

# Overcoming “Original Sin” to Secure Policy Space



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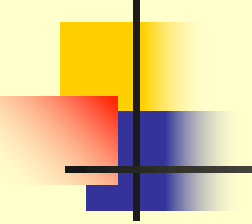
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*Discussion*

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# Original Sin and Shifting Currency Composition of Sovereign Debt

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- Timely and informative presentation
- Appropriately grounded in the pandemic effect
- Dominance of fiscal policies in policy responses
  - Large budget deficits
  - Sovereign indebtedness



# Toward Overcoming Original Sin

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- Most emerging governments are overcoming the “original sin”
  - But **not** a panacea
  - Slow recovery in portfolio flows in the **local currency** sovereign debt
- Shrinkage in the share of sovereign domestic currency sovereign bonds held **by foreign investors**, relative to recent trends
- How is the original sin being overcome?



# Original Sin Redux

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- Currency **mismatch**
  - Migration from borrowers to investors
- Higher Yields
- Higher **duration multipliers**
  - Above 1 for large EMEs
  - *Brazil, Mexico, Turkey, South Africa*
  - Is it driven by **the spread** between USD and local currency denominated bonds?



# Sin Mitigation

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- Imperative of **domestic capital market** development
  - Enhancing investor base (e.g., pension funds)
- Development of hedging markets
- Domestic **investor vs foreign investor?**
  - Discounting the “benefits” of domestic held debt?  
**Japan and Italy** – often cited as examples of economies with very high level of debt but large pool of domestic investors making debt sustainable.
  - Is this different for emerging markets?
- **Implications for low income countries** (sub Saharan Africa)



# Africa/SSA and Covid-19 Awakening

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- African economies got hit immediately even before the virus showed up in their shores
  - Global economic linkages: EU, US, China, UAE
  - Economic shocks and shrinkage of fiscal space
  - Debt distress and vulnerabilities
  - Covid-19 has awakened to the imperative of domestic resource mobilization and development of financial markets through integration

# Covid-19 and Rising African Indebtedness

*Brookings/UMD: Heitzig, Ordu, Senbet (October 2021)*

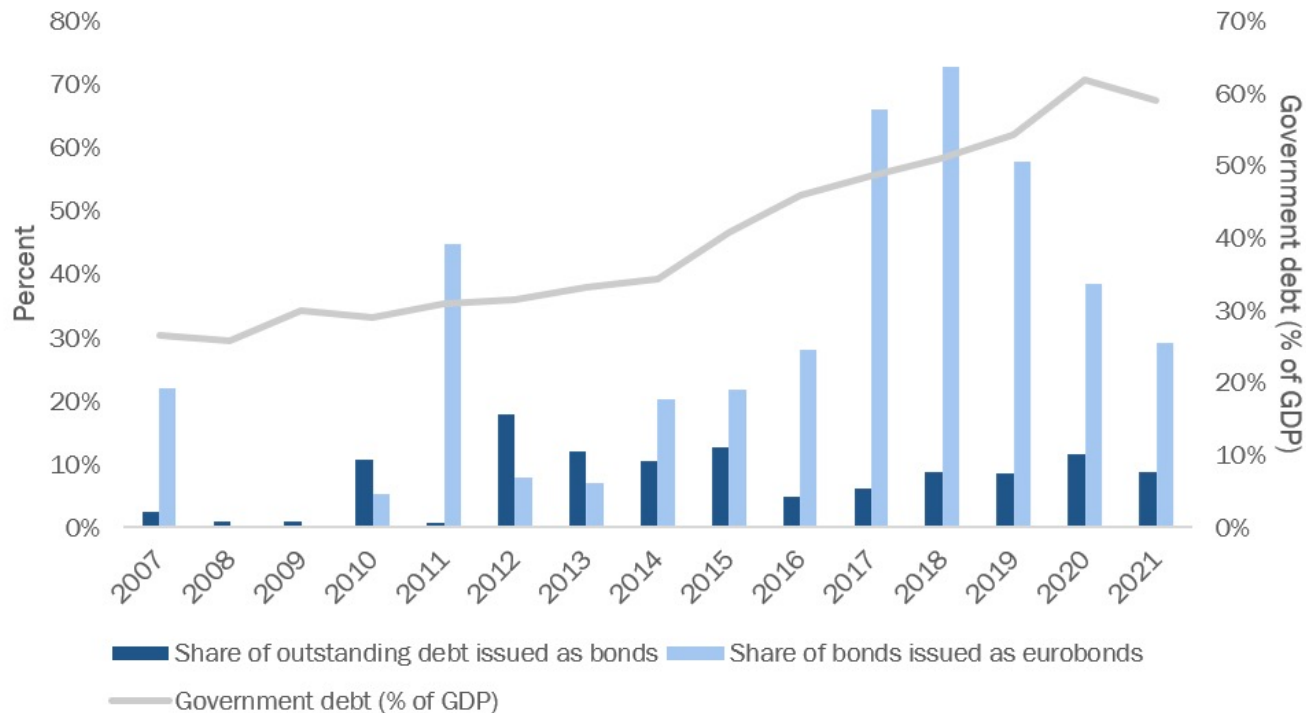
## General debt by country grouping

Group	Debt (% of GDP)		Debt (% of GDP) during pandemic		Percent change from Oct 2019 WEO to Apr 2021 WEO		
	2014	2019	2020	2021	2020 debt	2021 debt	2020 GDP
Central Africa	25.5	38.8	41.5	39.1	9.7	19.9	-7.3
Low income	46.9	63.1	71.9	66.9	9.2	2.8	-1.2
IDA	43.7	59.5	67.0	64.5	8.5	6.4	-0.3
HIPC	42.6	59.2	66.5	63.9	8.5	6.9	-0.7
East Africa	53.8	74.1	83.5	79.8	7.3	-0.6	-4.7
Blend	21.5	39.1	44.5	40.6	6.2	0.9	-10.5
Lower middle income	27.5	49.3	54.3	50.4	5.3	3.3	-9.3
Resource-rich	27.6	50.6	59.0	50.6	4.9	-1.5	-12.8
<b>Sub-Saharan Africa</b>	<b>35.1</b>	<b>55.4</b>	<b>63.1</b>	<b>60.3</b>	<b>4.5</b>	<b>3.4</b>	<b>-9.9</b>
Not resource-rich	42.9	58.5	65.7	67.1	4.2	6.3	-7.8
West Africa	23.1	37.3	43.7	41.8	3.6	4.0	-6.6
Southern Africa	43.9	71.2	83.5	82.2	2.7	3.4	-17.9
Not HIPC	31.2	52.3	60.0	57.1	1.7	1.0	-15.3
IBRD	42.4	68.1	81.2	81.3	-1.1	1.9	-20.5

# Increased Reliance on Domestic Debt

*Brookings/UMD: Heitzig, Ordu, Senbet (October 2021)*

**Role of eurobonds and domestic bonds in government debt, sub-Saharan Africa**



Note: Eurobonds include bonds denominated in dollars, euros, or British pounds.

Source: Bloomberg, 2021; IMF, 2021.

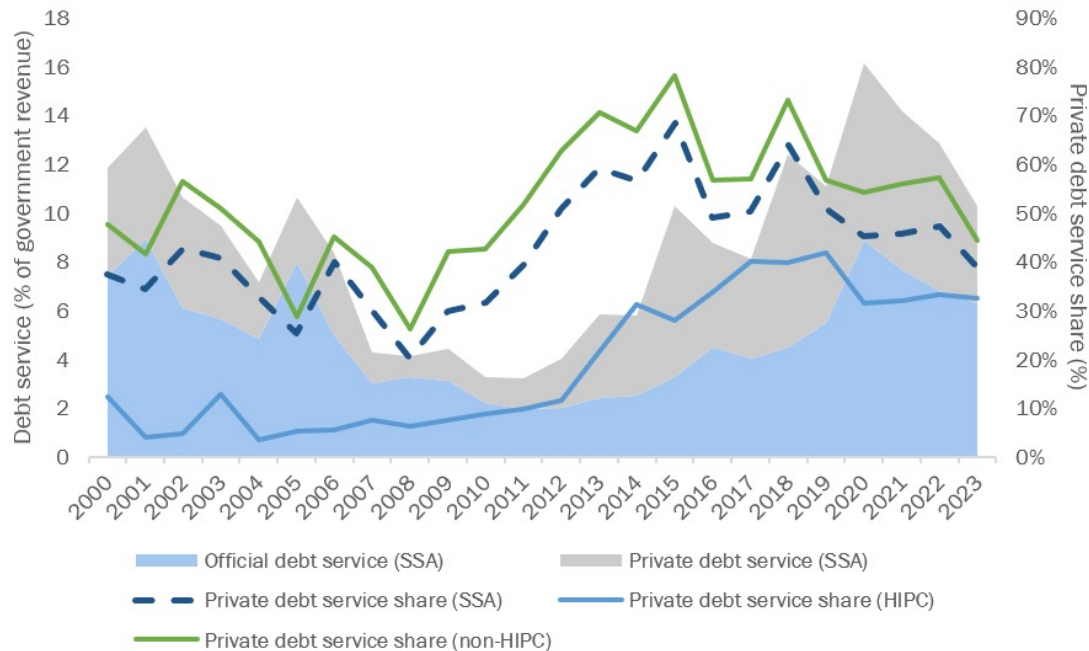


# Rising Debt Servicing Costs

## *Differential Access to Markets*

*Brookings/UMD: Heitzig, Ordu, Senbet (October 2021)*

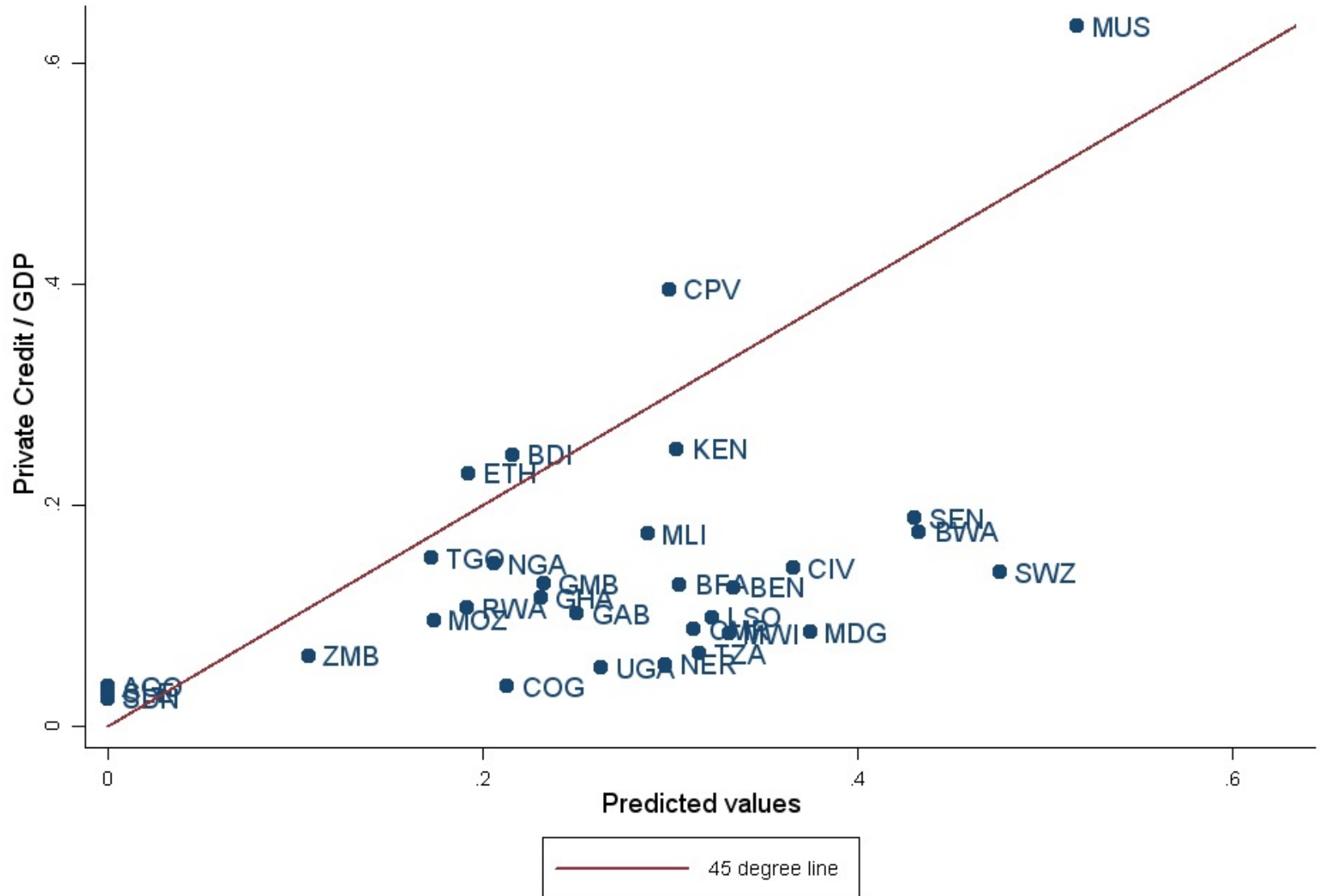
Scheduled and paid debt service by source, sub-Saharan Africa



Note: Values after 2020 are "scheduled" and will not likely reflect the debt servicing that country groupings will eventually pay.  
Source: International Debt Statistics. World Bank Group.

# The African Financial Development Gap

## *Actual vs. predicted*





# African Finance and the Way Forward

## *Financial Integration of Fragmented Markets*

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- Given the thinness and illiquidity of the disparate national stock exchanges, it is imperative that these **markets be consolidated through regional cooperation and initiatives**.
  - Harmonize trading laws and accounting standards, and promote convertibility of currencies.
  - Overcome political economy
    - Countries tend to treat **stock markets as national symbols** as they do national airlines. U
- Setting up a stock exchange is no different from **setting up a museum** if the exchange fails to serve multiple functions it is designed to perform – *liquidity, information production, price discovery, markets for corporate control, etc*

# Financial Integration

## *The Good News*

- There is a growing recognition for financial integration in Africa
- Key Initiatives for and regionalization and consolidation of markets
  - **BVRM (Abidjan)** – the world's first regional stock exchange serving 8 Francophone West Africa
    - Benin, Burkina Faso, Guinea Bissau, Cote d' Ivoire, Mali, Niger, Senegal and Togo.
  - Prospects for other regions
    - **West African Stock Markets** *[in progress]*: BVRM, Nigeria, Ghana, Siera Leone, Cape Verde
    - **East Africa** – Kenya, Uganda, Tanzania, Rwanda *[in progress]*
    - **Southern Africa (SADC)**
- African stock markets and regionalization as opportunities for **financial globalization** of Africa – the case of Africa-based funds

# African Continental Free Trade Area (*AfCFTA*)



- AfCFTA: Create a single African market for goods and services
  - Across **55 member states** of the African Union.
  - Spanning **1.2 billion people**; **About \$3 trillion GDP**
  - Scope exceeds that of a traditional free trade area, which generally focus on trade in goods
    - Includes trade in **services**, investment, e-commerce, etc.
    - Hence, **financial integration**

# Imperatives for African Finance

## *Awakening by COVID-19*

Include

- SMEs, Smallholder Farmers, Youth

Innovate

- Financial entrepreneurship, home grown (EQ)

Digitize

- Digital financial infrastructure, Fintechs

Integrate

- Regional exchanges, Pan African banks, AfCFTA

Capacitate

- Talented financial manpower, Regulatory capacity

Regulate

- Fit for purpose; Functional perspective, Compete

*The Political Economy of Execution*