

Presentation



MOBILIZING RESOURCES FOR AFRICAN DEVELOPMENT

Mobilizing Resources through the Bond Market

Structure of Presentation

- (i) Introduction
- (ii) Structure of African economies
- (iii) New Reforms taking place in Africa
- (iv) Africa Needs
- (v) Structure of Capital Markets in Africa
- (vi) Nairobi Stock Exchange – an example
- (vii) Why are African Capital Markets weak?
- (viii) The Importance of Bond markets in developed countries
- (ix) Potential Role of Bond markets in Africa
- (x) Why Bond markets are under-developed in Africa
- (xi) Prerequisites for effective Bond market development
- (xii) The Special Role of a Government Bond Market programme
- (xiii) Reforms required
- (xiv) The Case for Universal Banking
- (xv) Importance of Big Business Groups in an Economy
- (xvi) Does African Development Bank have any role in Bond Market Development
- (xvii) The Need for securitizations
- (xviii) Conclusion

I. Introduction

Purpose of Presentation

- (i) Appreciate importance of the Bond Market in an economy
- (ii) Seek explanation for African bond market under-development
- (iii) Make proposals on how to speed up Bond market development

II. Structure of African Economies Selected Countries

Indicator	Population 2003 (millions)	Life Expectancy	Overall GDP (US\$)	GDP per Cap (US\$)	Inflation	Foreign Reserves	Growth rate (%)
BOTSWANA	1.7	38	7.4 bn	4,352.94	9.20	5.25 bn	3.5
EGYPT	67.6	69	82.4 bn	1,218.93	4.30	14.22 bn	4.1
GHANA	20.4	55	7.7 bn	377.45	26.70	1.469 bn	5.4
KENYA	31.9	46	13.8 bn	432.60	9.8	1.455 bn	4.3
MOROCCO	30.1	68	44.5 bn	1,478.41	1.2	14.08 bn	
NAMIBIA	2	42	4.7 bn	2,350	7.3	325.2 mn	4.8
NIGERIA	135.6	45	50.2 bn	370.21	13.8	7.128 bn	4.3
SOUTH AFRICA	45.3	46	159.9 bn	3,529.80	5.9	7.972 bn	3.5
TUNISIA	9.9	73	24.3 bn	2454.55	2.7	2.949 bn	
ZIMBABWE	13.1	39	-	-	384.7	78 mn	-8.2
UGANDA	25.3	43	6.2 bn	245.05	7.9	1.08 bn	5.0
TANZANIA	35.9	43	9.9 bn	275.77	4.4	2.064 bn	
MAURITIUS	1.2	73	5.2 bn	4333.33	4.2	1.598 bn	
MALAYSIA	24.8	72	103.2 bn	4,161.29	1.1	44.58 bn	

- Overall underdevelopment of Africa
- Low economic growth rates

III. New Reforms taking place in Africa

(A) Political Reforms

- Institutionalization of Democracy
- Good governance
- Peer review of Leaders
- Independence of Central Banks
- Civil service reforms

- **Goal: Emergence of enlightened Leadership**

(B) Economic Reforms

- Relaxation of exchange controls
- Liberalization of interest rates (financial reforms)
- Trade liberalization
- Privatizations
- Pensions
- Regional economic integration
- National Social Security industry
- Land Reforms??

- **Goal: Engineer faster economic development**

(C) Social Reforms

- Free primary education
- Attack HIV/AIDS pandemic
- Water and sanitary provisions
- Security concerns
- **Goal: Well educated and healthy population**

(D) Legal Reforms

- Independent judiciary
- More property rights respect
- General respect of rule of law
- Anti-corruption institutions

- **Goal: Rule of law prevails**

(E) Peaceful Resolution of Civil Wars

- Southern Sudan
- Somalia
- Angola
- Others

IV. Africa Needs

- (i) A minimum growth rate of 7% p.a.
- (ii) About US\$ 30 billion p.a. of investment
- (iii) Vibrant capital markets

Question: ***What is the role of capital markets in Africa?***

V.

Structure of Capital Markets

(A) History of African Stock Exchange

COUNTRY	YEAR ESTABLISHED
South Africa	1887
Egypt	1888/1903
Zimbabwe	1946
Kenya	1954
Nigeria	1960
Cote d'Ivoire	1976
Botswana	1989
Mauritius	1989
Ghana	1990
Swaziland	1990
Namibia	1992
Zambia	1994
Malawi	1995
Tanzania	1996
Uganda	1997
Ethiopia	2000
Mozambique	2002
Rwanda	In formation

- Relatively New Markets

(B) Market Structure and Performance of Capital Markets in Africa

Stock Exchange	No of Listed Companies	Market Capitalization (US\$)	Trading Value	Turnover (%)	Local Index
Botswana	19	2131.00	87.00	4.4	2498.70
BVRM	38	1650.00	24.50	1.48	74.80
Cairo	967	27073.00	3278.00	12.11	5817.60
Ghana	25	1426.00	45.50	3.19	3535.40
Nairobi	51	4178.00	209.00	7.00	2737.60
Mauritius	40	1955.00	99.10	5.07	549.60
Casablanca Bourse	53	13152.00	694.00	5.28	79349.00
Namibian	13	308.00	2.00	0.65	58.2
Nigerian	200	9494.00	858.00	9.04	20128.9
JSE	426	267745.00	102808.00	38.40	10387.2
Tunis	46	2464.00	164.00	6.66	939.8
Zimbabwe	81	4975.00	1345.00	27.04	401542.90
Malaysia	897	168376.00	50135.00	71.1	-
Thailand	405	118705.00	96573.00	117.2	-
Brazil	367	234560	60435.00	32.4	-

- **Small Markets**
- **Ineffective immobilization of significant financial resources**

VI. Nairobi Stock Exchange – an example

(i) Structure of Nairobi Stock Exchange

- N.S.E. Organized in 1954
- 47 Listed Companies
- 80 Treasury Bonds
- 5 Corporate Bonds
- 17 Stock Brokers
- 4 Investment Banks
- 19 Investment Advisors
- 13 Licensed Fund Managers
- Trading Floor based
- Open-out-cry trading system
- Trading: Monday to Friday
- Trading hours: 10.00 a.m. – 12.00 p.m.
- Settlement Period: T + 4
- Capital Markets Authority established in 1989
- Member of African Stock Exchanges Association

(ii)

N.S.E. Market Performance

(a) Primary Market Raised (Kshs. Million)

YEAR	AMOUNT RAISED	RIGHTS ISSUE	PRIVATIZATION	BOND MARKET (Billions)
1992	496.10	-	358.0	0
1993	62.48	-	62.48	0
1994	2600.04	61.9	400.0	0
1995	124.0	-	22.0	0
1996	5108.0	1200.0	3842.0	856.5
1997	1944.6	1500.0	168.0	38,646.3
1998	1800.0	-	1800.0	47,288.368
1999	-	-	-	47,380.1
2000	997.63	619.63	378.0	25,147.0
2001	1155.0	30.0	1125	72,490.0
2002	331.208	-	331.208	71,228.0
2003	-	-	-	76,387.0
2004	2450.0	2450.0	-	91,399.0

(iii)

N.S.E. Market Performance (b) Secondary Market

EQUITIES												
YEARS	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Turnover (US\$ Million)	11.59	14.2	54.83	65.0 6	69.3 9	104.56	75.62	72.08	46.15	39.74	193.71	201.20
Volume (Million)	15	27	43	62	114	144	112	101	141.60	114.88	148.84	381.23
Market Capitaliz a-tion (US\$ Million)	635	1056	3058	1896	1800	1824	2024	1409	,330	1200	,400	4200
NSE 20- Share Index	1167	2513	4559	3468	3114	3115	2962	2303	1913	1355.05	1362.8 5	2737.59
Liquidity	1.83	1.34	1.79	3.43	3.86	5.73	3.74	5.12	3.71	2.78	3.60	8.52
BONDS												
(Kshs Million)	0	0	0	0	856. 5	11,524 .8	8,217.3 13	6,912.87 5	5,879.8 9	14,076. 17	33,629. 4	41,985.4 6

Growing Bond Market

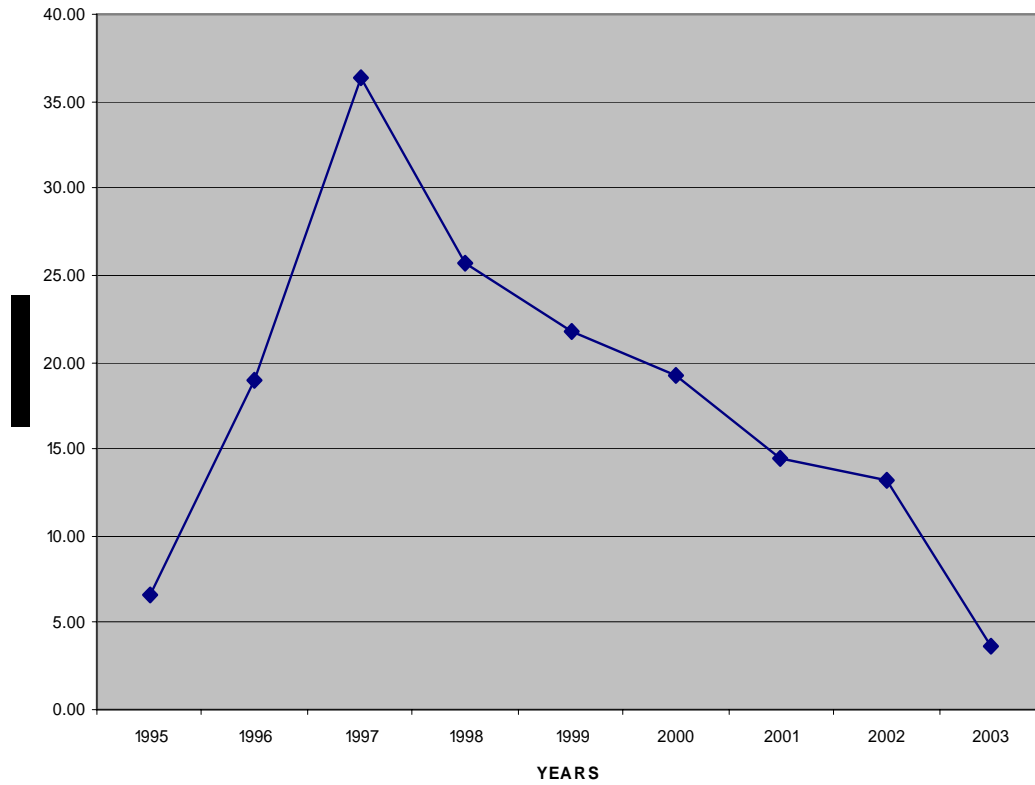
(iv) Foreign Investors Activity

YEAR	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
FIB Turnover (US\$ mio)	NA	NA	4.32	13.08	37.96	19.34	15.93	9.17	5.72	4.81	7.30
% of Total Turnover	NA	NA	6.60	19.00	36.30	25.67	21.72	19.20	14.39	13.15	3.63

Insignificant sources of Foreign portfolio investment

(v)

FOREIGN INVESTMENT ACTIVITY



(vi) Privatizations Through Nairobi Stock Exchange (1988 – 2004)

Year	Company	No. of Shares (million)	Amount Raised(Ksh. Million)
1999	Kenya Commercial Bank	7.5	150.0
1990	Kenya Commercial Bank	9.0	297.0
1992	Housing Finance	18.0	126.0
	Uchumi Supermarket	16.0	232.0
1993	BOC Kenya	1.6	42.0
	CMC Holdings	2.0	20.0
1994	National Bank of Kenya	40.0	400.0
	Firestone East Africa	40.0	1420.0
1996	Kenya Airways	235.4	2648.0
	National Bank of Kenya	40.0	600.0
	Kenya Commercial Bank	11.88	594.0
1997	Tourism Promotion Services	12.9	168.0
1998	Kenya Commercial Bank	28.0	1800.0
1998	ICDC Investment	9.4	282.6
1999	Housing Finance Company	30	420.0
2000	African Lakes	4	378.0
2001	Mumias Sugar	300	1125.0
2001	ICDC investment Company	13.968	331.208
2002			
2003			
2004			

NB: Missing: Utilities and Infrastructure

(vii)

Nature of Kenya's Bond Market

Government Issues		
Maturities		Amount (Kshs.)
1 year		32,005,000
2 year		24,686,000
3 year		27,898,000
4 year		26,158,000
5 year		20,914,000
6 year		20,434,000
7 year		10,330,000
8 year		11,969,000
9 year		9,555,000
10 year		8,634,000
		192,583,000
Corporate Sector		
(i)	EADB	2,800,000,000
(ii)	Safaricom	4,000,000,000
(iii)	Shelter-Afrique	Nil
(iv)	Mabati Rolling Mills	1,000,000,000
(v)	Faulu	500,000,000

Comment: (i) No proper Yield Curve
(ii) Amount raised not very significant

(viii) Drivers of Capital Markets

- Privatizations
- Foreign portfolio inflows
- Reformed pension funds industry
- Growing domestic big business (in South Africa)

VII. Why are African Capital Markets weak?

- (i) Lack of Over-the-Counter market (OTC)
- (ii) Unstable macro-economic environment
- (iii) Bond market under-development
- (iv) Absence of competitive financial markets
- (v) Non-existent or small Government bond market
- (vi) Absence of Big Indigenous Business Group (except South Africa)
- (vii) Commercial banks dominate financial system
- (viii) Proliferation of family owned companies

VIII. The Importance of Bond Markets in developed countries

	<i>All issuers</i>	<i>Public sector</i>	<i>Financial institutions</i>	<i>Corporates</i>
	<i>US \$ billions</i>	<i>(percentage share)</i>		
United States	14,335.8	56	28	17
Japan	6,329.0	76	13	12
Germany	1,603.4	43	56	1
Italy	1,213.3	77	21	1
France	1,005.7	59	30	11
United Kingdom	851.5	49	32	19
Spain	306.1	82	10	8
Brazil	306.7	83	16	1
South Korea	304.4	28	33	40
China	261.3	66	31	2
Argentina	83.7	31	69	0
Mexico	68.5	81	6	13
Turkey	47.5	100	0	0
Hong Kong, China	41.5	40	49	11
Poland	30.5	100	0	0
Czech Republic	20.9	78	12	11
Singapore	22.3	39	0	9
Hungary	14.9	97	0	3
Russia	8.8	100	0	0
Kenya	2.70	97	0	3

Kenya is a “typical” country in Africa

IX. Potential Role of Bond Markets in Africa

- (i) Mobilize long-term funds for infrastructure and housing development
- (ii) Provide competition to commercial banks
- (iii) Tap international capital markets
- (iv) Facilitate monetary policy management

X. Why Bond Markets are under-developed in Africa

- (i) Under-development of Government bond market
- (ii) Role of IMF in funding African
 - Balance of payment deficits
 - Fiscal budget deficits
- (iii) Role of Donors/Aid agencies
- (iv) Lack of Big Business Groups
 - Exception: South Africa

XI. Prerequisites for Effective Bond Market Development

- (i) Credible and stable Government
- (ii) Sound, stable and predictable fiscal and monetary policies
- (iii) Effective legal, tax and regulatory infrastructure
- (iv) Smooth and secure settlement mechanism
- (v) Efficient and competitive financial system
- (vi) Aggressive merchant and/or investment banks – intermediaries
- (vii) Vibrant Government securities market

XII. The Special Role of a Government Bond Market Programme

- (i) Starting point in capital market development
- (ii) Provide a realistic Yield Curve in an economy
- (iii) Benchmark for pricing Corporate Bonds
- (iv) Facilitate integration of regional Capital Markets
 - Through cross-border listing
 - Risk-less assets
 - But Foreign Exchange risks exist

XIII. Reforms Required

- (i) Create Stock Exchanges
 - Facilitate secondary market trading
 - Facilitate access by wider investor base
 - Pivot/platform for Reforms Advocacy
 - Sequence of Capital Market Development
 - start with Government Bond Market
- (ii) Reform the banking sector
 - Proper capitalization
 - Proper prudential regulation
- (iii) Embrace the Big Integrated Business Groups
- (iv) Reform the Pension Fund/Retirement Industry
- (v) Reform and Promote the Life Assurance Industry
- (vi) Promote the Unit Trusts or Mutual Funds Industry
- (vii) Rate African Countries
- (viii) Promote Creation of Rating Agencies
 - Rating of Bonds
 - Rating of Municipalities
 - Rating of Banks
- (ix) Embrace Universal banking

XIV. The Case for Universal Banking

(a) What is it

- Model of continental European banks
 - Deposit taking
 - Commercial banking
 - Investment banking
 - Underwriting
 - Venture Capital
- Interlocking shareholding/directorship
- Equity investments in large business enterprises
- Long-term view of corporate growth
- Offer complete range of financial services

Concerns

- greater risk
- central banks regulation
- conflicts of interests
- concentration of power – inhibiting competition

(b) Evidence supporting universal banking

- German: 26% of income = commissions/fees
- Switzerland: 47% income from fees/dividends etc
- South East Asia development model
 - (See: “economic backwardness in historical perspective” by Gerschenkron)
- The South African experience
- The Japanese model
- Major underwriters of corporate bonds

XV. Importance of Big Business Groups in an Economy

Embrace the Integrated Business Group Concept

- Contributions of big business to economic development
- Entrepreneurship
- Internal capital market
- Management (business school type)
- Venture capital

NB:

- 10 Chaebols export 90% of South Korean goods
- 10 Grupos constitute 90% of market capitalization of JSE
- Major issuers of
 - IPO's
 - Debt instruments

XVI. Does African Development Bank have any role in Bond Market Development?

NB: ADB is well capitalized, highly rated (AAA rating).

- (i) Issue bonds in domestic currencies to lend to domestic corporations.
- (ii) Provide genuine competition to oligopolistic banking system
- (iii) Invigorate domestic capital and bond markets
- (iv) Inject more discipline in international banks
- (v) Eventual securitization of current loans required
- (vi) Facilitate emergence of a “Continental Yield Curve”

XVII. The Need for Securitizations

Definition: . *Pooling of Assets, reconstitution into securities*
– *(bonds)*

. **Bonds** *backed by securities or collateral*

- (i) Cheaper Financing sources
- (ii) Improvement of Liquidity
- (iii) Diversification of funding sources
- (iv) Improved credit risk
- (v) Matching assets and liabilities
- (vi) Raising finances in times of distress
- (vii) Tapping international Capital Markets
- (viii) Surrogate Yield Curves
 - where no government securities available
- (ix) Areas: Airport receivables, mortgages, credit cards, water, electricity, road toll, etc.

XVIII.

Conclusion

Financing Africa's development will require:

- (i) A universal banking system
- (ii) A vibrant bond market
- (iii) A reformed pension fund/retirement industry
- (iv) Think about securitizations
- (v) Finance as a developmental strategy
- (vi) South Africa should not abandon universal banking

XIX.

Thank you

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Questions & Answers