macroeconomic and Financial Management Institute of Eastern and Southern Africa

HIGHLIGHTS OF THE 2018 MEFMI COMBINED FORUM

THEME:

LEVERAGING AFRICA'S FINANCIAL RESOURCES

9 October 2018
Holiday Inn Resort Bali Benoa
Bali, Indonesia

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ACRONYMS

ACFTA	African Continental Free Trade Agreement
AfDB	African Development Bank
BOP	Balance of Payments
CENDEP	Central Bank Deposit Programme
COMESA	Common Market for Eastern and Southern Africa
EAPS	East African Payment System
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
KYC	Know Your Customer
LCFP	Local Currency Funding Programme
MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
PPPs	Public Private Partnerships
REPSS	Regional Payment and Settlement System
SADC	Southern African Development Community
SDGs	Sustainable Development Goals
SIRESS	SADC Integrated Regional Electronic Settlement System
SMEs	Small and Medium Enterprises
SSA	Sub Saharan Africa
SWFs	Sovereign Wealth Funds

FOREWORD

MEFMI held the annual Combined Forum for Governors, Permanent Secretaries and Ministers of Finance and Economic Planning on the side-lines of the IMF/World Bank annual meetings on 9 October 2018 in Bali, Indonesia. The theme **Leveraging Africa's Financial Resources**, was explored under three topics :

- Promoting Intra-African Trade
- Africa Resource Mobilisation; and
- Yield Trends and Implications for Sovereign Liabilities.

Trade related bottlenecks if addressed, would further support member countries in pursuit of economic growth. MEFMI also has keen interest to ensure its member countries achieve this growth in a sustainable manner.

I would like to acknowledge African Export-Import Bank (AFREXIMBANK) for supporting the 2018 Combined Forum. Collaboration of this nature is critical as it ensures that the relevant capacity gaps that drag down growth are identified for the Institute to play its part to address them through enhancing capacity development. With partners like AFREXIMBANK we can work towards developing mitigation strategies relevant for the region. Indeed the presentations by AFREXIMBANK and Investec Asset Management at the Forum brought to the fore critical issues that policy makers in the region should remain aware of as the continents endeavours to drive the development agenda.

It is my hope that the outcomes of the discussions of the Forum, highlighted in this report, will assist stakeholders of the Institute to design relevant policy interventions that address these emerging issues. The urgency to do so even takes importance in the wake of the on-going de-risking by international financing partners who are reviewing their relationships with banks in the Africa region.

Michael Atingi-Ego

MEFMI Executive Director

EXECUTIVE SUMMARY

African leadership has demonstrated the aspirations to grow continental trade by signing the African Continental Free Trade Agreement (ACFTA). Closely associated with this is the need to address trade related bottlenecks, including making trade related information available. The continent faces major constraints to foster intra-African trade flows, including, a narrow export base dominated by low value added products (primary products) and low industrial capacity of most African countries. The AFREXIMBANK has developed several initiatives intended to bridge these gaps. These include a pan African payments and settlements platform, inspection and certification centres, guarantee programs and the MANSA credit repository platform.

In response to this African

- Entities are called upon to leverage pan African initiatives so that the continent can bridge gaps where it has been lagging behind the rest of the world.
- Countries need to invest in technology and develop domestic entrepreneurial skills to close the existing gaps if the great potential for sustainable economic development through Intra-African trade is to be realized.

Most of Africa's financial resources are invested off the continent in more developed financial markets. At the same time African Development Financial Institutions lack sufficient funding, making them less effective as catalysts of promoting Intra African trade.

One way to bridge this gap is for African sovereign institutional investors like Pension funds, Sovereign wealth funds and Central banks to consider investing in Pan African financial institutions. This could be modelled on a similar programme run by the Foreign Trade Bank of Latin America, Inc.

Over the past decade, Sub Saharan Africa (SSA) took on high levels of external debt, taking advantage of investor appetite for SSA Eurobonds, while enjoying high commodity prices for their exports. This seemed a great opportunity against the backdrop of a generally low interest rate environment at the time. Subsequently, Eurobond issuances have proven to be a risk to balance sheets of most SSA countries owing to the on-going normalization of monetary policy in advance economies, strengthening US dollar now exerting pressure on SSA countries' currencies and translating into higher debt servicing costs. Hence the SSA region finds itself faced with debt sustainability risks.

To address these developments SSA countries need to consider:

- Development of local currency bond markets to minimise future external debt vulnerabilities.
- Adoption and implementation of fiscal rules that limit borrowing to manageable levels.
- Countries could consider exploring and supporting the development of sustainable Public Private Partnerships (PPPs).

I. OPENING AND WELCOME REMARKS

WELCOME REMARKS BY Mr. MICHAEL ATINGI-EGO, EXECUTIVE DIRECTOR, MEFMI

The incoming MEFMI Executive Director, Mr. Michael Atingi-Ego, was introduced by the Vice-Chairman of Board of Governors and Chairman of the MEFMI Executive Committee, the Governor of the Bank of Rwanda, John Rwangombwa. Michael joined MEFMI in September 2018, replacing Caleb Fundanga whose tour of duty ended in August 2018.

In his opening remarks as ED, Michael introduced the theme for the Forum "Leveraging Africa's Financial Resources" , explaining that it would be explored through presentations on three (3) topics namely; Intra- Africa Trade, Africa Resource Mobilisation, and Yield Trends and Implications for Sovereign Liabilities.

Michael also acknowledged the AFREXIMBANK for the substantial support towards the 2018 Combined Forum. He extended a special welcome to Mr. Denys Denya, the Executive Vice President (Finance, Administration & Banking Services), and his team.

KEY NOTE ADDRESS BY Mr. DENYS DENYA, EXECUTIVE VICE PRESIDENT, AFRICAN EXPORT - IMPORT BANK

The keynote address was delivered by Mr. Denys Denya - Executive Vice President of AFREXIMBANK on behalf of Professor Benedict Oramah, President and Chairman of the Board of Directors of AFREXIMBANK.

He advised that AFREXIMBANK pays close attention to emerging issues in the Africa region and has developed several initiatives aimed at tackling some of these challenges. Some of these would be discussed later in the day. He thanked the Central Banks present at the Forum who helped AFREXIMBANK to raise $5.8 billion by 2017 to Finance Africa's Trade and reduce the cost of funding for African entities.

Denys commended the efforts of MEFMI and wished everyone successful deliberations.

This section highlights key presentation points and discussion points.

2. FORUM PRESENTATIONS AND DISCUSSIONS

2.1 SESSION 1: PROMOTING INTRA-AFRICAN TRADE

This session discussed a few initiatives by AFREXIMBANK aimed at promoting intra-African trade. These included the following;

a) Payments and Settlements

To support mainstream informal trade into economies of African countries, the Bank has developed the Pan African Payment and Settlement Platform which seeks to address the settlement and foreign currency constraints to intra-African trade and formalize the enormous informal trade flows. The main objective is to provide an alternative to the current high-cost and lengthy correspondent banking relationships to facilitate trade and other economic activities among African countries, through a simple, continent wide, low-cost and risk- controlled payment clearing and settlement system. Specifically, the platform is intended to achieve the following objectives to:

- Reduce costs of cross-border payments, and the duration/time variability of cross-border payments across all of Africa.
- Decrease liquidity requirements of commercial banks for correspondent banking relationships; and liquidity requirements of central banks for settlement.
- Strengthen Central Banks' cross border payment systems oversight through effective reporting and sound risk management.

b) Industrial Parks and Export Processing Zones

In support of light manufacturing in Africa, the Bank has developed an initiative for establishment of Industrial Parks and Export Processing Zones focusing on agro-processing industries and light manufactures that are aimed at stimulating industrialization in African countries.

c) Inspection and Certification

In its efforts to support African exports to attain international standards, the Bank is supporting the establishment of internationally accredited Inspection and Certification Centres that will support African exports to meet international standards and accredited conformity assessments.

d) Guarantee Programmes

The Bank has developed various guarantee programmes ; First, the country risk guarantees, which cover exporters African countries against country risk events in the destination country of their goods or services. Second is the Intra-African investment finance and guarantee programme that facilitates Foreign Direct Investment (FDI) flows between African countries and ring-fences the rights of investors from one African country operating in another African country. Third is the interstate transit guarantees which aim to facilitate easier flow of goods and services across borders and also reduce transit time and costs, particularly in Africa's landlocked countries.

e) Intra-African Trade Fairs

The Bank will organise the Intra-African Trade Fairs to take place every two years to facilitate countries to showcase their investment, tourism and cultural/ creative economy products with the inaugural one taking place from 11 to 17 December 2018 in Cairo, Egypt.

The MANSA Repository Platform

The MANSA Repository Platform, named after Mansa Musa, the powerful ruler of the West African Malian Empire in the 1300s who championed significant regional trade in his time. Specifically, it is single source of primary data required to provide more insight on African counterparties for due diligence procedures.

The ultimate aim of the platform is to increase trade in, and with, Africa by de-risking compliance and strengthening relationships between international banks and global trading entities with their African counterparties, by promoting good governance, transparency and accountability.

Key Discussion Points

The presentation generated a rich discussion on the following issues:

a) The motivation for these initiatives are supported by the relatively low ratio of intra-African trade estimated at 13-15 percent of the total African trade. By comparison, intra-Asian trade is estimated at 59 percent of total trade of Asian Economies. Similarly, intra -European trade is estimated at 69 percent of total trade.

b) That the fundamental problem is with poor infrastructure and connectivity between African states. Although air transport is improving, it should be acknowledged that rail transport is very important for trade over long distances. However the significant funding constraints to address infrastructure gaps in most African countries explains the low industrialisation and laggard development in the region.

c) The lack of high entrepreneurship cadres that are key to value added production which calls for skills development in the continent. AFREXIMBANK provides support in this area by facilitating investment guarantees to support entrepreneurs take up risks.

d) Multiplicity of regional payment systems with significant overlap which needs to be streamlined. For instance SIRESS serves SADC, EAPS serves EAC and REPS serves COMESA. Consequently, a number of countries use more than one platform which justifies the AFREXIMBANKs platform that would serve the whole continent and further support local currency payment so as to deal with foreign exchange risk constraints.

2.2 SESSION 2: AFRICA RESOURCE MOBILISATION

This session covered the AFREXIMBANK initiatives for Africa Resource Mobilisation, namely the Central Bank Deposit Programme (CENDEP), and the Local Currency Funding Programme (LCFP)

a) Central Bank Deposit Programme (CENDEP)

Almost all of Africa FX Reserves are held in deposits with financial institutions outside of the African Continent where investors can access deep liquid markets with securities that exhibit a low correlation to domestic environment. The African sovereign investors in these markets sacrifice yield in this arrangement while African Development Financial Institutions may struggle to find funding. CENDEP therefore endeavours to mobilize part of these reserves and provide favourable returns to the depositors while adhering to investment best practice. At inception, CENDEP raised US$75.0 million and has grown to US$ 5.8 billion as at the end of 2017.

The CENDEP is modelled around a similar programme run by the Foreign Trade Bank of Latin America, Inc (Banco Latino Americano De comercio Exterior, S.A - BLADEX,) a Latin American Multilateral Bank that started in January 1979, which mobilizes funds from Central Banks in Latin America to a tune of US$2.5 billion annually for export finance.

The key objectives of CENDEP are threefold. First, the Programme aims to enable the Bank provide term loans in support of value added exports in CENDEP deposit holding countries. Second, the Programme aims to facilitate the financing of essential imports to CENDEP participating countries. Third, the Programme aims to contribute to ongoing efforts at improving regional trade and integration of African economies by supporting intra-African trade flows.

b) Local Currency Funding Programme (LCFP)

Driven by the need to reduce exchange rate risks related to borrowing in foreign currencies, the Bank established the Local Currency Funding Programme (LCFP) in 2016, as an opportunity to finance trade programmes in local currencies. The Programme seeks to raise funding from both the money markets as well as local debt and capital markets with a goal of raising a cumulative amount of US$10 billion from Africa by end of 2021.

The LCFP has four key objectives. First is to help promote intra-regional transactions, second is to broaden and complement the Bank's existing menu of instruments aimed at assisting African businesses; third is to reduce currency mismatches on balance sheets of clients across the continent and the fourth is contributing to the development of capital markets in the Bank's member countries. This is done by supporting the countries to raise funding within the country through currency swaps, issuing bonds, commercial paper, and facilitating borrowing on bilateral basis.

Key Discussion Points

The discussion focussed on the following issues:

a) Development of capital markets in the continent cognisant of the looming threat of external debt vulnerability in the continent. To this end AFREXIMBANK has in place an advisory capital markets department to study countries' current debt structures and advise how to best maximise the benefits of different funding sources while minimizing the associated costs and risks. The provision of AFREXIMBANK funding to member countries to lower cost of borrowing to support trade and trade related activities.

b) Commended AFREXIMBANK on the CENDEP Programme modelled on similar initiatives by BLADEX in Latin America, which is a unique initiative in the African Context. This however, calls on the need to leverage funds like the pension funds and sovereign wealth funds to its support.

c) Investment grade of AFREXIMBANK - rated Baa1 (Moody's), BBB+ (Global Credit Rating) and BBB- (Fitch) all with a stable outlook while most guidelines of African central banks call for reserves to be invested in at least an A rated agency.

d) Commended MEFMI for its efforts in developing an alternative tool that meet regional needs. The Internal Credit Risk Analysis Tool (ICRAT) that seeks to identify inconsistencies in market based information and flags them for closer scrutiny by the Reserves managers is an example.

2.3 SESSION 3: YIELD TRENDS AND IMPLICATIONS FOR SOVEREIGN LIABILITIES

2.3.1 Main points in the presentation:

The Session sought to revisit the borrowing trends and explore developments over the previous few years. Starting in 2006 – when the first Sub Saharan African Eurobond was issued by Seychelles, more than a dozen governments in the region have issued Eurobonds, raising about USD29 billion in 35 issuances between September 2006 and June 2017.

Most of these issuances were oversubscribed, reflecting high investor interest, particularly from the USA and Europe. This interest was mainly driven by the high yields on these bonds compared to the record low interest rates in the U.S. and in other countries at the time. This was mainly due to the coordinated monetary easing in the aftermath of the 2007-2008 financial crisis. Given the global economic environment then, Eurobond issuance seemed a great tactical opportunity for African sovereigns. In issuing these bonds, the sovereigns anticipated that their economies would stay on a positive upward growth path, and hence hoped that their debt-to-GDP ratios would remain low. However, fast forward to 2018, the narrative has been very different. The plunge in commodity prices has left countries with weaker balance of payments, budgetary stress, exchange rate pressures and inadequate foreign exchange reserves to meet their external financial obligations.

Moreover, the debt which seemed cheap at the time of issuance has become expensive as a result of depreciation of the domestic currencies of most of these countries, especially during 2014 -2015 when the US dollar strengthened substantially. The effective cost of borrowing is the interest rate at which a bond is issued, adjusted by the annual currency depreciation rate.

2.3.2 Key Discussion Points

a) Although the session presentation focused on the risks of external debt, the discussions emphasised the need to look at the overall sustainability of debt levels including domestic debt, in the search for solutions. To mitigate the external debt vulnerability over the long term, it was emphasised that countries need to focus on the development of their domestic capital markets to reduce debt vulnerabilities associated with external borrowing.

b) Use of fiscal rules in SSA countries was called for in managing the build-up of debt levels. Experience of Brazil and a few other Latin American countries who adopted a fiscal rule to control the growth of federal spending to the rate of inflation was cited. Supporting efforts on fiscal discipline including on putting in place strong macro frameworks were called for.

c) The use of Public-Private Partnership (PPPs) to scale up delivery of infrastructure was explored as an alternative to borrowing. South Korea and South Africa were given as examples where infrastructure projects have been successfully implemented using the PPP model. It was however noted that some countries in the MEFMI region faced challenges with Power Purchase Agreements like:

   i. Supply-demand mismatches, which lead to creation of contingent liabilities when supply of the power outstrips the demand.

   ii. Mismatch in tariff structure on the utility side and cost of the producers, which necessitates government to intervene and pay to top up for the utility side

   iii. Mistiming arising from cases where power has been generated but not transmitted, leading to governments paying for the resultants costs to the private sector.

To manage this, Governments should put in place credible and transparent regulatory frameworks for managing these projects to ensure that the expected efficiency gains and value-for-money are achieved.

d) Furthermore attention was drawn to off- balance sheet items that increase the governments' indebtedness. In deciding to borrow or not, governments should ensure that they have adequate resources if the projects that they have borrowed for cannot generate returns to pay back.

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