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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

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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

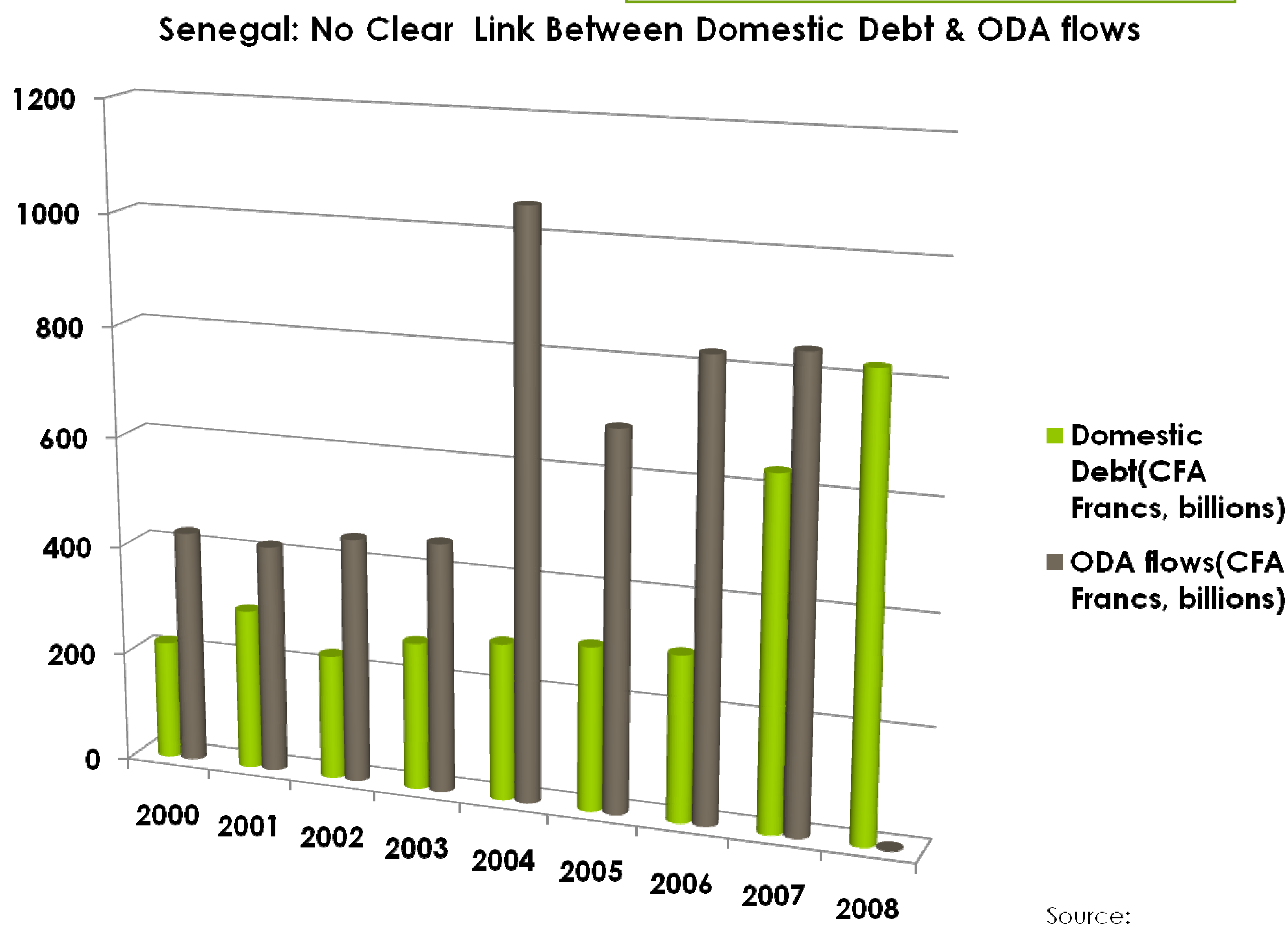
- 2000-2005: Domestic debt stable (<5% of GDP) before rising significantly thereafter

Causes of increased domestic borrowing:

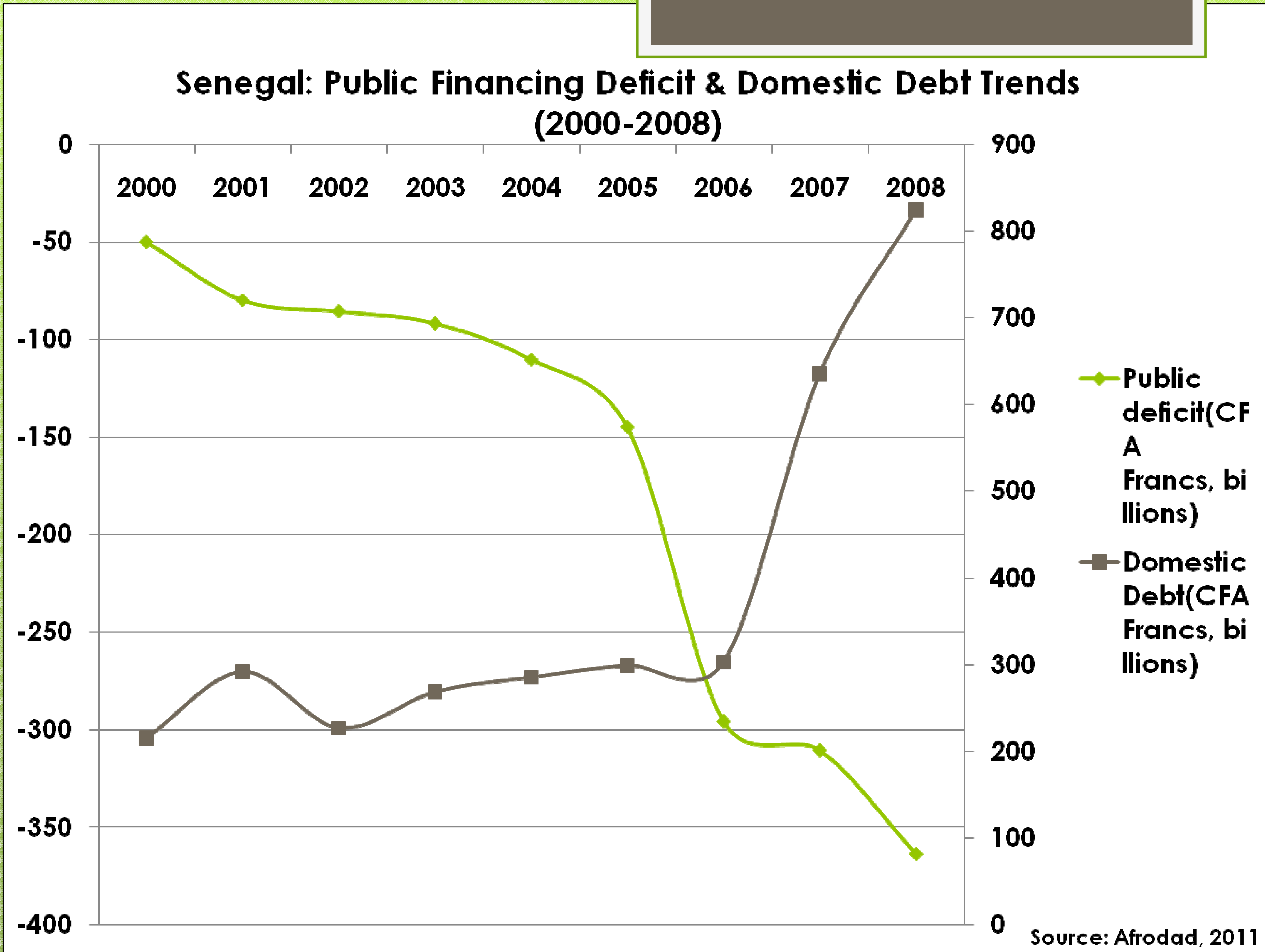
- Drop in government fiscal revenues
- Election year spending, also big government
- Deficits by SOEs and local governments guaranteed by central government

Net effect:

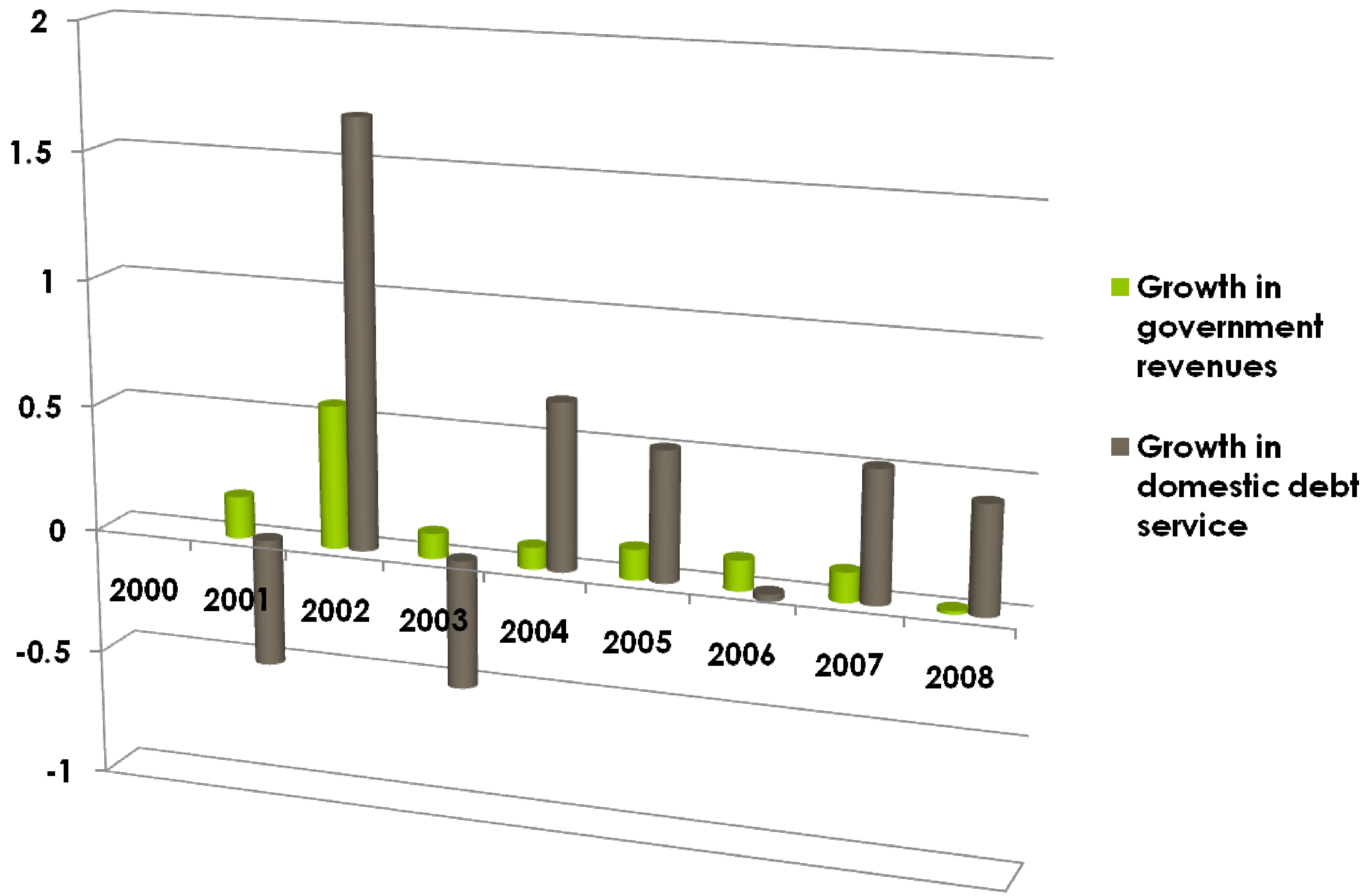
- Expenditure burden too high
- Government unable to invest in productive sector to stimulate the economy



Source: Afrodad 2011

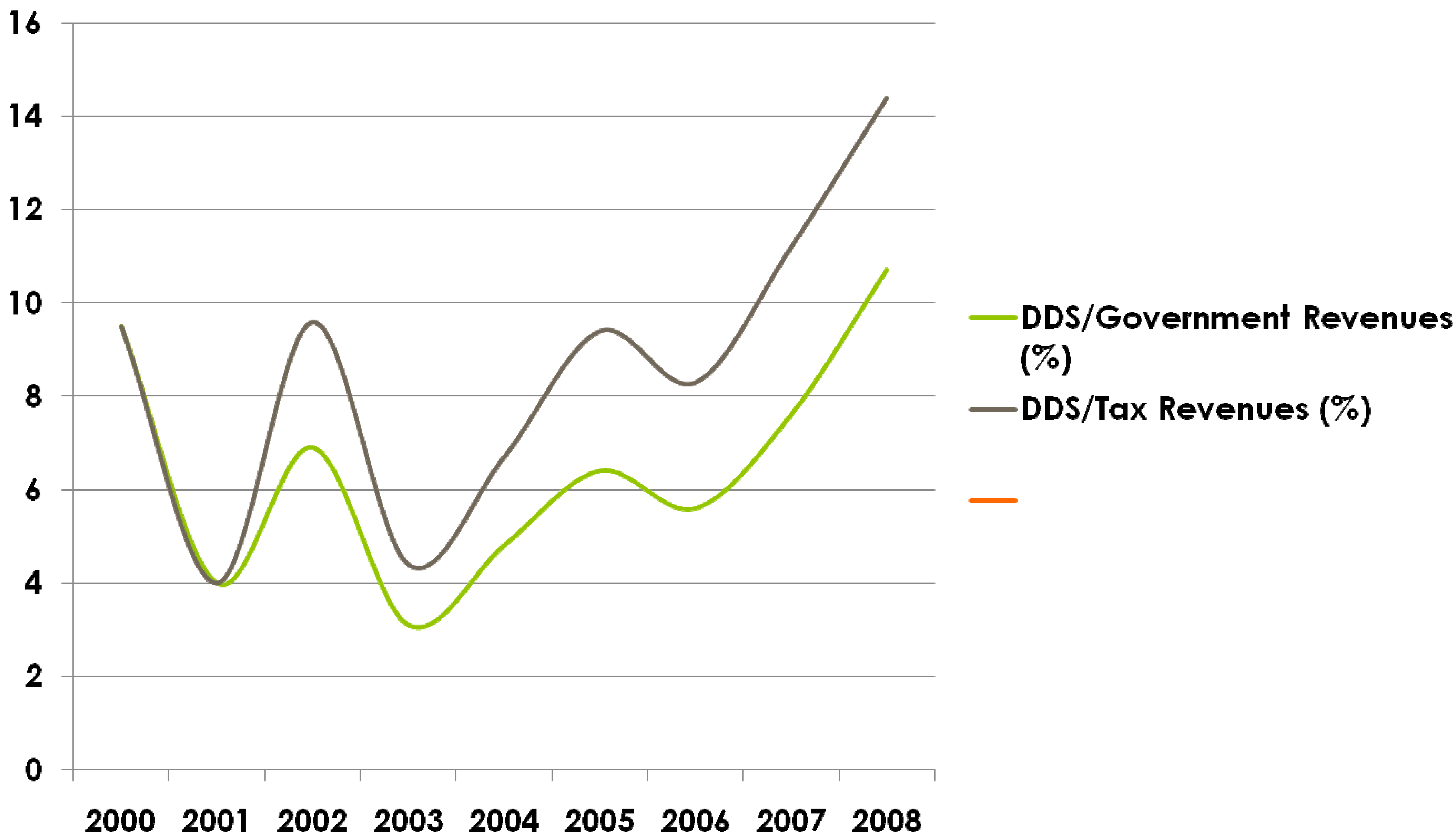

Senegal: Public Financing Deficit & Domestic Debt Trends (2000-2008)
0
-50
-100
-150
-200
-250
-300
-350
-400
2000
2001
2002
2003
2004
2005
2006
2007
2008
900
800
700
600
500
400
300
200
100
0
Public deficit(CFA Francs, billions)
Domestic Debt(CFA Francs, billions)
Source: Afrodad, 2011

Senegal: Growth in Domestic Debt Service not matched by Growth in Government Revenues (%)



Source: Afrodad, 2011

Senegal: Growth in Domestic Debt Service vis-à-vis Government Revenues



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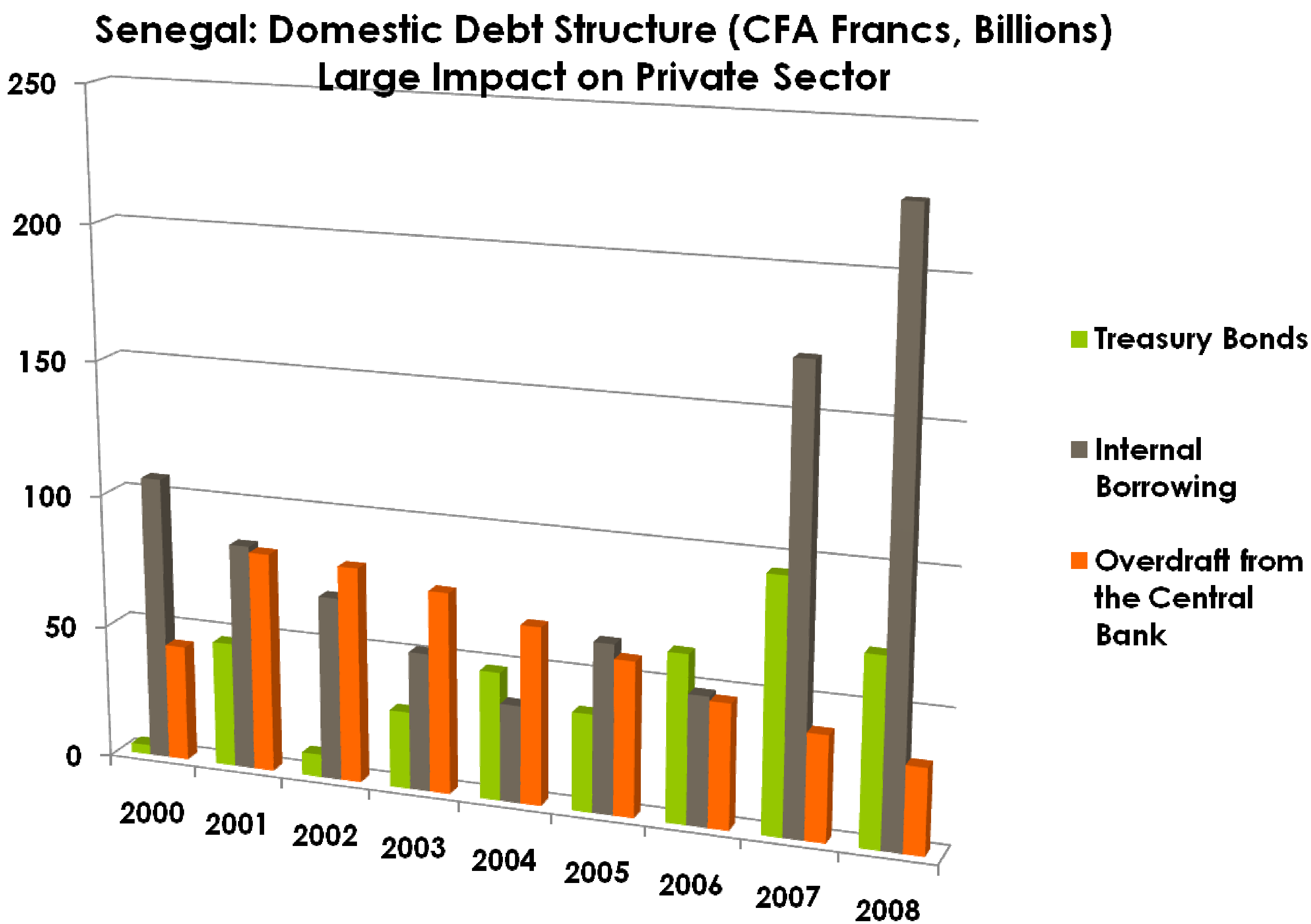


Source: Afrodad, 2011

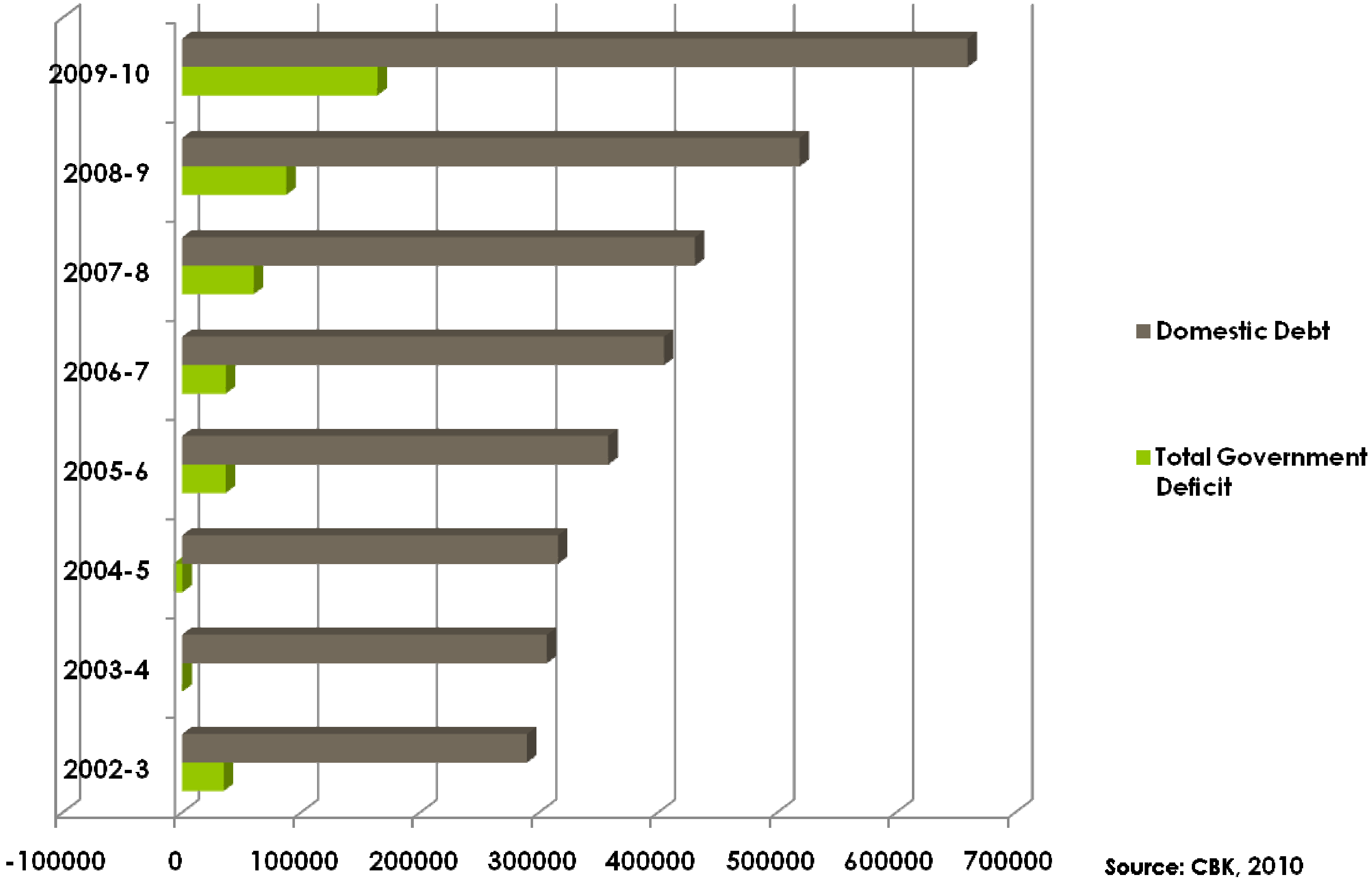
Senegal: Impact

- 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 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

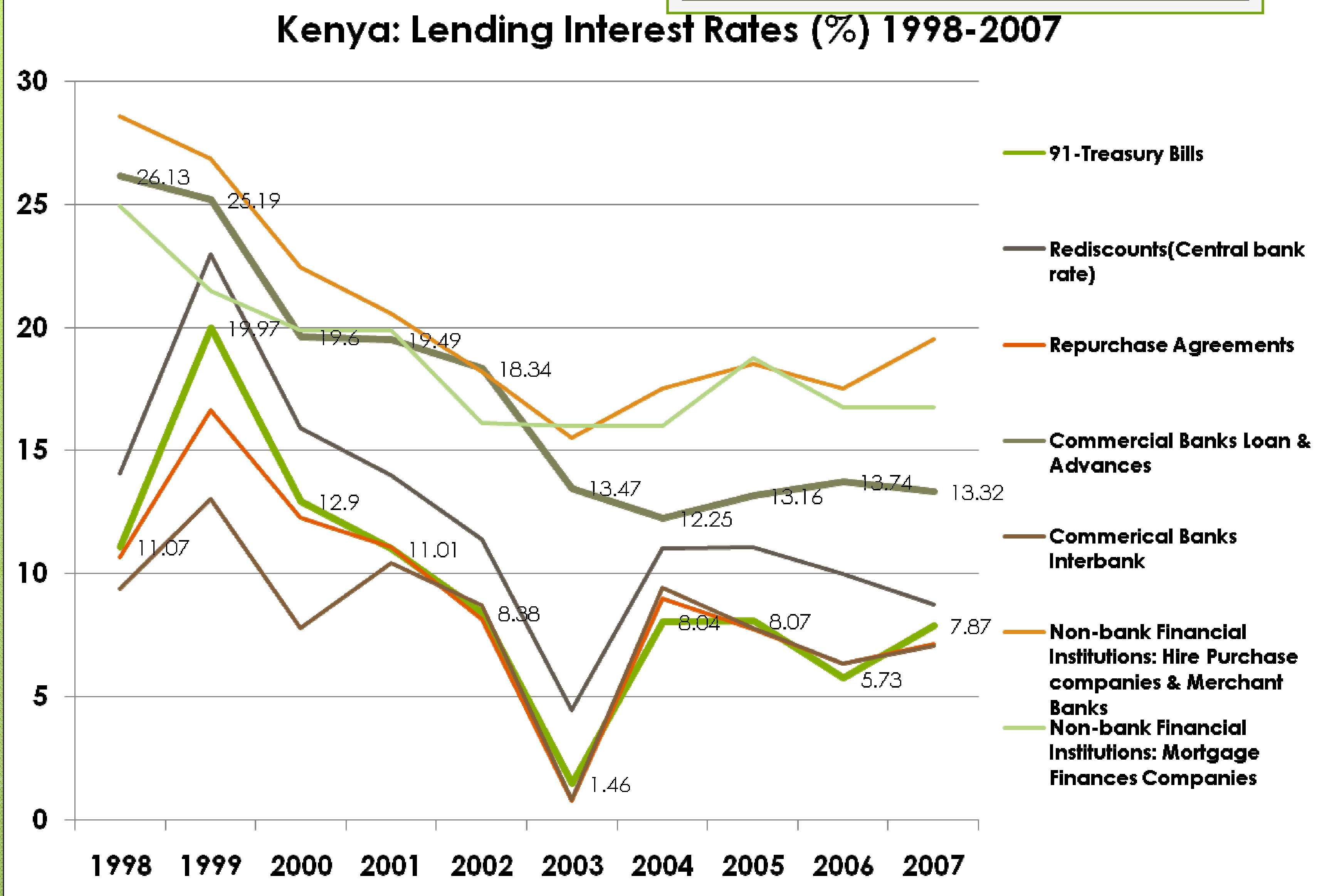
Kenyan Government Deficit Financing and Public Debt 2002-2010(shillings millions)



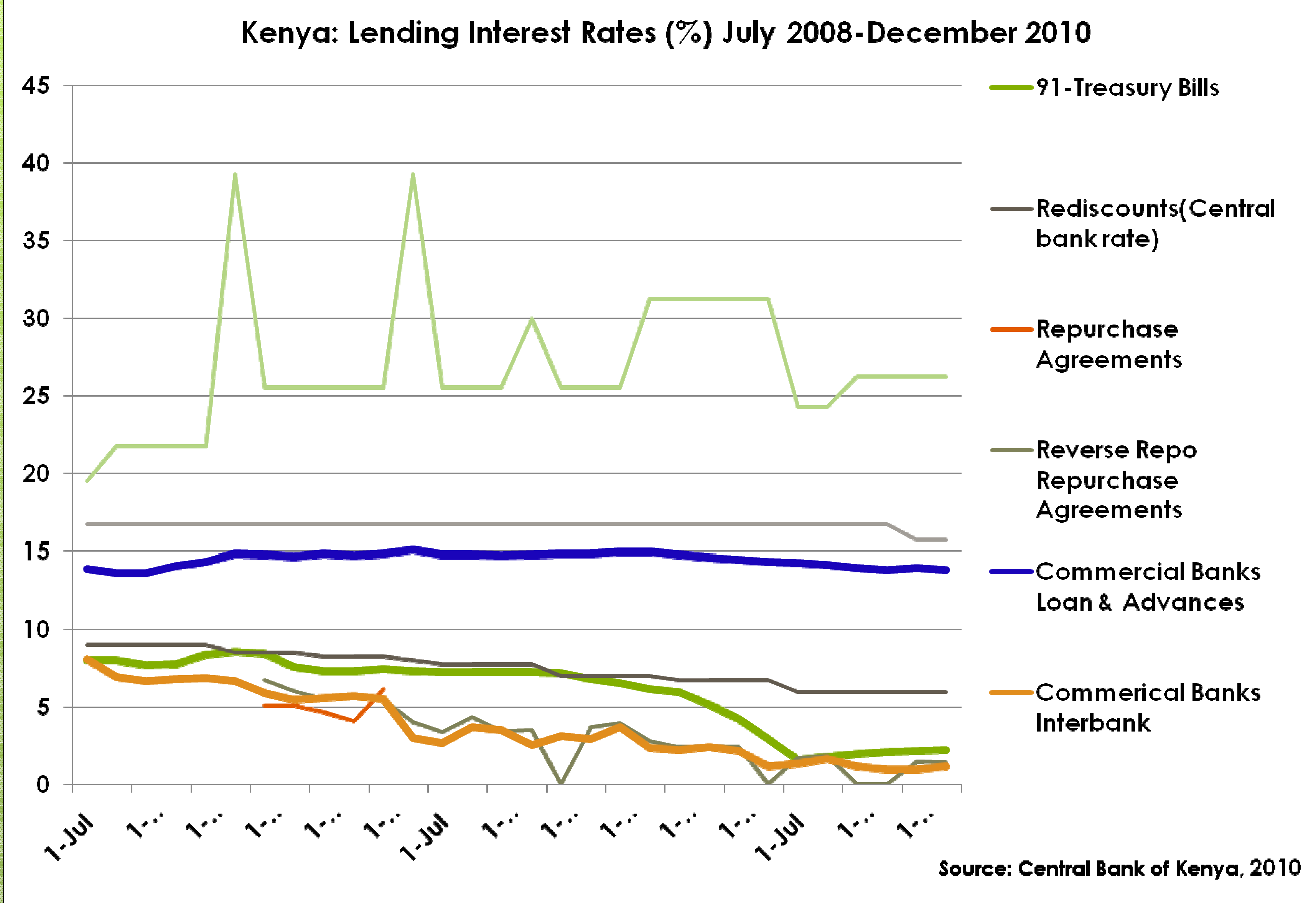
Source: CBK, 2010

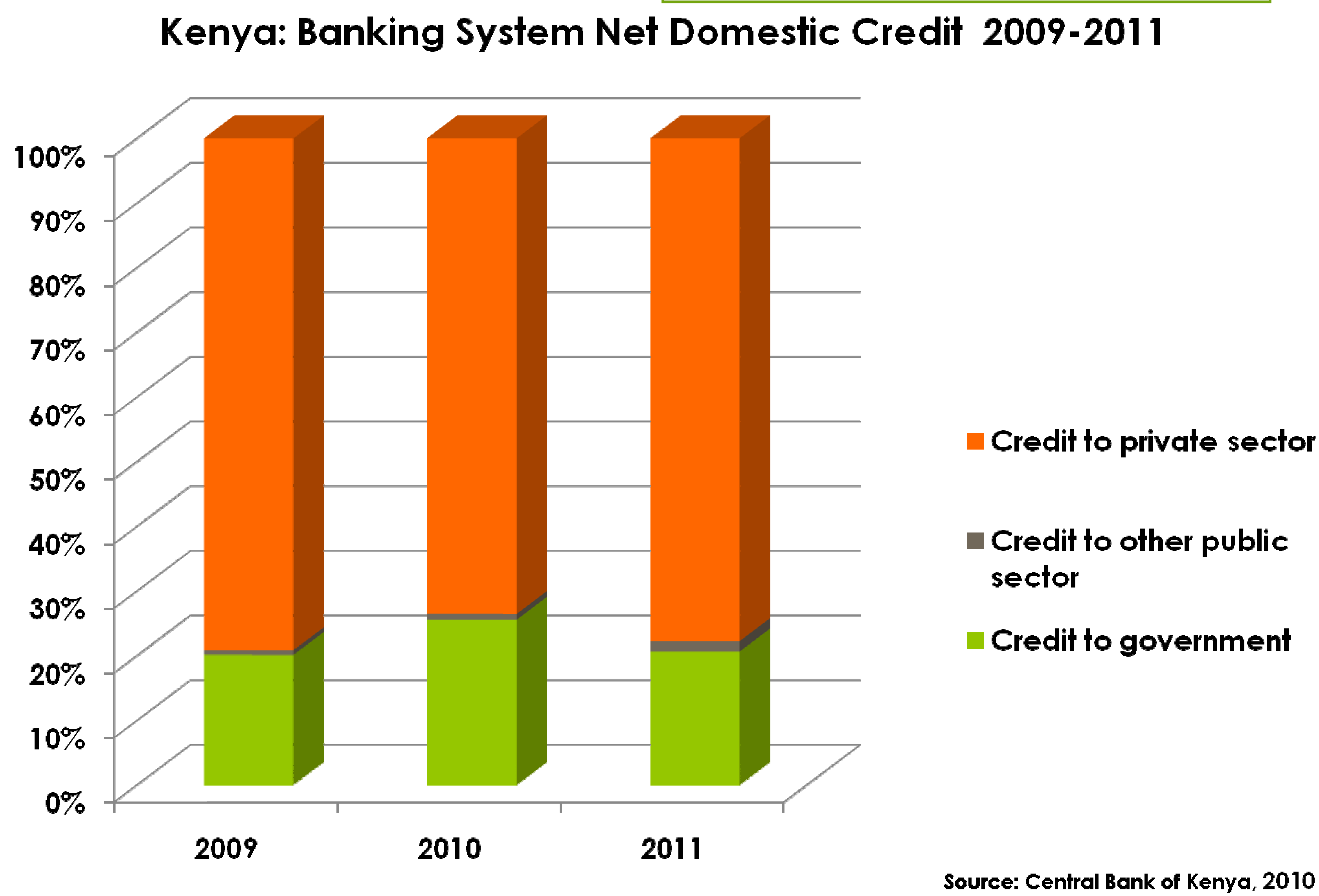
Impact

- 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
45
40
35
30
25
20
15
10
5
0
1-Jul
1-..
1-..
1-..
1-..
1-..
1-Jul
1-..
1-..
1-..
1-..
1-..
1-Jul
1-..
1-..
91-Treasury Bills
Rediscounts(Central bank rate)
Repurchase Agreements
Reverse Repo Repurchase Agreements
Commercial Banks Loan & Advances
Commerical Banks Interbank
Source: Central Bank of Kenya, 2010


Kenya: Banking System Net Domestic Credit 2009-2011
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
2009
2010
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