



DBSA

Development Bank  
of Southern Africa

# Enhancing Regional Financial Cooperation in Southern Africa Against the Backdrop of the Global Financial Crisis

“Developing Regional Capital Markets: Some Perspectives”

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# Presentation Structure

1. Insights into financial markets in SADC: A few perspectives
2. Global financial crisis & infrastructure challenges in SADC
3. Obstacles to local currency financing of infrastructure
4. Possible interventions & consequences
5. Municipal financing approach

# SADC Financial Markets [1]

- *The integration of money markets is important in achieving regional monetary unification, and for the effective transmission of monetary policy across the region*
- *Central banks need to promote the capital market (stock exchanges) in the member countries and work towards establishing a regional stock exchange in the near future.*
- *Ultimately, what is desirable is to promote vibrant money markets at the short end of the market and capital markets at the long end.*
- *These markets are important for monetary policy transmission (money market) and support to the real sector (capital market)*

# SADC Financial Markets [2]

- *SADC states have stock markets most of which were established in the 1990s. The oldest stock markets are those of South Africa and Zimbabwe.*
- *In terms of market capitalisation and number of listings, which are used to measure market size, SADC stock exchanges, except those of South Africa and Zimbabwe, are relatively small.*
- *The majority of them are concentrated in a few sectors, indicating that the countries concerned do not have a diversified industrial base and/or those who own the enterprises do not want to go public.*
- *Absence [or generally underdeveloped] bond markets*

- The development of the domestic financial sector in Africa is critical for improving domestic resource mobilisation, thus need to focus on;
  - Promoting efficiency
  - Deepening the financial system
  - Accelerating financial inclusion
- Bank deposits/GDP ratios in Africa – 29%, compared to 65% in the rest of the world
- Poorly developed stock and bond markets in much of Africa
  - Sum of private and public bond market capitalisation to GDP amounts to only 42% in Africa, compared to 76% in the rest of the world

# GFC: Increasing scarcity of Financial Resources

- **Credit Crunch**
  - African banks survived the initial impact of the crisis due to lack of direct exposure to American 'toxic' debt.
  - However, international markets have raised thresholds for African banks, effectively cutting them off from accessing credit [with devastation for trade and investment in Africa]
- **Capital inflows**
  - Crisis is reversing the recent upward trend in capital flows
  - Bank credit and other private foreign capital flows are declining
- **Shortage of infrastructure financing**
  - Approx US\$80bn required per annum in Africa to close infrastructure gap
- **Access to finance for SME's**
  - Impact on employment, living standards and overall welfare given the labour-intensive nature of this sector

# Infrastructure projects have been affected, but not as much as export sectors.....

In the region and international community, there are major efforts to step up, and at least protect the infrastructure investment thrust. The public sector has a counter-cyclical approach, and the private sector seeks exposure to sectors with lower demand elasticities/strong domestic demand that will be less affected by the global crisis.

<b>Impact</b>	<b>Investment Affected US\$ m</b>	<b>% of Total</b>
<b>No impact to date</b>	<b>1,144</b>	<b>48%</b>
<b>Higher cost of financing</b>	<b>375</b>	<b>16%</b>
<b>Delayed</b>	<b>392</b>	<b>17%</b>
<b>Cancelled</b>	<b>450</b>	<b>19%</b>
<b>Total</b>	<b>2,361</b>	<b>100%</b>

*World Bank, Based on analysis of PPI projects being financed or tendered August-November 2008.*



# SSA's development finance requirements have been re-estimated and are much higher than earlier estimates

**Overall price tag of sensible targets US\$80 bn, split evenly between investment & maintenance**

US\$bn. pa over 10 years	Capital expenditure	Operating expenditure	Total
ICT	0.8	1.1	1.9
Irrigation	4.1	0.8	4.9
Power	23.2	19.4	42.6
Transport	10.7	9.6	20.3
WSS	2.7	7.3	10.0
<b>Total</b>	<b>41.5</b>	<b>38.2</b>	<b>79.7</b>

Source: Preliminary results AICD, 2008

# SSA's development finance gaps are high, especially in power, water and irrigation ...with little current spending

## Overall financing gap of US\$40 billion per year concentrated largely in power

US\$bn pa	Needs	Spending	Cost of targets minus On-going spending	Relevant Financing Gaps
Power	42.6	13.8	28.8	<b>28.8</b>
WSS	10	5.9	4.1	<b>4.1</b>
Transport	20.3	17.7	2.6	<b>2.6</b>
ICT	1.9	10	-8.1	<b>0.10</b>
Irrigation	4.9	0	4.9	<b>4.9</b>
<b>Total</b>	<b>79.7</b>			<b>40.4</b>

Source: Preliminary results AICD, 2008

# Obstacles to Expand Local Currency Financing for Infrastructure

- **Inadequacies in the local banking system**
  - Lack of sophistication and adequate instruments
- **Volatile exchange rates – currency risk**
  - Susceptible to wild fluctuations
  - Risk of entrenching indebtedness
- **Lack of diversification of economies**
  - Commodity dependent therefore ‘boom-bust’ tendencies
- **Macroeconomic instability**
  - In some cases, absence of predictable, coherent and consistent fiscal, monetary and trade policies

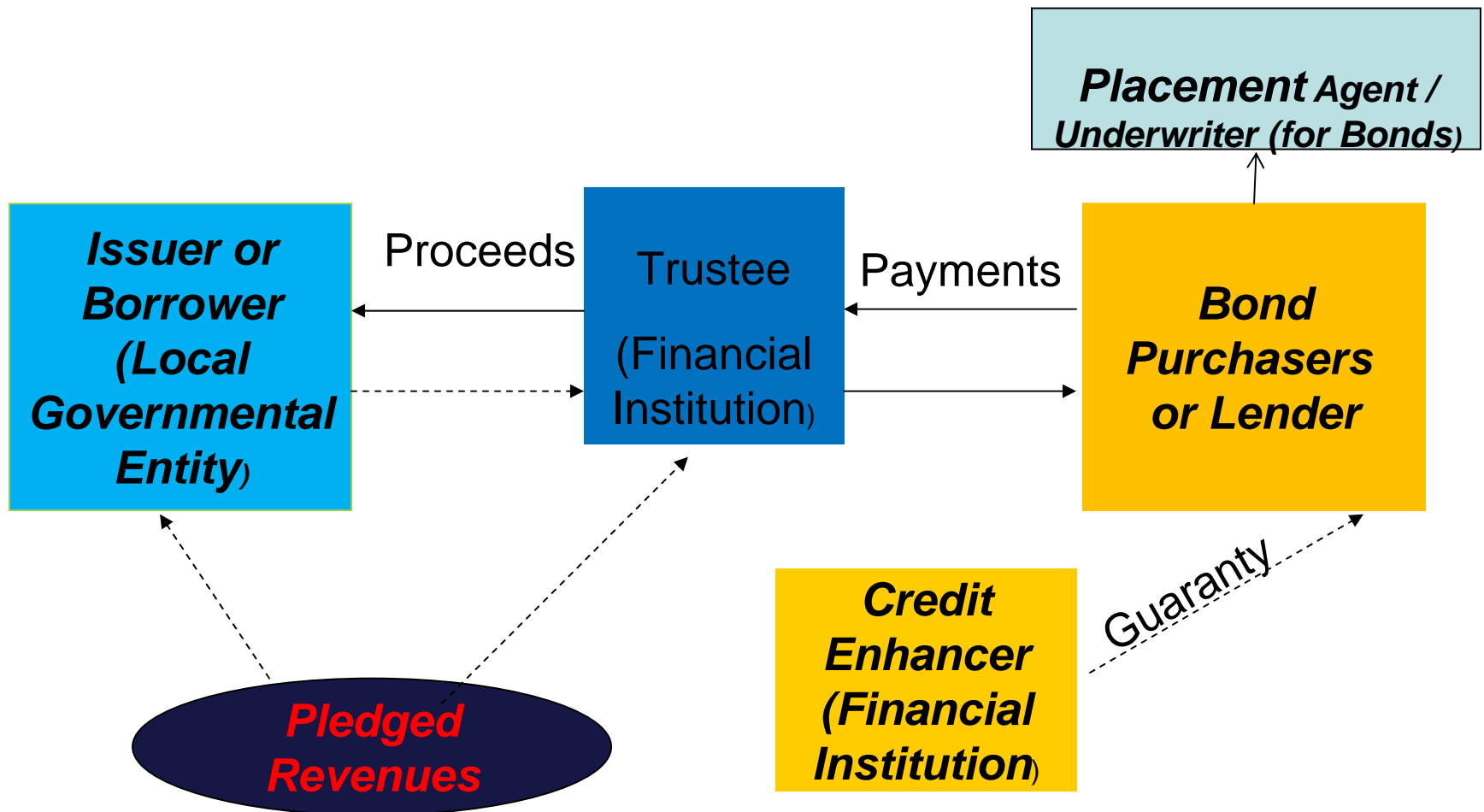
# Strategies for Domestic Resource Mobilisation

- **Narrow tax bases and inefficiencies in tax collection**
  - fiscal reforms required [fiscal stabilisation]
- **Private pension schemes are of limited coverage, dysfunctional or absent altogether**
  - Huge gap [therefore potential] exists
- **Social security schemes remain underdeveloped**
  - Compulsory schemes
  - Regulatory and operational efficiencies
- **Municipal bond market**
  - Amend legislation
  - Municipal credit ratings

# Municipal Financing in SADC

- General obligation lending based on credit worthiness
- Project based lending
- Grant funding / Technical assistance
- Political risk cover through Multilateral Investment Guarantee Agency (MIGA) on long-term infrastructure projects
- Underwriting of municipal instruments
  - originating (designing & planning); Risk bearing (acquiring a total issue & reselling it for > purchase price); Distribution (selling to investors)
- Credit enhancement mechanisms
- Municipal Bond Market

# Basic Municipal Finance Transaction: Participants & Structure



# Key Underpinnings of Municipal Finance and Challenges to Further Deployment [1]

- Key Legal Considerations:
  - Applicable legal authority in many SADC states currently does not exist and rests exclusively with central government with respect to:
    1. authority for local governmental entities to borrow and to pledge security for its borrowings
    2. flexibility for borrowing to occur through an optimal local governmental entity
    3. authority for local governmental entity to charge and collect taxes, fees or other revenues to be pledged for the borrowing

# Key Underpinnings of Municipal Finance and Challenges to Further Deployment [2]

- Key Economic & Market considerations :
  - scope and size of the local governmental entity's revenue base that is to be pledged for the borrowing
  - practical ability for local governmental entity to collect taxes, fees or other revenues pledged to support the borrowing
  - perceived creditworthiness of local governmental entity
  - scope and size of local capital market (for domestic bond offerings) is small or non-existent
- Limited access to foreign capital markets will require active domestic capital markets development to support municipal bond transaction in SADC countries



**THANK YOU!**

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