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ScienceDirect

Journal of African Trade 2 (2015) 87–109

Original article

Sovereign bond issues: Do African countries pay more to borrow?☆

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Received 4 December 2014; received in revised form 30 July 2015; accepted 10 August 2015
Available online 18 November 2015

Abstract

There is a new wave of external borrowing by African governments on private sovereign bond markets. The findings in this paper indicate that African economies pay higher-than-normal coupon rates on these markets; observed risk measures like agency ratings and debt to GDP ratios do not explain the deviation from the norm. We also find that countries in better financial standing tend to self-select into the private markets, such that their risk profiles cannot explain the high coupon rates. Further research steps and policy implications are discussed.
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Keywords: Sub-Saharan Africa; Sovereign debt markets; Development finance

1. Introduction

There is a new wave of external borrowing by African governments, and it is not from the Development Banks. No sub-Saharan African country had sold debt on private international markets in almost a decade before Seychelles issued a $200 million Eurodollar bond in September 2006. Now these countries once excluded from global finance appear to be the darlings of Eurobond markets. Many of the countries issuing debt were the subjects of debt restructuring and forgiveness at the turn

☆ We are grateful to Andrew Jensen and Samantha Cunningham for their research assistance and the feedback from the editor of the JAT and an anonymous reviewer.
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Peer review under responsibility of Afreximbank.

http://dx.doi.org/10.1016/j.joat.2015.08.003
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of the century, through programs like the World Bank's Highly Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiatives.

In 2007, Ghana became the first HIPC nation to issue sovereign bonds in international markets. Tanzania and Zambia followed in Ghana's steps, and their bonds were oversubscribed. Investors offered almost $12 billion as they clamored for a slice of Zambia's $750 million bond issue in 2012.[1] In July, 2014, Kenya raised $2 billion with a combination of 5 year and 10 year bonds. Once again, like so many other African issues it was oversubscribed, with $8 billion in bids.[2] Even Ethiopia, one of the poorest countries in SSA floated a $1B bond issue in December, 2014. This trend provokes many questions that have not been systematically addressed in the literature; our paper explores whether borrowing costs are unjustifiably higher for African countries, as well as whether African issuers of international sovereign bonds may be particularly prone to crises — in being more likely to borrow than other countries with comparable macroeconomic fundamentals.

First, we ask whether the costs of borrowing are higher for African countries — beyond what can be explained by risk ratings and other observable macroeconomic variables. Higher costs of borrowing are interesting because those costs are part of the government's debt burden and contribute to the risk of future default, even if in a small way. Secondly, higher borrowing costs motivate an inquiry into why governments will presumably take the high costs of the private market over the option of low-cost loans and grants from the development banking institutions. The paper then goes on to explore whether the countries participating in the sovereign debt markets are more vulnerable than average.

We focus on Africa because the region has been the locus of much work on debt relief and renegotiation to alleviate poverty, so it becomes important to examine whether the current wave of borrowing is consistent with these efforts. In the words of Stiglitz and Rashid (2013), "... are shortsighted financial markets, working with shortsighted governments, laying the groundwork for the world's next debt crisis?".

Nevertheless, one cannot deny the need for large investments in programs and infrastructure that support development on the continent.[3] Governments must borrow to pay for policies and infrastructure in order to address growth and poverty goals in the long term, but borrowing comes with the risk of crises (Lane, 2012; Arteta and Hale, 2008; Cole and Kehoe, 1996). Past African debt crises often involved re-structuring with official lenders under terms that required painful conditionalities. These conditionalities often harmed economic development (Jorra, 2012; Stein, 2012; Sachs et al., 2004; Mkandawire and Soludo, 1999). With this history, and faced with the need for foreign debt, African governments often face unpleasant options in the choice between the discipline of private markets and the international financial institutions.[4]

Our analysis suggests that the interest rates charged by investors are higher for sovereign bonds issued by governments in sub-Saharan Africa. This unexplained "*Africa Premium*" is about 2.9% points after controlling for relevant facts like the period of issue, the credit ratings of issuers and their macroeconomic fundamentals. A back of the envelope calculation, using current debt estimates of $14 billion suggests that the governments of sub-Saharan Africa will pay roughly $300 million of interest each year that is not

[1] Sources that describe the oversubscription of these bond issues include Sulaiman(2012a, 2012b) for Zambia and Kenya.

[2] There is significant overlap between the 49 countries categorized as SSA and the 39 HIPC countries. SSA is home to 34 of the HIPC participants — countries subscribed to internationally managed debt relief schemes to relieve poverty. Selection into the HIPC program is based on per capita income and IDA eligibility (IMF, 2013a; Birdsall et al., 2002).

[3] The Commission on Africa convened by British Prime Minister Tony Blair recommended a $75 billion hike in aggregate public spending in the region as a condition for meeting the Millennium Development Goals. The Commission's number included proposals to double annual public investment in infrastructure to approximately $40 billion. Against this funding gap, on must consider that in 2011, government budget deficits totaled 3.1% of GDP for the African continent.

[4] In principle, the borrowing rates of a country with the option of concessional lending from the International Financial Institutions should be lower if the option of low-cost funds is a potential bargaining tool. This is not evident from the data.

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