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Interactions between Government Domestic Borrowing Needs and the Corporate Sector

by

Ms. Lilian Macharia
Principal Resource Mobilization Officer
African Development Bank

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD
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Presented by: Lilian Macharia
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“Building Today, A Better Africa Tomorrow”
Background

- Domestic borrowing is part of governments’ development financing strategies

- Rationale for Domestic for Borrowing:
  - Finance budget deficits
  - Implementation of monetary policy through market operations
  - Financial markets development e.g. including through benchmarking
  - Management of risks – currency, maturity and volatility of external resources (decreasing)
When is Domestic Borrowing a Challenge?

- Depends on the purpose of borrowing and to which the resources are put e.g. current expenditure vis-à-vis capital investment for productive purposes.

- When governments’ excessive domestic borrowing exacerbates their inability to meet their obligations

- Insufficient government revenue can propel growth of domestic debt through:
  - arrears accumulation - resulting in liquidity/working capital constraints among private sector actors that provide goods and services
  - borrowing from the domestic capital markets to finance fiscal deficits - thus competes for same resources that private sector taps into; increases cost of capital and affects business
The African Experience

- Africa is not homogeneous - experiences vary

- Illustrative cases
  - Senegal
  - Kenya
Senegal

- 2000-2005: Domestic debt stable (<5% of GDP) before rising significantly thereafter

Causes of increased domestic borrowing:

- Drop in government fiscal revenues
- Election year spending, also big government
- Deficits by SOEs and local governments guaranteed by central government

Net effect:

- Expenditure burden too high
- Government unable to invest in productive sector to stimulate the economy
Senegal: No Clear Link Between Domestic Debt & ODA flows

Source: Afrobar 2011

- Public deficit (CFA Francs, billions)
- Domestic Debt (CFA Francs, billions)

Source: Ahmodad, 2011
Senegal: Growth in Domestic Debt Service not matched by Growth in Government Revenues (%)
Senegal: Growth in Domestic Debt Service vis-à-vis Government Revenues

Source: Afrodata, 2011
Senegal: Domestic Debt Structure (CFA Francs, Billions)
Large Impact on Private Sector

Source: Afrodad, 2011
Senegal: Impact

- Drop in economic growth mainly attributed to delayed repayments which forced key domestic companies to reduce their productivity
- Credit crunch with banks unwilling to lend to companies to compensate for uncollected claims from government
- More than a third of the companies in construction and public sector works in crisis
- Arrears have affected the functioning of utility companies affecting productivity and countries ability to attract FDI
Kenya

- Domestic debt plays a critical role to Kenya’s economic development (55% of total public debt, and 20% of GDP, June 2010)

- Domestic debt has been used to:
  - implement monetary policy,
  - bridge the gap resulting from reduced access to external funding,
  - develop domestic markets.

- Domestic debt holders include non-residents e.g. foreign intermediary financial institutions. Commercial banks hold the largest proportion (50.7% as of 2007).

- Instruments have included government securities, overdraft at Central Bank of Kenya and advances from commercial banks.

- Shift towards longer-dated instruments to minimize refinancing risks; develop domestic debt markets; develop a secondary market for government securities.

- Government has issued Diaspora, project-specific or infrastructure bonds to finance projects in roads, water & energy.

- Domestic debt resources used for capital expenditures for productive sectors of the economy.
Impact

- Positive economic growth especially from investments in infrastructure

- Credit to private sector has stabilized at around 78% of banking system (after an increasing trend)

- New domestic borrowing contracted on higher terms than external debt but not significant enough to negatively impact interest rates which remained stable (implications for future if trend continues?)

- Domestic interest payments have been rising higher than growth in government revenue and GDP. A significant part of government revenue goes to service domestic debt (needs to be properly managed)

- Contingent liabilities still pose a risk.

Source: Central Bank of Kenya, 2010
Kenya: Lending Interest Rates (%) July 2008-December 2010

- 91-Treasury Bills
- Rediscouts (Central bank rate)
- Repurchase Agreements
- Reverse Repo Repurchase Agreements
- Commercial Banks Loan & Advances
- Commercial Banks Interbank

Source: Central Bank of Kenya, 2010
Kenya: Banking System Net Domestic Credit 2009-2011

- Credit to private sector
- Credit to other public sector
- Credit to government

Source: Central Bank of Kenya, 2010
Lessons Learnt

- Accumulation of domestic debt is largely driven by the same factors.
- Domestic borrowing impacts on corporate sector variously according to the (relative) quantity (Senegal), depth of financial markets (Kenya) and utilization of mobilized resources, etc.
- No uniform solution but there is need for a domestic debt management strategy to guide & monitor the contraction of domestic debt.

Africa still faces huge developmental needs vis-à-vis:

- Limited and declining concessional resources
- Global crisis & international turmoil impact on access to international capital markets, exports revenues and ODA flows
- Forex risk associated with external debt
- Reducing fiscal revenues from trade liberalization

- Domestic borrowing seems set to rise & building capacities to manage associated risks required
- Private sector development and development of capital markets critical for Africa’s future: balance between government domestic borrowing and private sector development needs imperative.
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Thank you