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# The Role of Central Banks in Establishing Primary Markets

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March 9, 2018



# PRESENTATION OUTLINE

- **Introduction**
- **Background**
- **Monetary Policy Operations**
- **Domestic Bond Issuance Programme**



## INTRODUCTION

- The Bank of Botswana has established primary markets securities in two key areas:
  - (a) market-based monetary policy operations; and
  - (b) domestic capital market development .
- An overarching theme is the challenge of market development in the context of an economy where the Government has no immediate borrowing needs.



## BACKGROUND

- Bank of Botswana moved from direct to market-based monetary operations.
- Government had run an uninterrupted sequence of fiscal surpluses, eliminating any need to borrow.
- There was complete absence of short-term government debt (T-bills).
- Government should more proactively prepare for the time when access to capital markets for debt finance might be needed.



## MONETARY POLICY OPERATIONS

- Bank of Botswana Certificates (BoBCs) were introduced in 1991 in the absence of T-bills as the basis OMOs.
- BoBCs can also be used as collateral for accessing the overnight Credit Facility.
- BoBCs comprise the bulk (approximately 90 percent) of money market instruments.
- BoBCs were necessitated by conditions of chronic excess liquidity, meaning that the primary focus of monetary operations was liquidity absorption.



## MONETARY POLICY OPERATIONS CONT....

- BoBCs were initially issued with a range of maturities of up to one year.
- Today, with less excess liquidity and a sharper focus on the front of the yield curve, only 14- and 91-day papers are issued.
- access to BoBCs has been increasingly restricted, given their role as a monetary policy instrument.
- At the end of 2010, total BoBCs were equivalent to 20 percent of GDP.



## MONETARY POLICY OPERATIONS CONT....

- These restrictions came in two phases:
  - a) In 2009, access to BoBCs was limited to commercial banks only.
  - b) In 2011, to encourage more productive bank lending, the Bank imposed a cap on BoBCs issuance.
    - growth in bank lending accelerated sharply to the extent that some banks experienced liquidity shortages;
    - predictably, the limited supply caused money market rates to fall sharply, increasingly misaligned with the monetary policy stance.
    - To address this distortion, the cap was relaxed in late 2016, and money market rates have subsequently normalised.



## Domestic Bond Issuance Programme

- In 2001, Botswana was awarded the highest investment grade sovereign credit rating in Africa.
- In 2008, a P5 billion Government issuance programme was approved by Parliament, subsequently extended to P15 billion (approx. USD1.5 billion).
- Total issuance stands at P10.2 billion or approximately 6 percent of GDP.
- The central bank acts as government's agent for the bond issuance programme.



## Domestic Bond Issuance Programme CONT...

- However, Government's appetite for debt has reduced as public finances have improved.
- Currently bonds are auctioned on a single price basis, adding to the interest costs incurred by Government, and possibly contributing to the reluctance to borrow.
- Limited primary issues have contributed to the lack of liquidity in the secondary market.
- Demand is also uneven across the maturity spectrum with banks preferring the shorter-dated bonds for liquidity management, and pension funds focussing on the longer maturities.



## Domestic Bond Issuance Programme CONT...

- Demand is now more even following the decision in 2017 to remove the ceiling of six months on outstanding maturity.
- A further concern is the adequacy of the system of Primary Dealers (PDs) that is used to market the bonds.
- There is limited foreign participation in the domestic bond market.
- The Bank is in the early stages of a project to introduce retail bonds to further diversify revenue sources and support financial inclusion.



**I THANK YOU FOR YOUR ATTENTION**