

Sub-Saharan African Eurobond yields: What really matters beyond global factors?☆

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Abstract

This study explores the drivers of secondary market yields of Sub-Saharan African (SSA) sovereign Eurobonds from 2008 to mid-2017. Our results indicate that, beyond global ‘push’ factors, country-specific ‘pull’ factors such as inflation and GDP growth matter too for SSA Eurobond performance. A panel error-correction analysis suggests large heterogeneity in the short-term influence of our global and country variables across countries. We find no significant effect of bond-specific factors on yields when push and pull factors are accounted for. By emphasizing the prominence of country variables, reflecting the quality of countries’ macroeconomic management and their economic performance, our results qualify the common view that SSA countries have little control over their market borrowing costs.

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1. Introduction

During the 1980s and 1990s many Sub-Saharan African (SSA) countries saw an unsustainable build-up of external public debt, due to a toxic combination of commodity boom-bust cycles, easy lending by official creditors and international banks, bad domestic policy and, in some cases, civil war (Brooks et al., 1998; Easterly, 2002; Thomas and Giugale, 2015). Debt relief by creditors was initially limited to non-concessional reschedulings, allowing debtor countries only to postpone repayment.

Gradually, however, it was acknowledged that debt problems transcended temporary liquidity concerns and more extensive debt service and debt stock relief was granted (Cassimon and Essers, 2017). A watershed event was the 1996 Heavily Indebted Poor Countries (HIPC) initiative which aimed at reducing even the worst debt burdens to manageable levels, subject to policy reforms. The HIPC initiative was later deepened and complemented with the Multilateral Debt Relief Initiative (MDRI) in 2005 to result in well over US\$100 billion of debt cancellation for 30 SSA countries. Merotto et al. (2015) show that the public debt to GDP ratio of the average SSA HIPC came down from over 100% prior to HIPC decision points to below 30% just after HIPC/MDRI completion. Also a number of non-HIPCs, most notably Nigeria, have enjoyed large debt relief (Dijkstra, 2013).

Faced with huge infrastructure and other needs, SSA countries have been filling up again the ‘clean slates’ debt relief provided them with by borrowing from a wide range of domestic and external creditors (Prizzon and Mustapha, 2014; Cassimon et al., 2015; Merotto et al., 2015). This paper looks at one channel of external borrowing by SSA sovereigns that has attracted relatively much attention from policymakers, i.e., the issuance

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of international bonds in the Eurodollar market (henceforth: Eurobonds) (Mecagni et al., 2014; UNCTAD, 2016).¹

Starting in 2006, no less than 16 SSA governments (excluding South Africa) have issued Eurobonds, most of them for the first time ever, in what *te Velde* (2014) has called a ‘beauty contest’. Taken together, they have raised about US\$29 billion in 35 issuances between September 2006 and June 2017.² Notwithstanding potential benefits from debt diversification, Eurobond issuance holds a number of risks for SSA countries. First of all, the US dollar denomination of these bonds exposes their issuers to exchange rate risks. Because the required principal repayments are concentrated, typically in a single ‘bullet’ installment, Eurobonds also involve greater redemption risks than amortizing loans. In contrast to the syndicated bank loans that dominated the commercial debt of African countries during the 1980s, Eurobonds are marked by a much more diffused and diverse set of creditors (Bertin, 2016). Moreover, it is widely believed that investor appetite for SSA bonds has been fueled by record-low interest rates in advanced economies and commodity price recovery in the aftermath of the global financial crisis, trends that have now reversed or could reverse in the near future (Masetti, 2015; Standard and Poor’s, 2015; Sy, 2015). Indeed, a recent study by *Presbitero et al.* (2016) finds that low-income developing countries are more likely to issue international bonds when US interest rates are low and commodity prices high, particularly so for SSA sovereigns, and that issuance occurs at higher spreads in times of market uncertainty. But next to global factors, domestic fundamentals seem to matter too at issuance. *Presbitero et al.* (2016) show that low-income countries’ propensity to issue Eurobonds rises with economic size and development, lower external debt and higher government effectiveness, and that issue spreads are lower for countries with a stronger current account balance, lower public debt, faster economic growth and an effective government. *Olabisi and Stein* (2015) demonstrate that, even after controlling for such global and domestic variables, SSA sovereigns pay a premium on their bonds at the moment of issuance, relative to other regions.

This paper takes the analysis of SSA Eurobonds beyond the primary market by studying the drivers of the *secondary market* yields of these bonds. Whereas changes in secondary market yields have no immediate impact on the interest costs of existing fixed-rate securities, they do reflect the marginal cost of new borrowing through similar instruments. Concentrating on secondary market yields allows one to exploit important within-country variation, a dimension which is typically very limited in the primary market. It should therefore not come as a surprise that most of the literature on emerging market borrowing takes secondary rather than primary market yields/spreads as the object of study. Given our focus on SSA, where most countries

have so far issued only a few bonds each (usually separated by multiple years), the choice for secondary market yields makes much sense, we believe.

Apart from *Senga and Cassimon* (2018) who investigate spillover effects among SSA Eurobonds, *Gevorkyan and Kvangraven* (2016) is, to the best of our knowledge, the only paper to date that attempts to explain the variation in the secondary market yields of a larger set of SSA Eurobonds.³ With monthly data for nine countries (Republic of Congo, Côte d’Ivoire, Gabon, Ghana, Namibia, Nigeria, Rwanda, Senegal and Zambia) over December 2007 – February 2014, the authors find that yields in SSA are driven by commodity prices, global financial market uncertainty and US interest rates. We build and improve upon *Gevorkyan and Kvangraven* (2016) in several ways. First of all, we extend the sample to 14 countries, discarding the Republic of Congo and adding Angola, Cameroon, Ethiopia, Kenya, Mozambique and Tanzania, and update the time span to June 2017, thereby incorporating the latest oil price bust and recovery, and the start of monetary policy tightening by the US Federal Reserve. Second, next to global factors, we include in our empirical models a broad set of country-level variables, such as international reserves, public debt, GDP growth and inflation. Except for reserves, these variables are absent from the analysis by *Gevorkyan and Kvangraven* (2016). Including domestic macroeconomic fundamentals enables us to capture the domestic ‘pull’ factors that may drive SSA Eurobond yields, besides common international ‘push’ factors. Where possible, we also examine the influence on yields of bond-specific characteristics; among other, the size and maturity of individual bonds, the redemption schedule, and whether or not proceeds are used to fund infrastructure. To evaluate the relative importance of global, domestic and bond-specific variables more formally, we perform a dominance analysis using the methodology of *Azen and Budescu* (2003). Third, relative to *Gevorkyan and Kvangraven* (2016), this paper employs a larger variety of estimators, in line with key studies in the emerging market bond spreads literature (see e.g., *Dailami et al.*, 2008; *Gonzalez-Rozada and Yeyati*, 2008; *Bellas et al.*, 2010; *Kennedy and Palerm*, 2014). To distinguish between long- and short-run dynamics, we formulate a panel error-correction model, which we estimate with the Pooled Mean Group (PMG) estimator of *Pesaran et al.* (1999).

To preview our main conclusions, we find that, beyond global push factors, country-specific pull variables, including inflation and GDP growth, also affect SSA Eurobond yields. Our panel error-correction results suggest large heterogeneity in the short-term influence of global and country explanatory variables across countries. Bond-specific factors such as bond size and maturity generally enter our regressions with the expected signs but are not statistically significant once global and country variables are taken into account. The importance of country variables as drivers of yield is confirmed by our dominance analysis. Hence, the common view that market borrowing costs

¹ The term ‘Eurobond’ generally refers to an international bond denominated in a currency other than that of the issuer or of the place where it is issued. In parallel to issuing Eurobonds, SSA countries have also begun to develop their *domestic* bond markets. For more details, see *Dafe et al.* (2018), *Essers et al.* (2016), *Berensmann et al.* (2015) and *Mu et al.* (2013).

² Not all of this constituted additional funds, however, as some bonds were (partly) issued to roll-over or exchange older debt titles.

³ Some other studies have incorporated a handful of SSA countries in their bond samples, usually as constituents of the JP Morgan Emerging Market Bond Index (EMBI) Plus or Global.

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