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University of Antwerp

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Public debt: ally or competitor?

Danny Cassimon, Karel Verbeke, Dennis Essers

**Acropolis-BeFinD
Business Talk**

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Structure of the presentation

- Some basic concepts on public debt (management)
- Rwandan public debt evolution and outlook
- Rwandan public debt: ally or competitor to the private sector?

Some basic concepts on public debt

Public debt allows the government to spend more now than its (tax and non-tax) revenues, including grant aid. i.e. to run a fiscal deficit.

PPG debt: all debt owed by the Rwandan government to various creditors

- Domestic public debt: debt owed to Rwandan creditors/in local currency/ruled by Rwandan law
- External public debt: debt owed to foreign creditors/in foreign currency/ruled by foreign law
 - Bilateral, multilateral or commercial creditors
 - Concessional or non-concessional
- Publicly guaranteed debt: debt contracted by non-government actors but guaranteed by the government.

Some basic concepts on commercial public debt

- Tradable government debt
 - Treasury bills: maturity up to 1 year
 - Treasury bonds: maturity >1 year
- Non-tradable government debt: e.g. central bank advances
- Primary market: domestic issuance of treasury bonds and bills through auctioning (BNR)
- Secondary market: trading of treasury bonds on RSE
- Commercial creditors:
 - Commercial banks
 - Institutional investors: RSSB, Private pension and insurance firms, Agaciro
 - Retail/small investors: individuals/grouped in SACCOs
- Special case: 'Eurobond'
 - International bond issued in foreign currency, e.g. USD-bond of Rwanda

Public debt management

- *Main objective of public debt management is to ensure that government's financing needs and payment obligations are met at the lowest possible cost over medium to long run, consistent with prudent degree of risk (IMF Public Debt Management Guidelines 2014)*
- Part of the story is keeping debt sustainable, meaning *the government does not, in the future, need to default or renegotiate or restructure its debt or make implausibly large policy adjustments.*
- In practice, debt is sustainable if future debt obligations remain below the maximum capacity to repay expressed in relation to GDP, export proceeds, fiscal revenues.

Joint IMF/WB sustainability thresholds

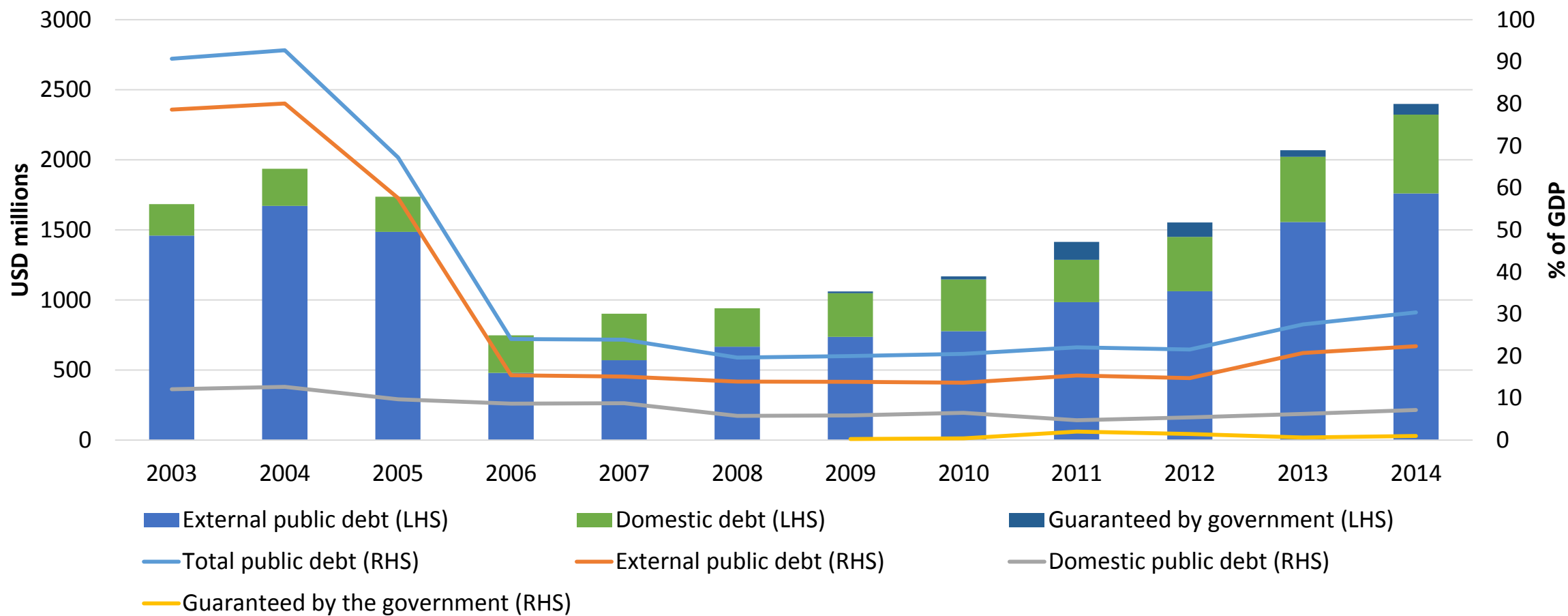
CPIA score	Policy performance	Debt Burden thresholds				
		Present Value of debt in percentage of			Debt service in percentage of	
		GDP	Exports	Revenue	Exports	Revenue
HIPC			150	250		
CPIA \leq 3.25	Weak	30	100	200	15	18
3.25 < CPIA \leq 3.75	Medium	40	150	250	20	20
CPIA > 3.75	Strong	50	200	300	25	22

Evolution of Rwandan public debt after relief

- Timing HIPC-MDRI debt relief
 - Decision point: December 2000
 - Completion point: April 2005
 - MDRI: December 2005
- Increase in debt stock after completion point
 - In nominal terms, overall Rwandan public debt stock is now higher than before debt relief
 - However, in relative terms increase in debt stock has been limited
 - Rwanda has smallest public debt stock (in % of GDP) of all EAC countries
 - Relative increase in *domestic* public debt (partly due to relief on *external* public debt)

Evolution of Rwandan public debt after relief

- Evolution of **public debt stock** (2003-2014)



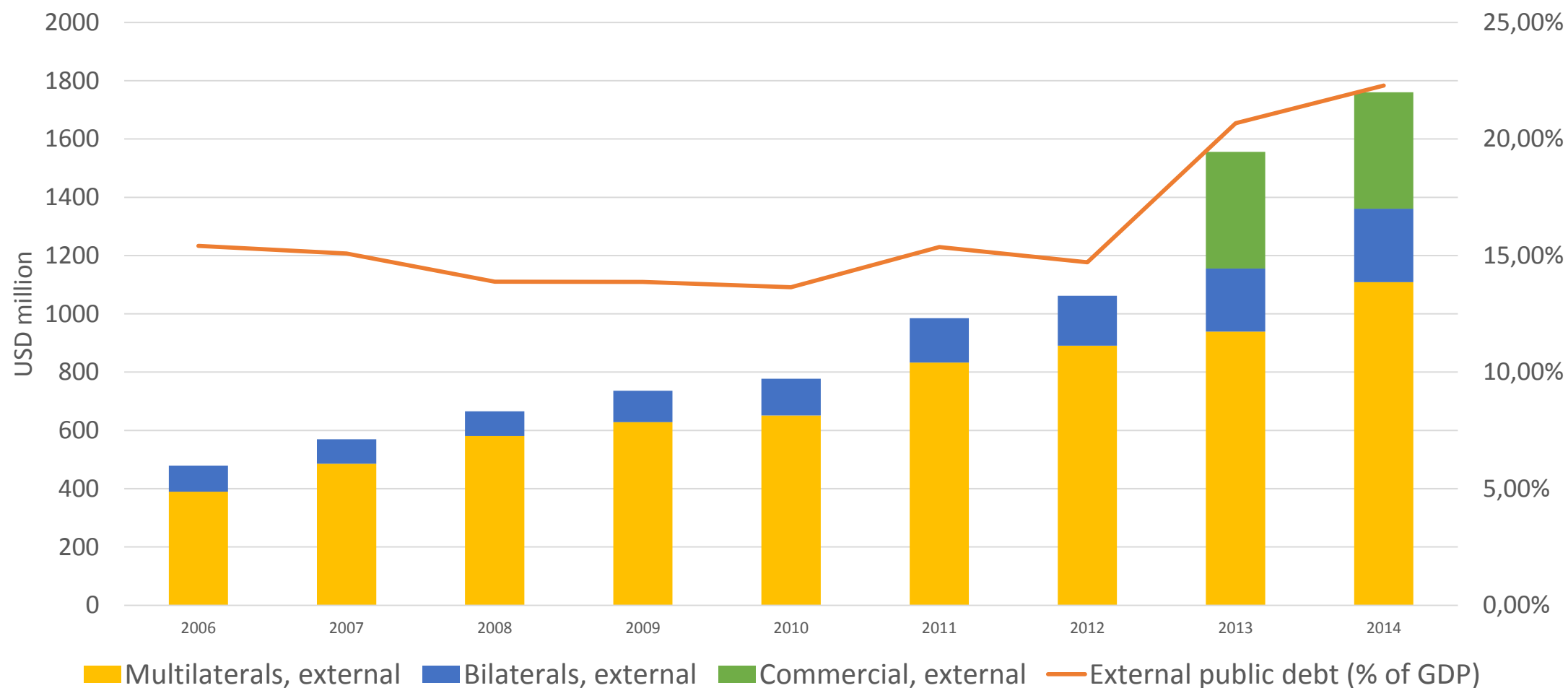
Source: MINECOFIN

External public debt

- Traditionally, highly concessional loans from multilaterals and bilaterals have constituted the lion share of Rwanda's public debt stock
- Following HIPC: increased diversification of external debt: commercial debt, new bilateral donors
- Multilateral debt (mainly IDA and AFD)
 - Given low risk of debt sustainability, Rwanda will receive a growing share of its financial assistance in the form of loans (see e.g. IDA). Certain bilateral donors might follow this policy (e.g. Japan and Korea)
- Bilateral debt
 - China, India, Kuwait and Saudi Arabia are the main bilateral creditors.
- Commercial debt
 - Eurobond issued in 2013

External public debt

- Evolution of outstanding **external public debt stock (2003-2014)**



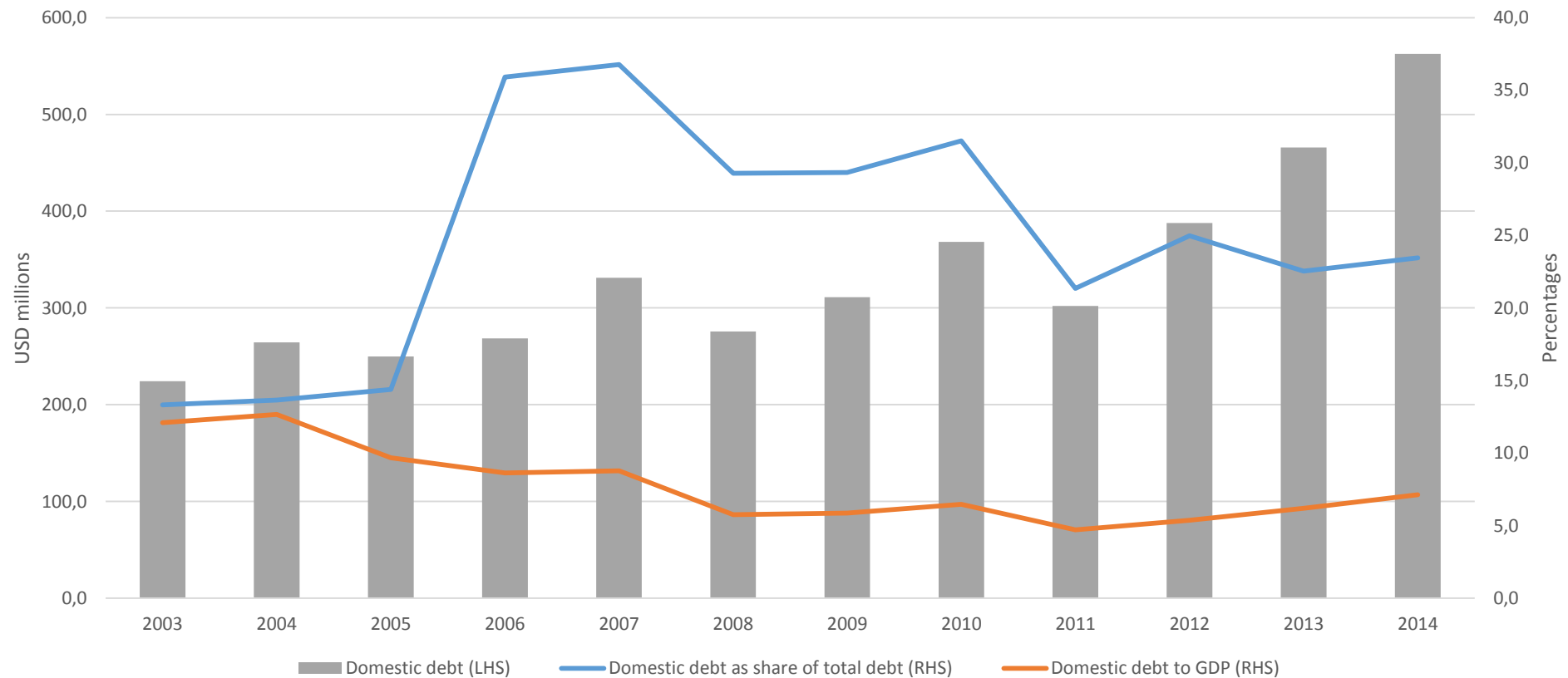
Source: MINECOFIN

Domestic public debt: local currency bonds

- Primary market
 - Weekly issuance of T-bills of 28-91-182-364 days
 - Quarterly issuance (since Feb 2014) of T-bonds of 3-5-7-10 years (15 years expected in May 2016)
- Secondary market
 - Post issuance T-bonds are listed on the RSE (regulated by CMA), although almost no trading occurs

Domestic public debt

- Evolution of total outstanding **domestic public debt stock** (2003-2014)



Current debt outlook and vulnerabilities

- Currently Rwanda has a low risk of debt distress (cf debt sustainability thresholds) and has a policy of prudent borrowing.
- Relatively strong performance on debt management.
- However vulnerabilities remain:
 - Small and undiversified export base, if shocked negatively, may quickly drive debt/export ratio up to and beyond threshold
 - Foreign exchange shortage
 - Eurobond exposes Rwanda more to changes in global investor sentiment and requires huge bullet payment

Public debt as ally and competitor

- From a public debt perspective, the government is both an ally and a competitor to the private sector:
 - Ally
 - Financing infrastructure to tackle the key constraints for private sector development
 - Foreign exchange inflow in case of external public debt
 - Providing safe assets for financial intermediation by issuing T-bills and T-bonds.
 - Capital market development: pricing benchmark for corporate bonds
 - Competitor
 - Competing for limited foreign exchange through imports for public investments and debt service payments
 - Crowding out access to private credit from the banking system through banks holding T-bills
 - Crowding out capital market financing for corporates through issuing T-bonds
 - Crowding out of business through debt conditionalities

Application to the Rwandan context

- Traditionally, external financing has occurred through aid in grants, as well as through highly concessional loans from multilaterals and bilaterals, that constituted the lion share of Rwanda's public debt stock
- Official grants and highly-concessional loans
 - Ally:
 - Infrastructure, human capital development,...
 - Potential net foreign exchange inflow
 - Competitor
 - Crowding out of business in case of tied aid
- Access will (gradually) diminish as Rwanda develops; traditional and emerging donors move to less concessional finance;
- and willingness by Rwandan authorities to accept them decreases, opening the door for other financing options;

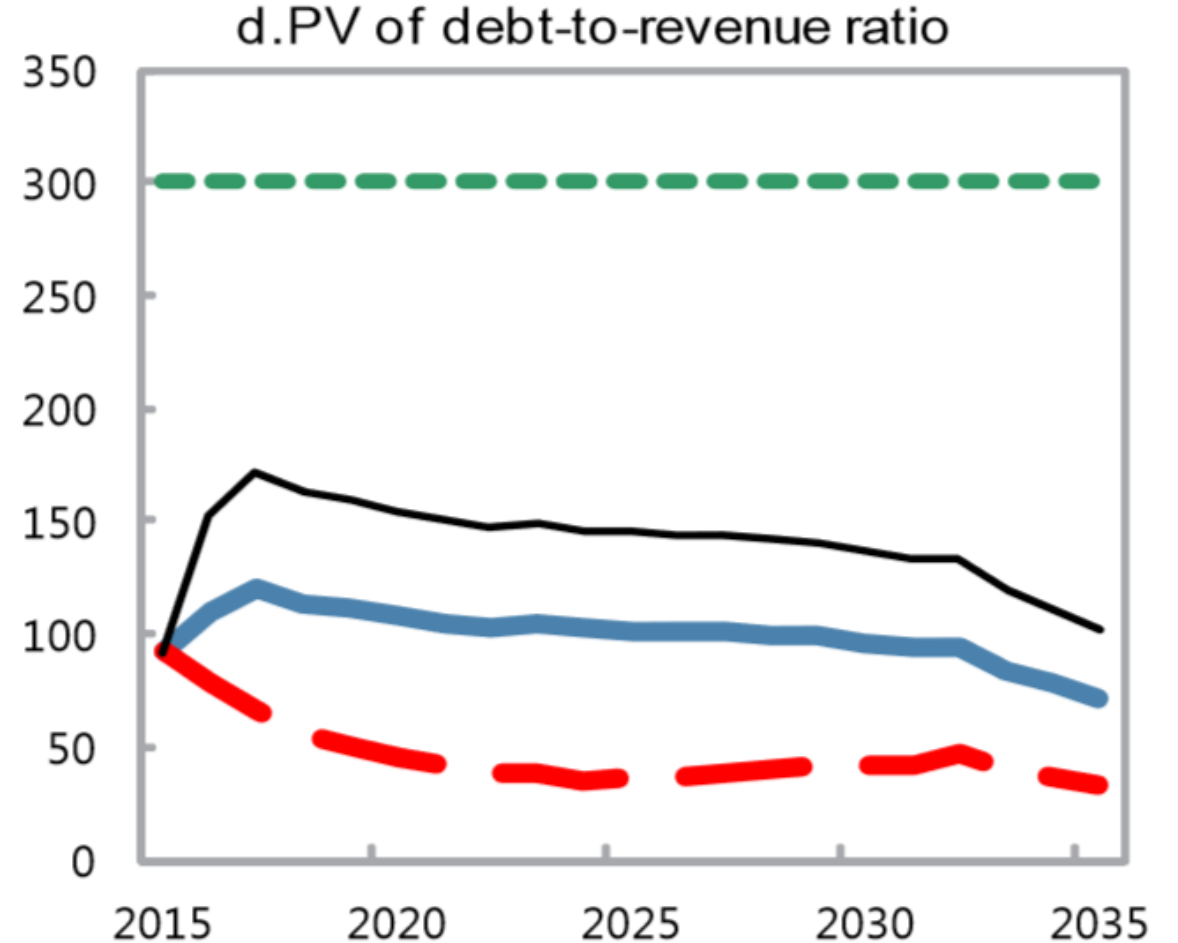
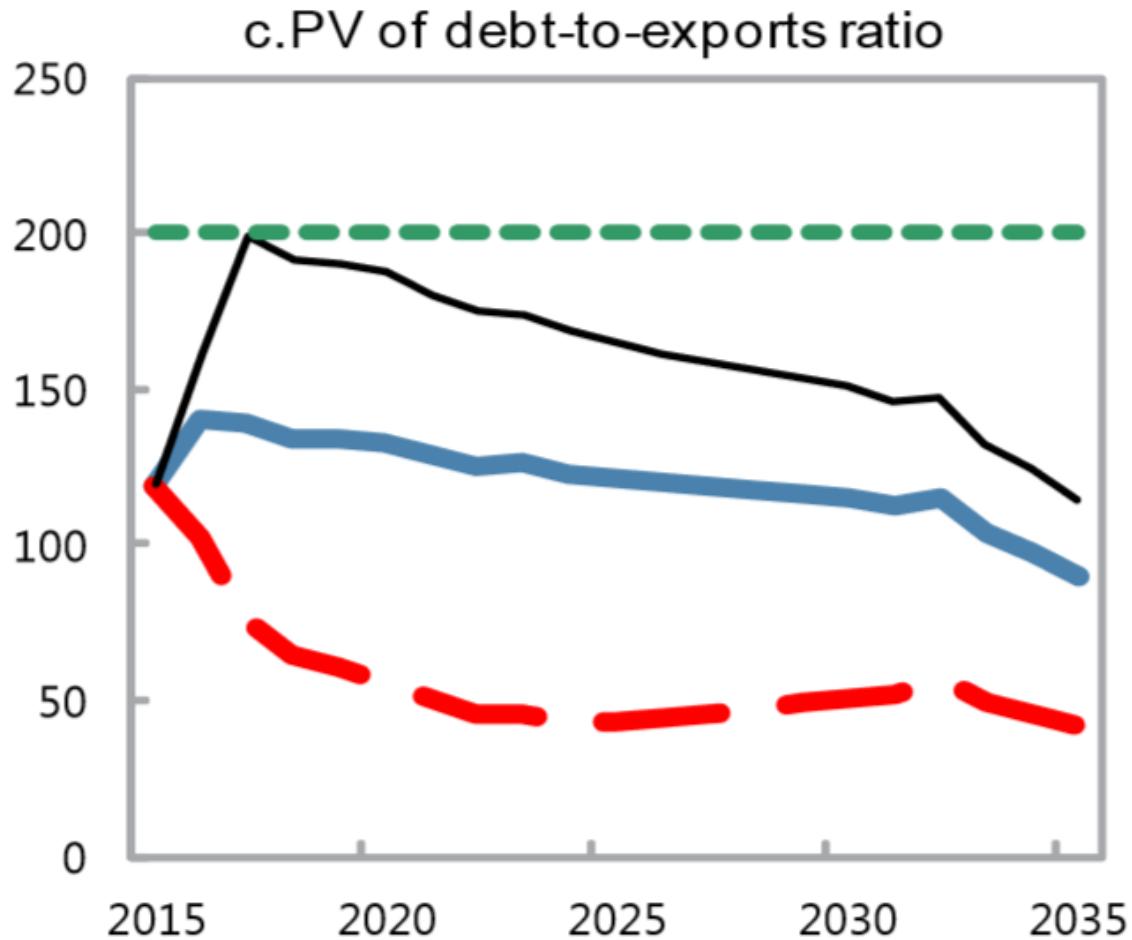
Application to the Rwandan context

- Different alternatives to grant aid and concessional loans:
 - External commercial creditor public debt (like Eurobond):
 - Ally
 - Financing infrastructure, e.g. Kigali Convention Centre
 - Frontloaded foreign exchange inflows
 - Competitor
 - Competing for limited foreign exchange through imports for public investments, interest payments and large bullet repayment
 - Domestic public debt (T-bills and bonds):
 - Ally
 - Financing infrastructure to tackle the key constraints for private sector development
 - Providing safe assets: T-bills for banks and T-bonds for RSSB.
 - Benchmark pricing of corporate bonds, that are still in pipeline
 - Competitor
 - Limited crowding out as banks only hold liquid T-bills
 - Limited crowding out on capital markets as appetite for long term assets is high.

THANKS FOR YOUR ATTENTION

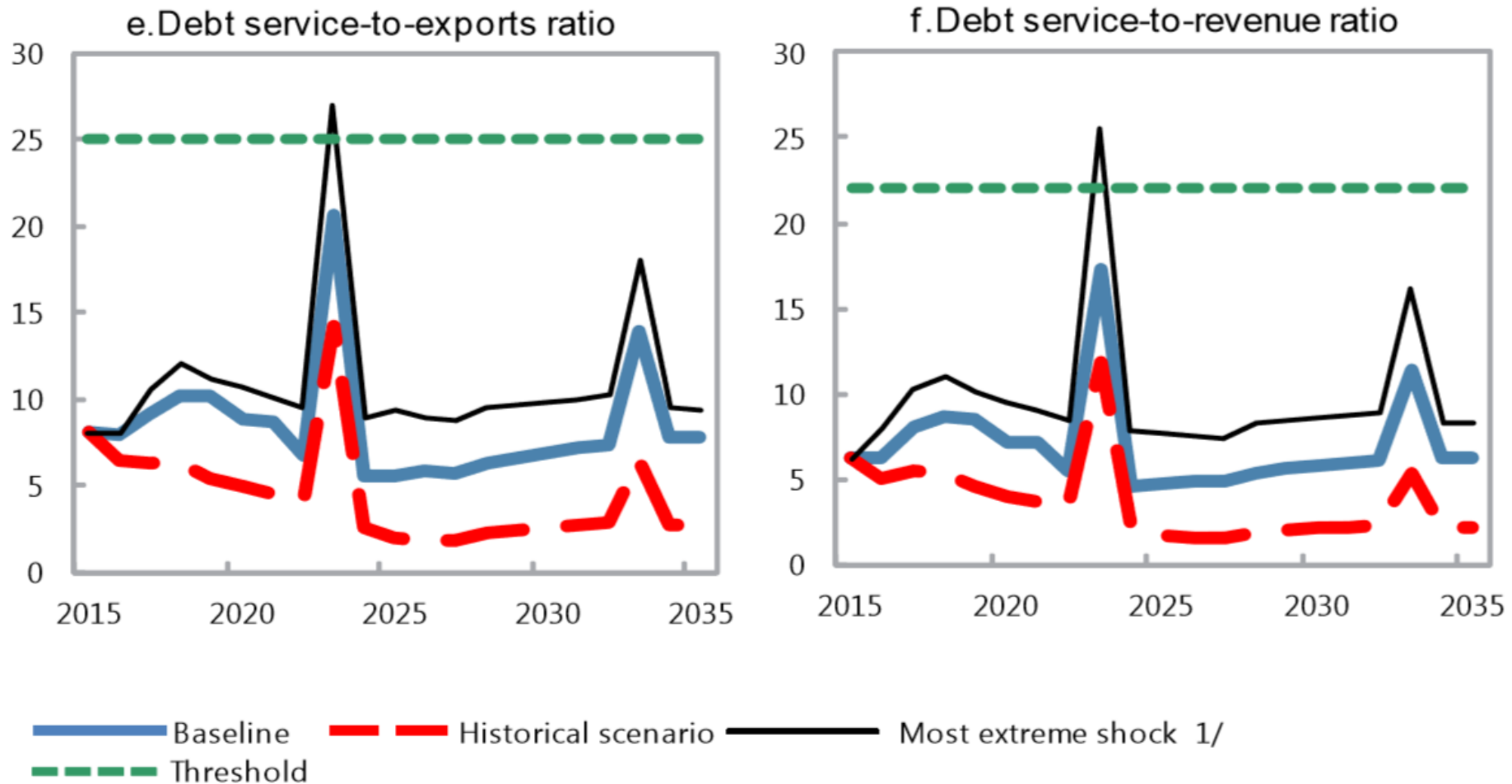
Future debt sustainability

- External public debt stock indicators (under various DSA scenarios)



Future debt sustainability

- External public debt service indicators (under various DSA scenarios)



Some additional basic concepts on public debt

- **Concessionality of debt:** the degree to which the loan looks like a grant: the so-called 'grant element', GE (expressed in %)
- To calculate the GE we need the present value of the debt:

$$PV \text{ of debt} = \sum_{t=0}^n \frac{\text{principal repayment}_t + \text{interest payment}_t}{(1 + \text{discount rate})^t}$$

Present value (PV) is lower...

the lower the interest rate

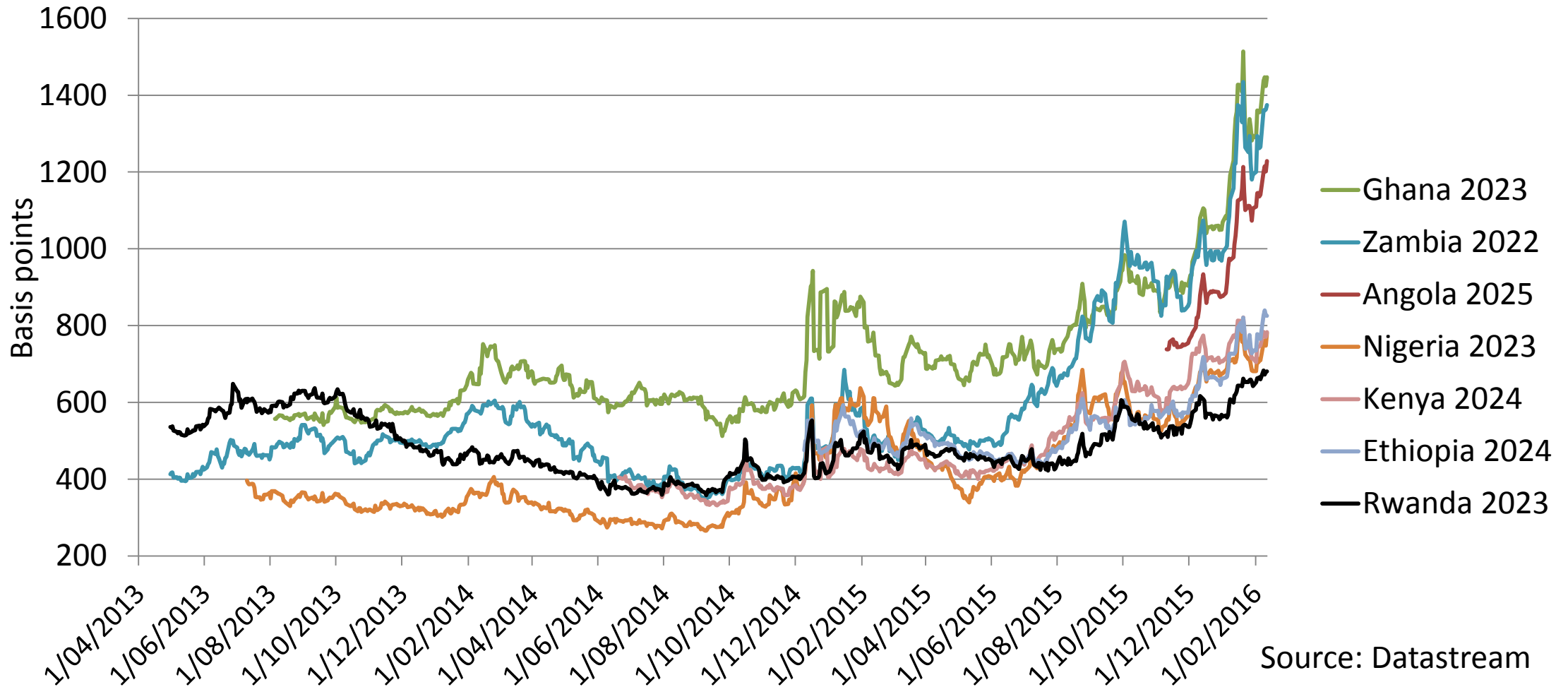
the longer the maturity

the longer the grace period

- Grant element = (Nominal value – Present value)/Nominal value
 - The GE varies between 0% (commercial loan) and 100% (pure grant).
 - All debt lies somewhere in between these two extremes.

Commercial external debt: the Eurobond

- Evolution of Eurobond yield spreads (over US Treasuries): Selected African issues



Domestic public debt: local currency bonds

- Yield curve on 28/01/2016



Source: BNR