In Pursuit of Best Practice in Debt Management

Presentation on Efficient Debt Planning and Management in the Public Sector ; the Question of Sustainability :

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Presentation agenda

1. What is Public Debt Management and Why is it Important?
2. Summary of the Debt Management Guidelines
3. Debt Management Objectives and Coordination
4. Transparency and Accountability
5. Institutional Framework
6. Debt Management Strategy
7. Risk Management Framework
8. Development and Maintenance of an Efficient Market for Government Securities

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What is Public Debt Management and Why is it Important?

- Sovereign debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

- Sovereign debt managers seek to ensure that both the level and rate of growth in their public debt is sustainable, and can be serviced under a wide range of circumstances while meeting cost and risk objectives.

What is Public Debt Management and Why is it Important?

- Sovereign debt managers share fiscal and monetary policy concerns that public sector indebtedness remains on a sustainable path and that a credible strategy is in place to reduce excessive levels of debt.

- Debt managers ensure that the fiscal authorities are aware of the impact of government financing requirements and debt levels on borrowing costs. This include public sector debt service ratio, and ratios of public debt to GDP and to tax revenue.

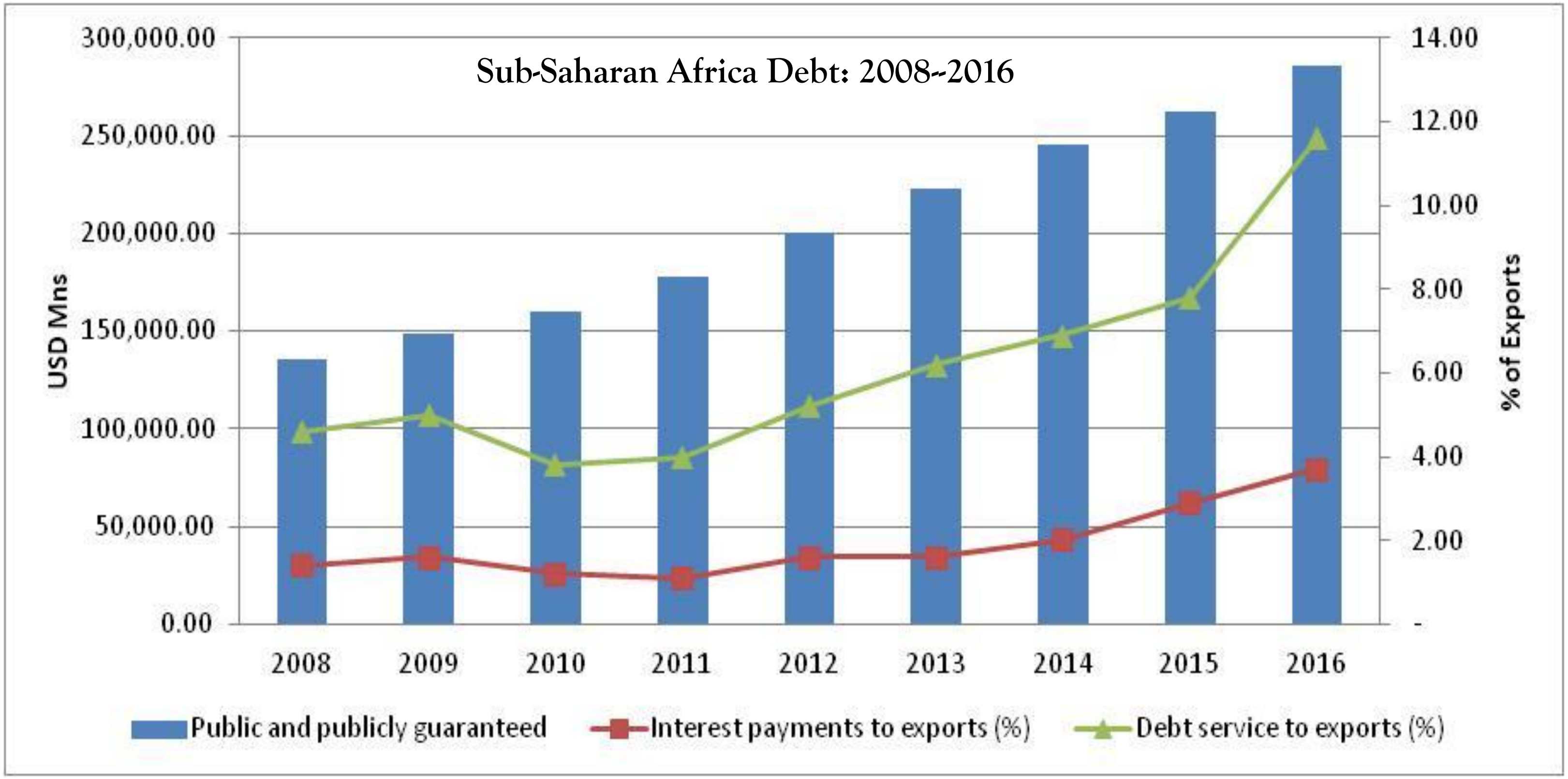
“A government's debt portfolio is usually the largest financial portfolio in the country”

What is Public Debt Management and Why is it Important?

- Remember, there are limits to what sound debt management policies can deliver. Sound debt management policies is not a cure or substitute for sound fiscal and monetary management.

- If macroeconomic policy settings are poor, sound sovereign debt management may not by itself prevent any crisis. Sound debt management policies reduce susceptibility to contagion and financial risk by playing a catalytic role for broader financial market development and financial deepening. Experience supports the argument, for example, that developed domestic debt markets can substitute for bank financing (and vice versa) when this source dries up, helping economies to weather financial shocks

Introduction to African Debt



Source: World Bank, International Debt Statistics

Africa's debt

Genesis of the debt crisis

•The external debt crisis of Sub-Saharan Africa is best understood when considered as an integral part of the global debt crisis that emerged in 1982.

•The global debt crisis arose as a result of:

- Over-borrowing by the developing countries and reckless lending by international commercial banks in the 1970s
- Collapse of world commodity prices (including especially petroleum) in the early 1980s,
- sharp increase in international interest (lending) rates in 1982

Africa's debt Crisis Cont.

•Increase in foreign borrowing that preceded the debt crisis was triggered by the oil price shocks of 1973 and 1979, which resulted in acute current account deficits in most non-oil producing less developed countries.

• These countries resorted to foreign borrowing to overcome the problems raised by the internationally generated shocks to their balance of payments.

•At the same time, during the period following the oil price hike of November 1973, the international commercial banks were awash with "petro dollars" that they were anxious to recycle.

•The immediate effect of the financial crisis was that developing countries debts could no longer be rolled over- the debtor countries could only service their debts by increasing exports or reducing imports.

Africa's debt Crisis Cont.

•Public debt as a share of GDP has increased since 2013 and is now above 50 percent of GDP in close to half of the Sub-Saharan economies. Median level of public sector debt in Sub-Saharan Africa rose from 34% of GDP in 2013 to 48% in 2016 and is expected to exceed 50% in 2017. The number of low-income countries in debt distress or facing high risk of debt distress increased from 7 in 2013 to 12 in 2016, and all of the region's frontier markets or other countries with credit ratings, except Namibia, have been downgraded below investment grade.

•The debt increase has been driven by a widening in fiscal deficits, slow growth, the slump in commodity prices, and exchange rate depreciations in some countries. While current accounts have improved and exchange market pressures eased somewhat, international reserves are below adequacy levels in many countries.

Africa's debt Crisis Cont.

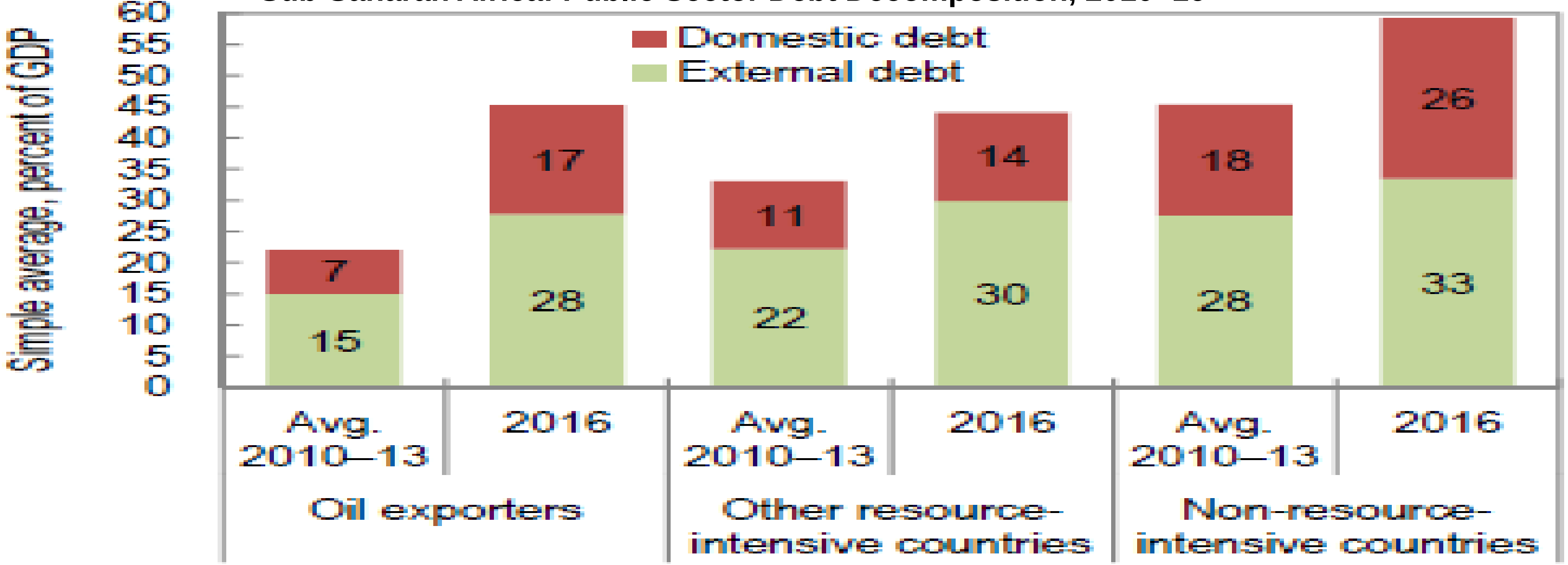
•Elevated public debt levels raise concerns about debt sustainability in the region.

•Debt servicing costs are becoming a burden, especially in oil-producing countries, and in Angola, Gabon, and Nigeria are expected to absorb more than 60 percent of government revenues in 2017.

African Debt Crises Cont.

•The composition of public debt has changed since 2013. Though external debt remains dominant, its share in total public debt has fallen in recent years as governments in oil exporting and non resource-intensive countries have increasingly relied on domestic bank and nonbank financing.

Sub-Saharan Africa: Public Sector Debt Decomposition, 2010–16



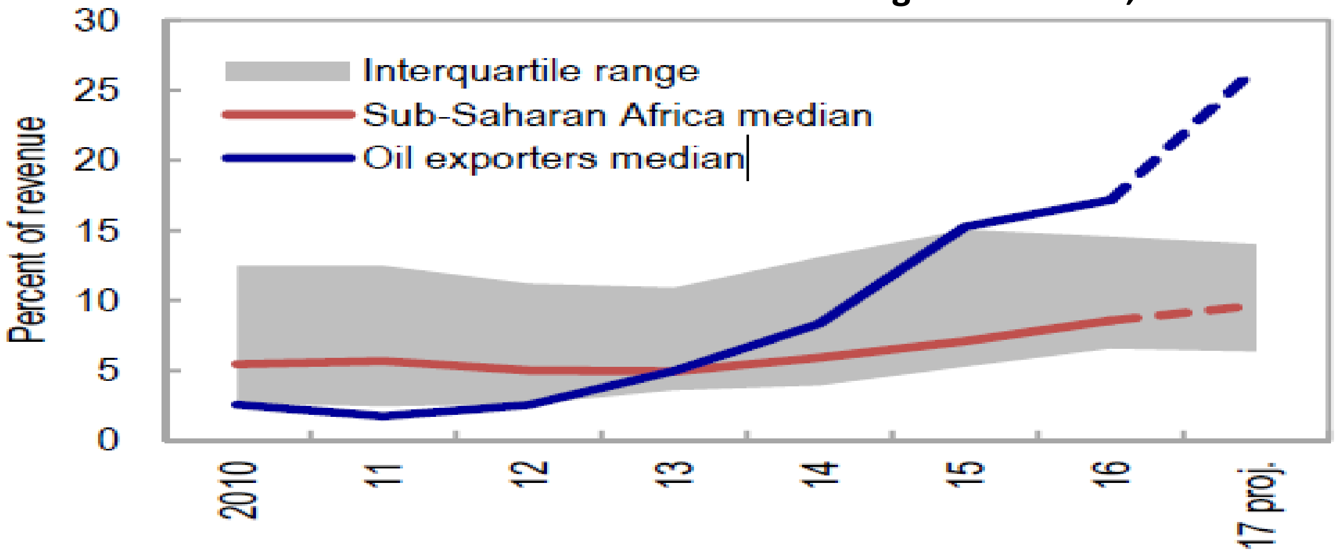
Sources: IMF, Debt Sustainability Analysis database; and IMF staff calculations.

Note: Debt is recorded on a currency basis. See page 76 for country groupings table.

African Debt Crises Cont.

•Debt service costs have risen sharply, especially in oil-exporting countries. The median debt service-to revenue ratio among sub-Saharan African countries increased from 5 percent in 2013 to almost 9 percent in 2016 and is expected to reach nearly 10 percent in 2017. In oil-exporting countries the median debt-service-to-revenue ratio more than tripled between 2013 and 2016, and in 2017 is expected to exceed 26 percent, with the highest expected increases in Gabon (from 55 percent in 2016 to 71 percent in 2017) and Nigeria (from 22 percent in 2016 to nearly 62 percent in 2017).

Sub-Saharan Africa: Total Debt Service as a Percentage of Revenue, 2010–17



Source: IMF, World Economic Outlook database.
Note: See page 76 for country groupings table.

Debt Relief Initiative

•Debt relief wiped away much of Africa's sovereign debt, but after a decade of growth, debt stocks are rising again.

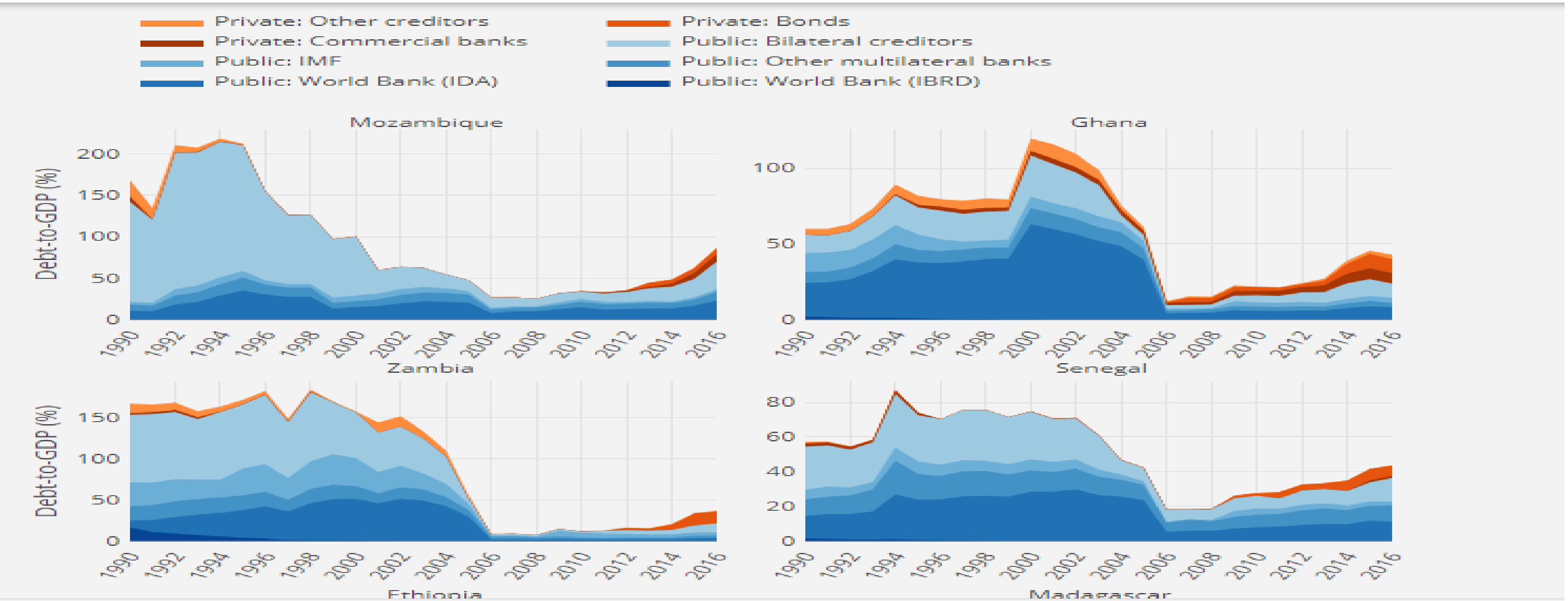
•The IMF and World Bank's Heavily Indebted Poor Countries initiative (HIPC) began the programme in 1996, but it took close to a decade of negotiations between the Bretton Woods institutions, Paris Club creditors, and the debtors for the process to culminate with about 100 percent debt relief for 36 countries—30 of which were in Africa.

•Countries like Ghana saw its debt fall from about120 percent of GDP in 2000 to just 12 percent in 2006. Mozambique's fell from over 200 percent down to the mid-20s over a similar time period.

Debt Relief Initiative

•**This time is different: private creditors, not the Paris Club, hold much of Africa's debt now**

•Fast forward to 2018, and some of those same countries are gradually accumulating fairly significant sovereign debts again



African Debt ; Is this a Modern Day Slavery?

•Countries often experience external borrowing and capital flight simultaneously. At first glance this may seem anomalous. Why would we observe large capital flows in both directions at once?

•External borrowing implies that both lenders and borrowers expect attractive investment returns. Yet capital outflows appear to signal higher returns elsewhere. In practice, the two phenomena may not only co-exist but also be causally linked.

•External borrowing can lead to capital flight, and capital flight can lead to external borrowing. Understanding these linkages is important for the formulation of appropriate policy responses.

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•In debt-fueled capital flight, external borrowing finances private wealth accumulation outside the borrowing country. On the borrower side, the government contracts loans in the name of the public. Debts that fuel capital flight are considered 'odious' under international law.

•Odious debts are liabilities contracted by governments without the consent of the people, from which the people did not benefit, in circumstances where creditors knew or should have known these conditions to hold (King 2015)

• Some officials and other politically connected individuals then siphon part or all of the money into their own pockets – via kickbacks, procurements contracts and diversion of funds – and stash part or all of the proceeds abroad for safekeeping.

African Debt ; Is this a Modern Day Slavery?

- Debt servicing problem is of paramount importance. Three factors warrant attention here.
    - Increases in the interest burden, which often exceeds increase in the national income.
    - Increase of debt as a proportion of national income.
    - Consideration of the ratio of debt service payments to export earnings.

African Debt ; Is this a Modern Day Slavery?
Case Study
Nigeria

- Debt as a share of GDP stands at comfortable levels, but remains high relative to historical averages and on an upward trajectory. However, interest payments as a share of federal government revenue rise to unsustainable levels under unchanged policies, to above 80 percent by 2022.

Figure 1. Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(Percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	10.4	16.0	19.6	22.3	25.3	26.0	26.0	26.4	26.6
Public gross financing needs	0.2	3.5	4.3	8.8	7.5	6.7	6.1	5.9	5.7
Real GDP growth (in percent)	6.9	2.7	-1.6	0.8	2.1	1.9	2.1	2.0	2.0
Inflation (GDP deflator, in percent)	9.4	2.9	9.5	17.0	15.7	14.2	14.8	13.8	14.0
Nominal GDP growth (in percent)	16.9	5.6	7.8	17.9	18.1	16.3	17.2	16.0	16.2
Effective interest rate (in percent) [4/]	8.6	9.0	8.6	8.6	7.2	7.3	7.8	8.1	8.4
Adjusted Effective interest rate (in percent) [5/]	8.8	9.5	9.8	9.9	8.0	8.3	8.7	8.9	9.0

As of November 10, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		410
5Y CDS (bp)		308
Ratings	Foreign	Local
Moody's	B2	B2
S&Ps	B	B
Fitch	B+	B

Source: IMF

African Debt ; Is this a Modern Day Slavery?
Case Study
Ghana

- Debt as a share of GDP stands at above 70 per cent.

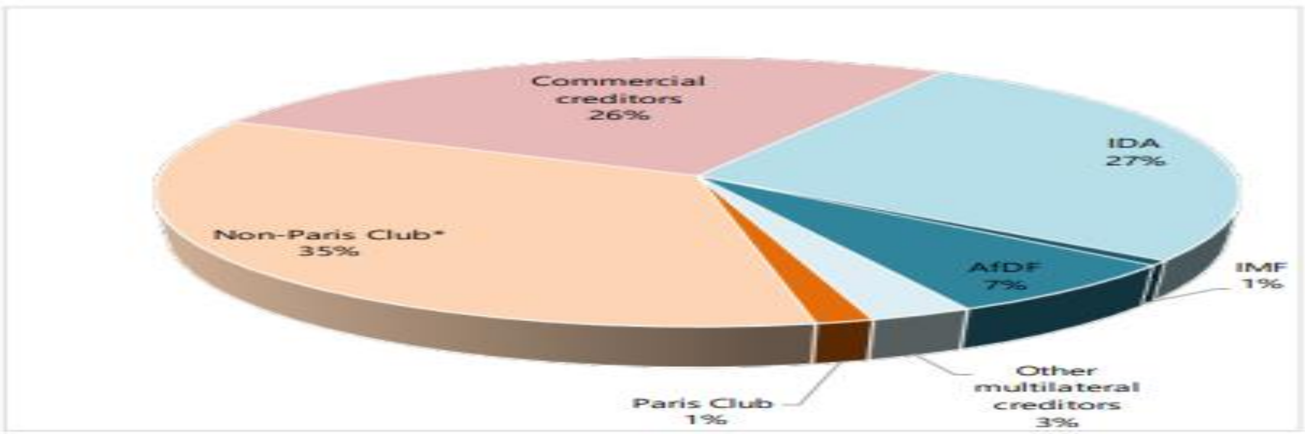
- *"Thresholds for the PV of external PPG debt-to-GDP and PV-to-revenue ratios would be breached for five and two years, respectively, the debt service-to-revenue ratio is projected to stay well above the threshold over the entire projection period (currently at above 80% of government revenue), with an upward shift compared to the previous projections. In order to improve the debt service-to-revenue ratio, the authorities should continue to seek stronger domestic revenue mobilization along with a proper financing mix Interest payments as a share of government revenue rise to unsustainable levels under unchanged policies, to above 80 percent by 2022" Source: IMF, Article IV*

African Debt ; Is this a Modern Day Slavery?
Case Study
Ethiopia

- Debt as a share of GDP stands at above 70 per cent.

- *"Ethiopia's risk of debt distress was assessed as "moderate" in the 2016 Debt Sustainability Analysis (DSA), but risks have increased. In the 2016 DSA, one indicator—the present value of debt to exports (PDVE)—breached the threshold under the baseline." Source: IMF, Article IV*

(As at June 30, 2017)



Source: Ethiopian authorities, IMF staff calculations.
*Includes external liabilities of the National Bank of Ethiopia.

Legal Requirement and IMF/WB Threshold

- The Kenya Government through the National Treasury endeavours to maintain public debt and obligations at sustainable levels in line with section 15 (2) (d) of the Public Finance Management Act (PFMA). Public debt sustainability is the ability of a country to service its debt obligations as they fall due without disrupting its budget implementation.

- In the Debt Sustainability Framework (DSF), countries are classified into one of three policy performance categories (strong, medium, and poor) using the World Bank's Country Policy and Institutional Assessment (CPIA) index which uses different indicative thresholds for debt burdens depending on the quality of a country's policies and institutions. Kenya is rated a strong policy performer and being a lower middle-income country it is subject to public debt sustainability threshold of **74 percent** PV of Debt/GDP.

- The EAC public debt convergence criterion for PV of Debt/GDP is 50 percent.

External Debt Sustainability

- Under the baseline scenario, Kenya's debt ratios listed in Table below indicates that external debt is within sustainable levels for a country rated as a strong performer. The debt sustainability indicators show that Kenya faces a low risk of external debt distress. This is attributed to the high level of concessionality of current external debt and the positive outlook in other macroeconomic indicators.

Kenya's External debt sustainability

Indicators	**Threshold**	**2017**	**2018**	**2019**	**2026**
PV of debt–to-GDP ratio	**50**	22.6	22.5	21.4	18.3
PV of debt-to-exports ratio	**200**	137.9	132.2	124.1	103.5
PV of debt-to-revenue ratio	**300**	108.7	104.7	98.9	82.8
PPG Debt service-to-exports ratio	**25**	15.2	9.2	13.8	12.2
PPG Debt service-to-revenue ratio	**22**	12.0	7.3	11.0	9.8

Source: IMF Country Report No. 17/25, February 2017

Total Public Debt: Kenya

- Kenya’s public debt sustainability threshold on PV of Debt/GDP as a strong performer and a low middle-income country is **74 percent**.

- The PV of public debt-to-GDP, decreases from 49.0 percent in 2017 to 47.1 percent of GDP by 2019. In the long term, the PV of public debt-to-GDP is expected to decline to about 35.6 percent by 2026. Given Kenya’s relatively strong revenue performance, the PV of public debt-to-revenue ratio would gradually decline from 235.7 percent in 2017 to about 217.4 percent in 2019. Going forward, the debt service-to-revenue ratio is expected to decline from 35.8 percent in 2017 to about 24.3 percent in 2026. Overall, the results from the DSA indicate that Kenya’s public debt remain sustainable over the medium term.
- The EAC public debt convergence criterion for PV of Debt/GDP is 50 percent.

Public debt sustainability

Indicator	Threshold	2017	2018	2019	2026
PV of public sector debt to GDP ratio	**74**	49.0	48.6	47.1	35.6
PV of public sector debt-to-revenue ratio		235.7	226.6	217.4	161.4
Debt service-to-revenue ratio		35.8	30.5	33.4	24.3

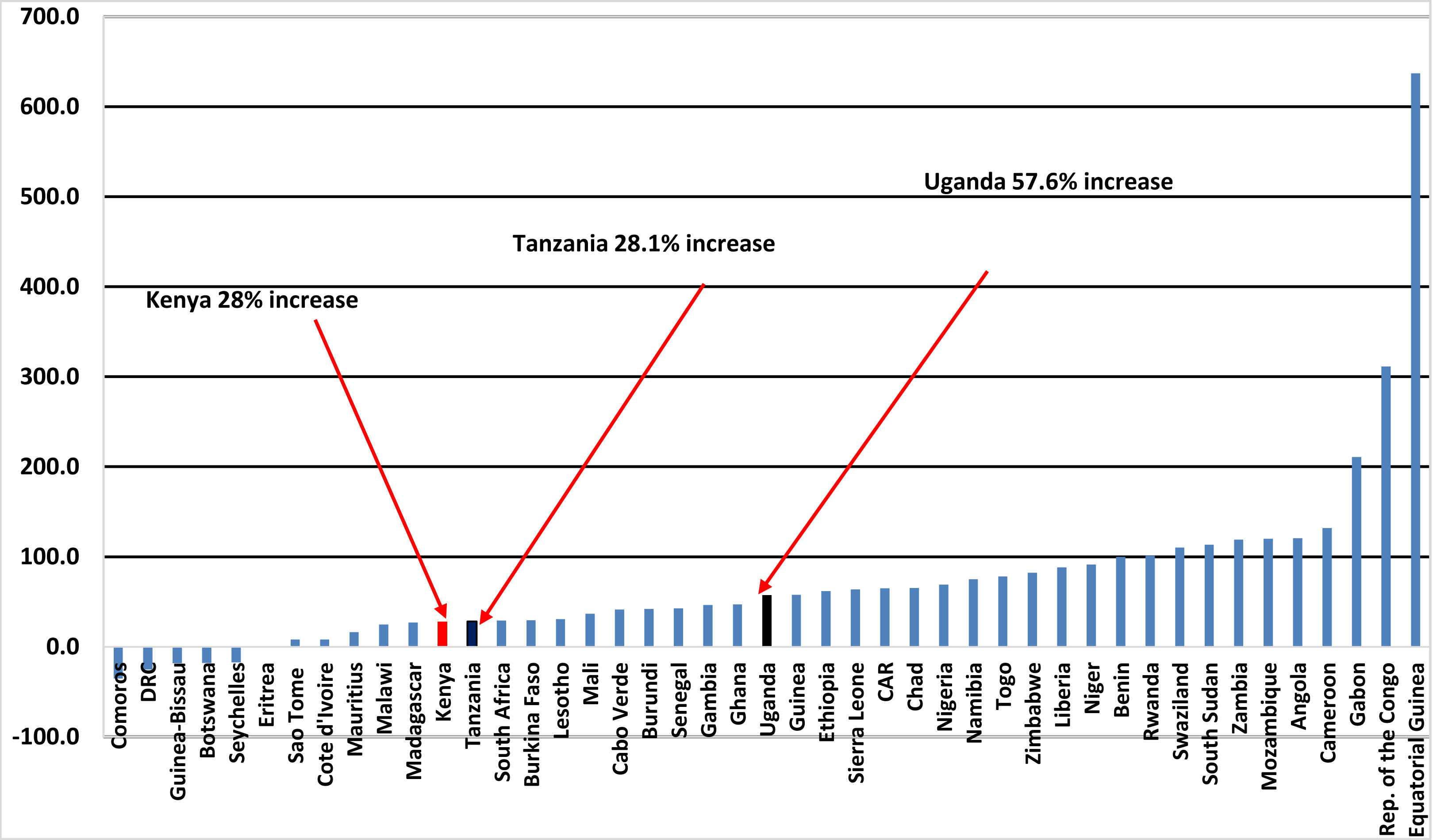
Source: IMF Country Report No. 17/25, February 2017

Sensitivity Analysis for Key Indicators of Public Debt

Indicator	**Threshold**	**2017 ratios**	Impact of 10% of GDP increase in borrowing in 2017 on debt indicators in 2018
PV of Debt as % of GDP	74	49.0	58
PV of Debt as % of Revenue		235.7	272
Debt Service as % of Revenue		35.8	35

Source: IMF Country Report No. 17/25, February 2017

Government Debt (Percent of GDP) and debt accumulation rate



Asanteni Sana

Q & A