Domestic funding for Africa

New ways to bridge infrastructure gap

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Africa faces a $50bn shortfall in the $93bn it needs to spend annually on roads, power supplies and other facilities that are crucial to long-term economic growth. This raises the question of whether local capital markets can play a role in bridging the infrastructure gap.

Global demand for commodities helped many African economies enjoy healthy growth over the past decade, albeit from a low base. This has improved average living standards and boosted the middle class, which is gaining importance in many countries. But African nations cannot continue to rely on commodity booms – as the collapse in demand shows. Growth must be more diversified, but this will not happen without significant improvements in infrastructure.

Africa needs to spend $93bn annually on roads, power supplies and other facilities that are crucial to long-term economic growth, boosting cross-border trade and reducing income inequality. Creating developed capital markets is key to securing funding for these projects.

Historically, African economies have been dependent on concessional financing from governments and development banks. In the face of weak internal revenue generation and tax collection, a number of governments still depend on international donors. However after a decade of healthy growth, African countries have more funding options open to them including international capital markets, development finance, foreign direct investment and domestic financial markets.

According to the 2016 African Economic Outlook report, financing flows to Africa were around $200bn in 2015, four times the level of 2002. They accounted for 9% of the collective GDP of African economies compared with 6% in 2000. Investors are turning to emerging markets in search of better returns because of deteriorating growth prospects in advanced countries and declining nominal interest rates.

To date, 20 African countries have issued eurobonds for around $50bn. However, after peaking in 2014, demand declined as the downturn in commodity prices reduced investors' appetite for risk. The International Monetary Fund warned African countries against rushing into issuing bonds and said that they might face exchange rate risks and problems repaying the debt. Even though demand has now picked up, it is reasonable to ask if the African eurobond rush will become a 'eurobomb'.

In spite of the influx of money, the infrastructure gap is still around $50bn a year. This raises the question of whether local capital markets can play a role in bridging the gap.

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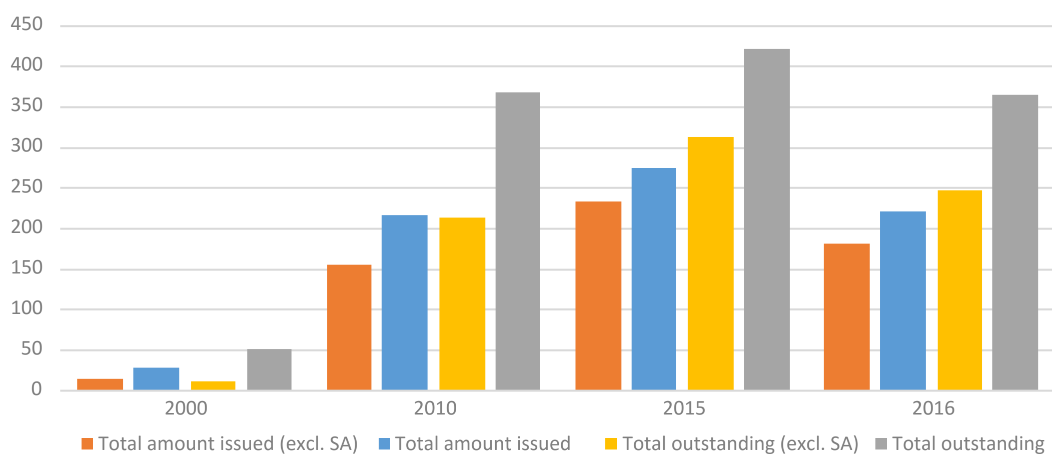
Government bond issuance rises between 2000-16

African sovereign bond market overview, $bn



Source: African Financial Markets Initiative, African Development Bank

The absence of a thriving local bond market limits companies' ability to finance expansion and build the infrastructure needed to support the growth of developing economies.

Domestic funding has become significant in other emerging markets, most notably in Latin America and Asia. Such financing can come from banks or institutional investors like pension funds and insurance companies.

Funding the infrastructure gap

Despite the continent's dominant informal sector, the total assets of African commercial banks are estimated at $1.5tn, the assets of the insurance industry at $300bn, pension funds $400bn and sovereign funds $121bn. The asset management industry is valued at around $634bn. These long-term resources were virtually non-existent until the 1990s. Another sign of the continent's progress is that around $520bn a year is collected in taxes. Transfers from Africans living abroad are estimated at $54bn-60bn annually, more than is received in official development assistance. The continent's foreign reserves are estimated at $400bn. Illicit financial flows that leave Africa are estimated at $50bn-60bn a year.

As countries develop and adopt market-orientated economies, they need efficient mechanisms for mobilising and allocating capital. These result from the interaction between banks, institutional investors, regulators, government, and stock exchanges. Over time they develop from basic systems to the sophisticated financial systems we see in many African countries today.

The total of government bonds issued has risen to $222bn in 2016 from $28bn in 2000 (see Chart). Bonds issued for a year or less represented 94% in 2000 compared with 74% in 2016. Just eight countries have issued bonds with maturities of at least 20 years: Botswana, Egypt, Kenya, Mauritius, Morocco Namibia, Nigeria and South Africa.

It is important that African governments recognise their responsibilities in developing financial markets. There has been progress in the past few years but there is a long way to go. The bond markets, in particular, need to evolve to accommodate deeper and more liquid non-governmental sector issuances.

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African countries are at various stages of development but all must understand that adopting sophisticated financial systems is a crucial part of building modern economies. Domestic saving is the most reliable source of financing for the investments needed to transform economies over the long term. If this is to be achieved, the strengthening of local financial systems is pivotal. ■

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South Africa accounts for 70% of equity market capitalisation in Africa

Exchanges	*Market Capital Equity, $bn*
Johannesburg Stock Exchange	756.86
Namibian Stock Exchange	91.1
Egyptian Exchange	55.7
Nigerian Stock Exchange	49.5
Casablanca Stock Exchange	45.8
Botswana Stock Exchange	37.5
Ghana Stock Exchange	15.0
Bourse Régionale des Valeurs Mobilières	12.4
Dar es Salam Stock Exchange	11.7
Uganda Securities Exchange	7.4
Stock Exchange of Mauritius	6.9
Lusaka Stock Exchange	5.7
Rwanda Stock Exchange	3.8
Zimbabwe Stock Exchange	3.1
Mozambique Stock Exchange	1.2
Malawi Stock Exchange	0.9
Swaziland Stock Exchange	0.7

Source: African Securities Exchanges Association 2015 report