1. The rapid growth of the government securities markets in Sub-Saharan Africa: the case of WAEMU[1][2]

Although the size of the WAEMU's government securities market remains modest (with debt outstanding accounting for 1.5% of the area's GDP in 2006), even with respect to the other low-income countries of Sub-Saharan Africa (SSA), government debt issuance registered a remarkable six-fold increase between 2001 and 2006. The choice of the WAEMU by the International Finance Corporation (IFC) of the World Bank Group in late 2006 for its first issuance of local currency bonds in SSA reflects the increasing attractiveness of this market.

The structural change in government financing, marked by a steady reduction in monetary financing, is illustrated by the recent development of the regional market, fuelled, on the one hand, by governments' almost systematic use of this type of financing and, on the other, by the rapid growth in the bond segment resulting from a significant lengthening of maturities. This extension of the average maturity of public debt in the WAEMU, which gives rise to a more diversified debt profile than in the rest of SSA countries, may be associated with the greater macroeconomic stability of CFA franc countries.

Excess liquidity in the WAEMU banking system has also facilitated government securities issuance. This excess liquidity could account for the relatively favourable issuance conditions, as well as the limited credit differentiation among the area's sovereign issuers.

This privileged situation is not expected to last as banking system liquidity may tighten and a number of highly-rated issuers have entered the market, which is likely to lead to a widening of spreads.

1.1. The WAEMU regional market has grown strongly since early 2000

1.1.1. But its size remains modest

In comparison with other SSA markets, which started to develop in the 1980s, the size of the government securities market in the WAEMU is still small. At end-2006, the public debt outstanding[3] only represented 1.5% of regional GDP.

[1] This study, conducted by the Banque de France (CFA Franc Zone and Development Financing Studies Division), has benefited from the comments and suggestions of the BCEAO Research Department.
[2] WAEMU (West African Economic and Monetary Union) members include Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo with CFA franc as common currency, and regional institutions, including a common central bank (BCEAO) and securities market (BRVM).
[3] Public debt includes short-term domestic Treasury bills and government bonds.

Outstanding public debt in the WAEMU

(as a % of GDP)

	2000	2001	2002	2003	2004	2005	2006
Benin	0.0	0.0	0.0	0.0	0.0	1.0	1.0
Burkina Faso	0.1	0.0	1.8	1.8	2.5	1.2	0.9
Côte d'Ivoire	0.3	0.4	0.8	1.3	1.3	1.7	1.9
Guinea-Bissau	0.0	0.0	0.0	0.0	0.0	3.7	3.9
Mali	0.0	0.5	0.5	0.6	0.8	1.0	0.0
Niger	0.0	0.0	0.0	0.0	0.0	0.9	0.8
Senegal	0.0	1.3	0.0	0.6	1.1	1.8	2.0
Togo	0.0	0.0	0.0	0.0	0.0	0.0	3.1
Total WAEMU	**0.1**	**0.4**	**0.6**	**0.9**	**1.1**	**1.4**	**1.5**

Sources: BCEAO, Banque de France calculations

Indeed, the WAEMU only started to develop a regional bond market since 1998, when the *Bourse Régionale des Valeurs Mobilières (BRVM)* was created in Abidjan. Before then, governments and non-financial corporations could only issue short-term marketable debt securities with maturities of between seven days and two years. The creation of this regional securities market in the WAEMU made it possible to implement the infrastructure necessary for changes in government financing (see Section 1.2.).

By way of comparison, over the 1980-2000 period, the outstanding stock of domestic debt represented on average 8% of the GDP of the 15 non-CFA SSA countries[4], eligible for the Heavily Indebted Poor Countries Initiative (HIPC), according to a recent study published by the IMF[5].

Domestic debt markets in SSA

(ratio of domestic debt to GDP)

	1980-1989	1990-1994	1995-2000
South Africa	30	37	45
Burundi	3	2	6
Gambia	3	13	23
Ghana	12	8	24
Kenya	21	23	22
Namibia	0	8	19
Nigeria	28	29	16
Zimbabwe	35	29	37
15-country average (non-CFA)	**11**	**12**	**15**
Of which HIPCs	*9*	*6*	*8*
Of which non-HIPCs	*14*	*18*	*23*

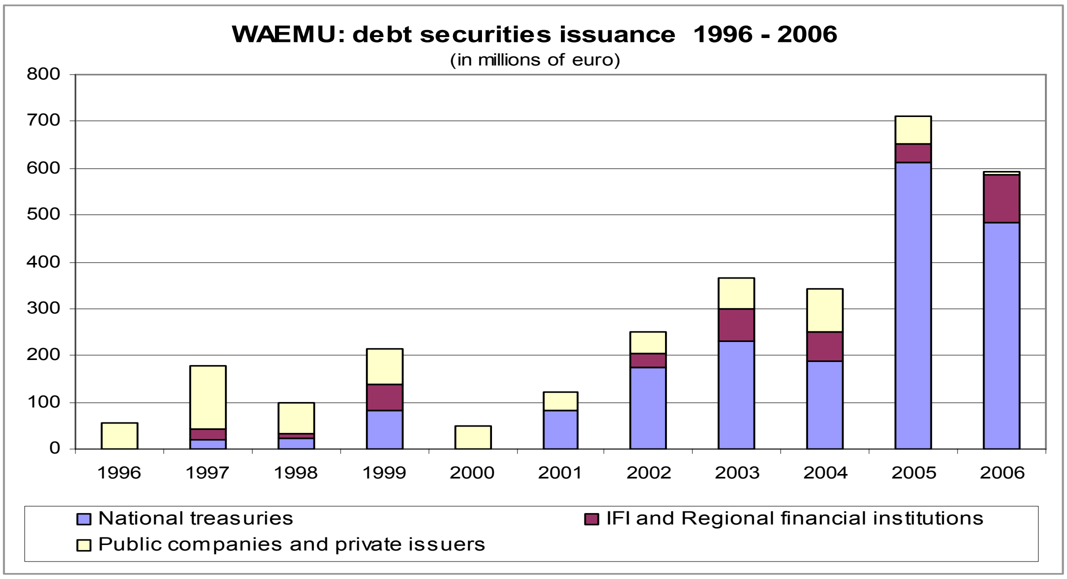
Source: IMF, J. Christensen, 2005

[4] Burundi, the Democratic Republic of Congo, Ethiopia, Gambia, Ghana, Guinea, Madagascar, Malawi, Mozambique, Uganda, Rwanda, São Tomé and Príncipe, Sierra Leone, Tanzania, and Zambia.

[5] J. Christensen, Domestic Debt Markets in Sub-Saharan Africa, IMF, 2005

1.1.2. A sharp increase in issuance volumes since 2001

The public debt market in the WAEMU has been growing sharply since 2001. Issuance by national treasuries rose almost six-fold between 2001 and 2006, from FCFA 55 billion to FCFA 318 billion (EUR 485 million). In total, for all issuer categories, average debt securities issuance on the sub-region's capital markets increased five-fold over the same period, from FCFA 79 billion to FCFA 383 billion (EUR 585 million)[6].



BCEAO, financial market indicators; Banque de France calculations

While the domestic debt market in the WAEMU is mainly a public debt market (i.e. over two-thirds of issuance volumes since 2001), private issuers played a key role during its launch phase (1998-2001).

Indeed, between 1998 and 2001, private issuers (mainly financial institutions, as well as industrial firms) accounted for the majority of issuance of both short- and longer-term debt. Since then, this trend has reversed, with public issuance outstripping private issuance.

Among the multinational financial institutions, the West African Development Bank (BOAD) is particularly active on the debt market, acting as a *benchmark* issuer at the regional level, by regularly issuing bills and bonds. Between 2000 and 2006, BOAD accounted for on average 12% of public debt issues. International financial institutions have only recently taken an interest in the WAEMU domestic debt market: the IFC, specialised in private sector financing, issued in December 2006 its first local currency bond in SSA, to the tune of FCFA 22 billion (around EUR 30 million)[7].

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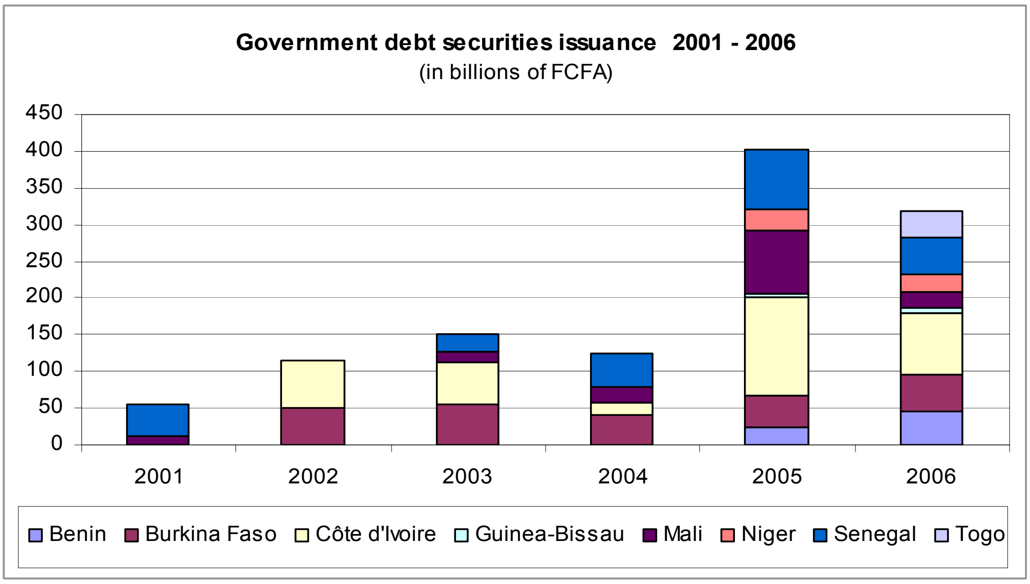
[6] See Appendix 1.
[7] The funds raised will be entirely reinvested locally, in the form of medium- and long-term loans to private companies.

Two factors have particularly contributed to this sharp growth in public debt issuance:

- *All of the region's eight countries now have access to the regional market*. While four countries (Côte d'Ivoire, Senegal, Burkina Faso and Mali) account for the lion's share of gross issuance, all WAEMU countries have issued bonds at least once on the primary market (Togo carried out its first issue in February 2006). The frequency of issuance by certain countries and the almost systematic publication of issuance programmes testify to the increasing use of domestic debt markets.



Sources: BCEAO, financial market indicators; Banque de France calculations

- *As of 2001, debt portfolios were diversified and maturities were extended (up to seven years),* enabling rapid bond market growth. On average between 1999 and 2006, almost one-third of debt issued (in volume terms) had a maturity of over three years.

At end 2006, around two-thirds of the public debt outstanding was made up of securities with a residual maturity of over 18 months and 45% of over two and a half years[8]. Its average maturity is therefore 22 months.

This result is to be set against the situation of public debt markets in SSA, where on average there is a greater concentration of issuance in short-term maturities. IMF data on the maturity structure of government debt in 14 non-CFA SSA countries at end-2000 showed that three-month bills accounted for 50% of debt outstanding, with 12-month representing around one-fifth[5]. The average maturity was eight months, and even six months for eight HIPCs.

[8] See Appendix 2

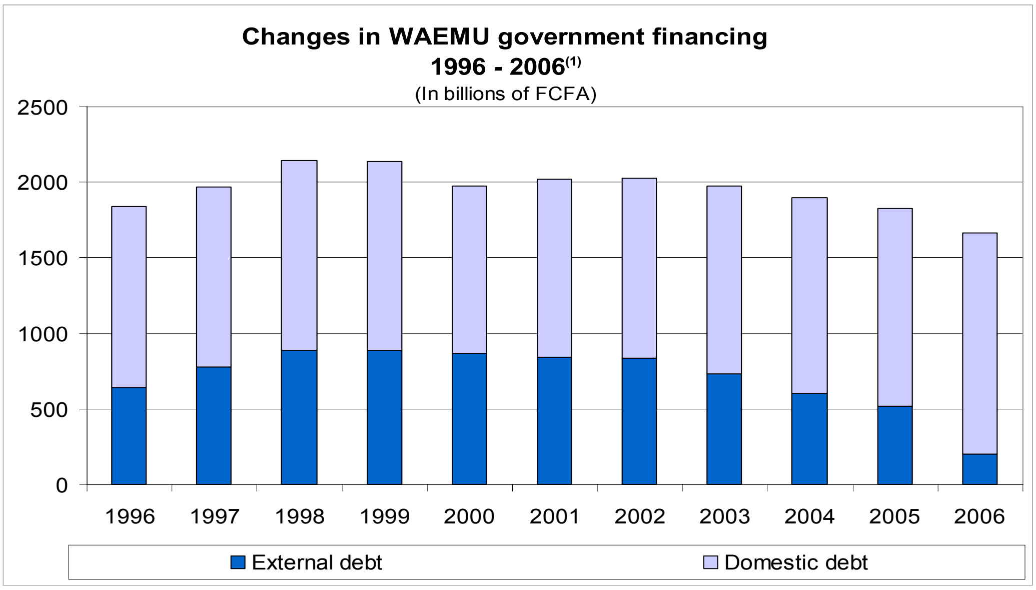
This extension of the average maturity of public debt in the WAEMU, giving rise to a more diversified debt profile than in the rest of SSA countries, may be associated with the greater macroeconomic stability in CFA franc countries. The area's relatively good inflation performance compared with that of the other SSA countries and the credibility of the exchange rate regime create favourable conditions for long-term debt issuance. For instance, over the 1960-2004 period, CFA franc countries registered an average annual inflation rate of 8%, compared with 76% for non-CFA SSA countries[9].

The lengthening of maturities also reflects the learning effects from which national treasuries have benefited thanks to their regular issuance, at the outset, of short-term debt (e.g. Burkina Faso).

1.2. A structural change in government financing

1.2.1. A large predominance of domestic debt

Over the past decade, governments have been resorting increasingly to domestic debt, which now outweighs external debt by almost three times. The latter is traditionally obtained from bilateral creditors and international financial institutions.



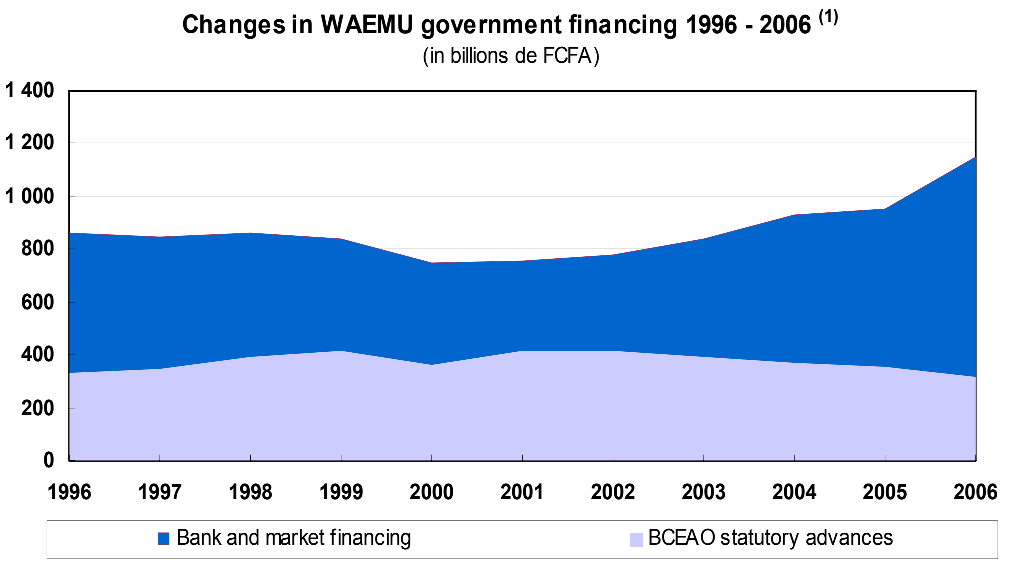
Sources: CFA Franc Zone annual reports; BCEAO
(1) Government net borrowing requirement. External debt excluding debt cancellation.

1.2.2. A steady reduction in monetary financing

The gradual elimination of central bank financing is the most noteworthy trend in domestic financing since the start of the 2000s.

While advances by the BCEAO to governments, set out in the Statutes (Articles 15 and 16), remained relatively stable until 2001, their amount has regularly declined since then, with bank and market financing soaring by 23% between 2001 and 2005. Between 2001 and 2005, the share of monetary financing in total government financing contracted by almost 10 percentage points, decreasing from 36% to 27%.

[9] E. Yehoue, The CFA Arrangements – More Than Just an Aid Substitute?, IMF Working Paper, January 2007



Sources: CFA Franc Zone annual reports; BCEAO
1) Government net borrowing requirement

The decline in the recourse to monetary financing is due to the gradual phasing out of BCEAO statutory advances.

A timetable for consolidating statutory advances to governments was approved in September 2002. It took effect on 1 January 2003, prohibiting any further advances and providing for the repayment of existing advances on a quarterly basis over a period of 10 years. Since then, no more advances have been granted and the majority of governments are up to date with their repayments.

Statutory advances from the BCEAO to governments between 2002 and 2006

(in billions of FCFA)

	Outstanding at 31/12/2002	Outstanding at 31/12/2005	Outstanding at 31/12/2006	Outstanding 2006/2002
WAEMU	414.6	354.8	316.9	– 23.5 %

Sources: BCEAO; CFA Franc Zone annual reports

This trend decline in monetary financing is one of the main factors behind the development of the regional financial market. It has allowed governments to diversify their sources of financing, especially since domestic markets offer a number of advantages for national treasuries over alternative sources, in particular external financing:

- governments enjoy greater leeway in accessing resources as they have relative control over issuance programmes, the amounts raised and the maturities;

- there is greater predictability in terms of funding, as access to these resources is not dependent, as is the case for that granted by multilateral organisations, on specific policies or the assessment of their results;

- such financing may be used for daily and recurring needs, whereas funds from international or bilateral lenders are often granted for specific projects, in the framework of programmes established by mutual agreement;

- lastly, the use of market financing fosters more effective treasury management.

1.3. Issuance conditions are attractive, but are nevertheless likely to tighten in line with liquidity conditions

1.3.1. Excess liquidity is the main factor behind the rapid growth of the government securities market

The WAEMU banking sector is characterised *by* a low loan-to-deposit ratio, with results in a high level of excess liquidity. This situation stems from the relatively small number of bankable projects, which in turn reflects a lack of sectoral diversification of the economies, an insufficiently developed formal private sector and more generally weaknesses in the business environment (lack of guarantees for the legal security of creditors, complexity of legal systems, etc.).

This excess liquidity in the banking sector gives rise to sizeable deposits by credit institutions at the central bank, which largely exceed required reserves. The ratio of excess reserves to the broad monetary aggregate M2[10] constitutes the most common measure of excess bank liquidity in developing countries.

Excess liquidity in the WAEMU banking sector (1)

	In billions of FCFA	as a percentage of M2
2000	288	6.7
2001	233	4.9
2002	391	7.1
2003	418	7.4
2004	478	7.9
2005	360	5.6
2006	205	2.9

Sources: BCEAO; CFA Franc Zone annual reports
(1) reserves in excess of required reserves, as an annual average (BCEAO)

This high level of excess liquidity therefore constitutes one of the key factors behind the rapid growth of the government securities market. Given that reserves at central banks are not remunerated and that there has been little development of other products on the regional financial market, banks have diversified into interest-bearing debt instruments.

Indeed, WAEMU banks are the main holders of government securities, alongside other institutional investors (pension funds, life insurance companies, etc.). However, few data on government securities holdings across sectors are available. That said, according to BCEAO data, the share of government debt held by the central bank does not exceed 5% of the public debt outstanding, which is far lower than in other SSA countries (see table below).

[10] The broad monetary aggregate M2 includes currency in circulation, savings deposits and time deposits.

Holdings of government debt across sectors

(In percent)

	Banking sector		Non-bank sector
	Central bank	Commercial banks	
Burundi	55	22	23
Ghana	27	39	34
Kenya	11	39	50
Nigeria	66	30	4
Uganda	17	73	10
Tanzania	44	42	14
Zimbabwe	19	35	47
Average non-CFA SSA countries	**16**	**54**	**30**
HIPC	*17*	*54*	*29*
Non-HIPC	*16*	*53*	*31*

Source: IMF, J. Christensen, 2005.

Moreover, by averting the upward pressure on interest rates that may be present when resources are scarce, the excess liquidity in the WAEMU has no doubt allowed governments to borrow on the domestic market at fairly advantageous terms in relation to their credit rating.

On the bond market, the B+ rated (speculative grade) 5-year Senegalese bonds are only 75 basis points higher than the AAA-rated CFA franc IFC bonds of a similar maturity. Similarly, the *spreads* between the most highly rated government securities (Senegal) and those of other countries in the region, often not rated, are relatively narrow and do not exceed 100 basis points. This limited credit differentiation among issuers shows that the situation of excess liquidity in the WAEMU appears to result in a bias that prevents market mechanisms from fully playing their role in credit risk assessment.

Characteristics of bond issuance in the WAEMU since 2003

	Rating	Amounts (in millions of FCFA)	Date of issuance	Maturity	Rate
Burkina Faso	B	25,000	01/03/2003	5 -year	7.5
Côte d'Ivoire	n.r.	40,403	01/09/2003	3 -year	6.5
		86,132	14/07/2005	2 -year	5.5
		84,200	01/07/2006	3 -year	6.5
Sénégal	B +	45,000	25/07/2005	5 -year	5.5
Togo	n.r.	36,300	20/02/2006	5 -year	6.5
BOAD	n.r.	6,400	11/05/2005	6 -year	4.5
		18,600	11/05/2005	8 -year	5.0
SFI	AAA / Aaa	27,000	14/12/2006	5 -year	4.75

Sources: BCEAO; Standard & Poor's et Moody's
n.r. = not rated

Although subject to caution due to their partial differences, a comparison with recent issues by emerging countries on international markets seems to confirm the existence of more favourable financing conditions for WAEMU states borrowing on the regional market rather than on international markets.

For instance, South Africa, which enjoys a BBB+ investment grade rating, issued in May 2006 a bond with a nominal amount of EUR 750 million, a maturity of 10 years, and a coupon of 4.50%.

Although the terms of borrowing in relation to credit ratings appear relatively favourable for WAEMU states compared with those of issuing on international markets, the growing recourse to markets has increased their financing costs. Previously, financing was obtained through less costly advances from the central bank, offered until 2003 at the rate of 4.95%.

1.3.2. Towards a greater differentiation between issuers?

Two factors are likely to result in a widening of spreads in the WAEMU:

- On the one hand, 2006 appears to have been marked by a significant tightening of bank liquidity. According to the BCEAO, the level of excess liquidity in the banking sector contracted by over 75% between 2005 and 2006, to stand at FCFA 205 billion at end-December 2006, while between 2002 and 2005, banks' excess reserves exceeded FCFA 400 billion on average. In this context, sovereign spreads have already widened in countries where the decline in excess liquidity has been the greatest.

Impact of liquidity changes on the cost of issuance

	Excess liquidity 2006/2005 (in billions of FCFA)	Treasury bill spreads (basis points)
Benin	–27,6	+85
Burkina Faso	–27,0	+88
Guinea-Bissau	–0,1	+39
Mali	–5,4	+11
Niger	–6,0	+130
Senegal	–35,9	+129

Sources: BCEAO, IMF

- On the other hand, the entry into the market of a new category of issuers, benefiting from the highest credit ratings assigned by agencies, is likely to result in a greater differentiation between issuers. The emergence of issuers such as the IFC, rated AAA, could create new *benchmarks* for government and corporate issues in the WAEMU.

These recent developments, especially if bank liquidity continues to tighten over a prolonged period, call more than ever for disciplined fiscal policies. In a context marked by an increased recourse to domestic debt for financing government policies, the sustainability of public finances is essential to ensuring a balanced development of the regional market. By creating upward pressure on interest rates, over-reliance on domestic debt could, furthermore, result in an increase in the cost of government financing and jeopardise the sustainability of public finances in the medium term.

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Appendix 1

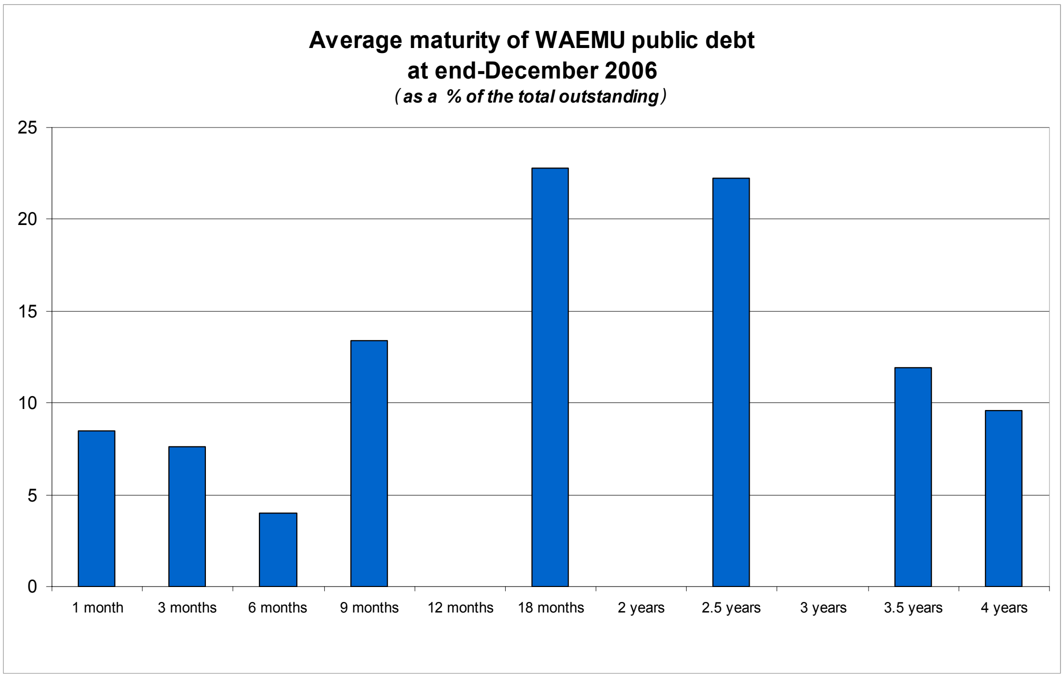
Total gross issuance of debt securities in the WAEMU

In millions of FCFA

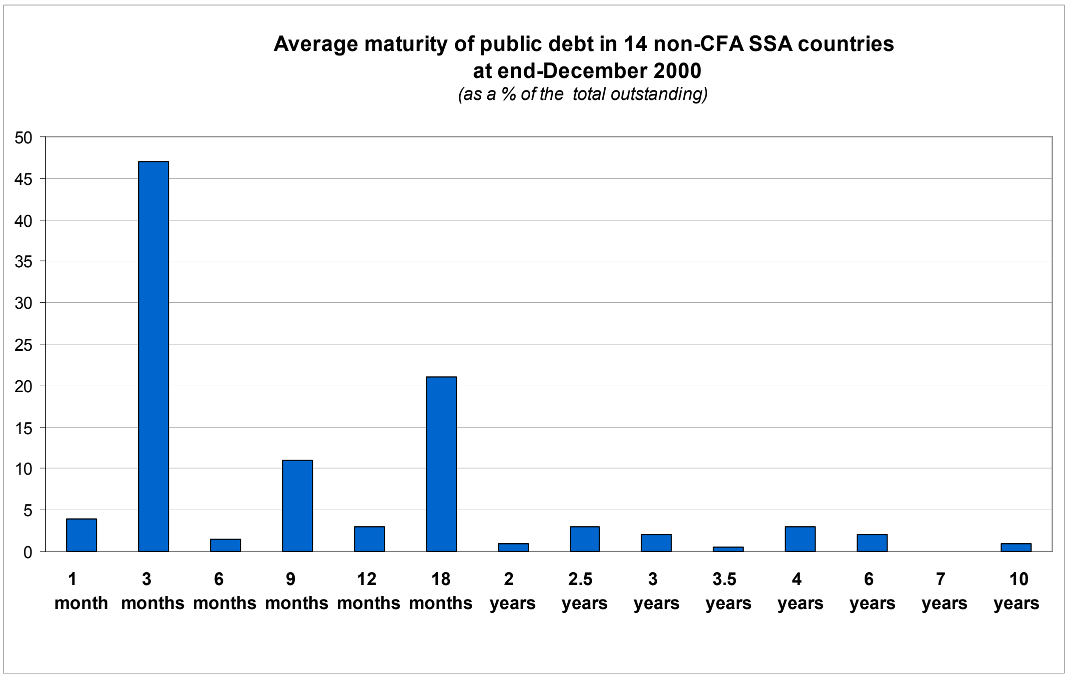
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Commercial paper	35,000	45,000	–	23,805	4,215	16,925	1,400	2,000	15,000	–	–
Certificates of deposit	–	2,000	–	–	7,000	2,000	1,100	–	–	–	–
Bills issued by financial institutions	–	6,000	6,300	6,300	–	–	–	5,000	4,200	180	3,200
Bills issued by regional financial institutions	–	15,000	27,200	–	–	–	7,855	45,000	17,300	–	15,000
Treasury bills	–	13,000	15,000	23,850	–	54,900	49,850	85,375	123,500	270,540	198,030
Total marketable debt instruments	**35,000**	**81,000**	**48,500**	**53,955**	**11,215**	**73,825**	**60,205**	**137,375**	**160,000**	**270,720**	**216,230**
Securitisation of public debt	1,500	35,640	–	4,544	–	–	–	1,500	–	–	–
Bonds	**–**	**–**	**17,000**	**84,420**	**20,505**	**5,004**	**103,372**	**99,903**	**65,200**	**194,898**	**166,644**
Issued by regional financial institutions	–	–	–	37,220	–	–	11,947	–	22,700	25,000	46,144
Issued by public issuers	–	–	–	30,200	–	–	63,978	65,403	–	131,133	120,500
Total	**36,500**	**116,640**	**65,500**	**140,819**	**31,720**	**78,829**	**163,577**	**238,778**	**225,200**	**465,618**	**382,874**
Issued by national treasuries	0	13,000	15,000	54,050	0	54,900	113,828	150,778	123,500	401,673	318,530
Issued by regional financial institutions	0	15,000	6,300	37,220	0	0	19,802	45,000	40,000	25,000	61,144
Issued by private issuers and public companies	36,500	88,640	44,200	49,549	31,720	23,929	29,947	43,000	61,700	38,945	3,200

Source: BCEAO, financial market indicators

Appendix 2



Sources: BCEAO, financial market indicators; Banque de France calculations



Sources: IMF, J. Christensen, 2005.