East Africa

Regional Debt Profile 2017

1. Introduction

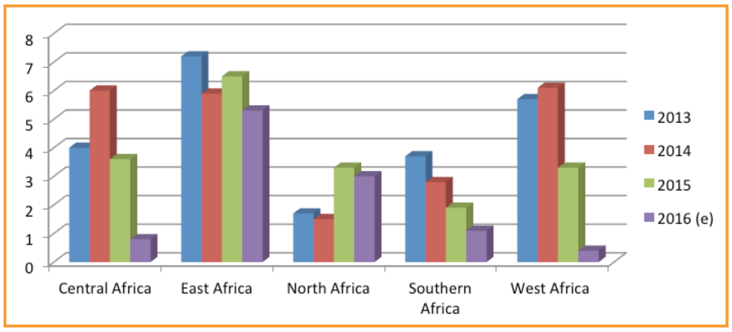
The East African sub-region, according to the United Nations Economic Commission for Africa (UNECA), has the following 14 countries: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Rwanda, Tanzania, Somalia, Uganda, Seychelles and South Sudan. It is also the region where the East African Economic (EAC) community is found. EAC is an inter-governmental organisation mandated to front the East African economic, social and political integration. The EAC is currently comprised of six member states namely Burundi, Kenya, Rwanda, Tanzania, Uganda and South Sudan. As one of the fastest growing regional economic blocs in the world, the EAC is widening its economic, political and social integration.

2. Economic Overview of East Africa

According to the African Economic Outlook (2017), East Africa is the fastest economic growing region in Africa and continued to lead in 2016 with an estimated growth of 5.3%. Economic growth of the EAC region has been faster than in the rest of Sub-Saharan Africa since 2005 and almost doubled the rates achieved in the previous 15 years (IMF, 2011).

Figure 1, shows the region registering high growth rates for 2013 (7.2%), 2014 (5.9%) and 2015(6.5%).

Figure 1: Africa Economic Growth by region as % of GDP – 2013 – 2016



Compilation based on African Development Bank Statistics

The region`s economic growth has been driven mainly by Ethiopia and Tanzania which are amongst the fastest-growing countries in the world with growth between 6% to 10%. The rapid economic growth is due to strong performance in industry, construction, services, information and communication sectors. Countries such as South Sudan have continued to record low growth rates but large support from donors has helped secure progress in peace and state building.

Despite the high economic growth in the region, public debt still remains one of the main economic policy challenges facing governments and could plunge the region into economic crisis.

3. Regional Debt Trends

A public debt refers to credit owed to both external and internal parties by Governments of independent countries. External debt is money owed to external creditors who are multilateral creditors (International Financial Institutions) or bilateral creditors who are essentially other countries and commercial creditors (World Bank 2015).On the other hand, domestic debt is money owed to holders of Government securities such as treasury bills and treasury bonds. Public debt is one of the macroeconomic indicators that forms a country's image in the international market and is an inward foreign direct investment flow determinant (Iberia et al, 2012).

The regional total debt stock as presented in Table 1 and Figure 2 below, shows an incremental trend from 2007 to 2015. A slight decline in external debt between 2009 and 2010 was due to the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI). Public and publicly guaranteed (PPG) external debt was at $33,395 billion in 2010 and increased by 90% to $63,454 billion in 2015. Since 2007 the sub-regional debt stock has been rising steeply mainly driven by Ethiopia, Kenya and Tanzania who have been borrowing heavily since 2007 from international and domestic markets. At the end of 2015 the bulk of the sub-regional PPG external debt was owed by Ethiopia which held 31% of the debt, Kenya 24% and Tanzania with 17%. The least amount of external debt was held by Comoros which constituted about 0.16% of the total debt.

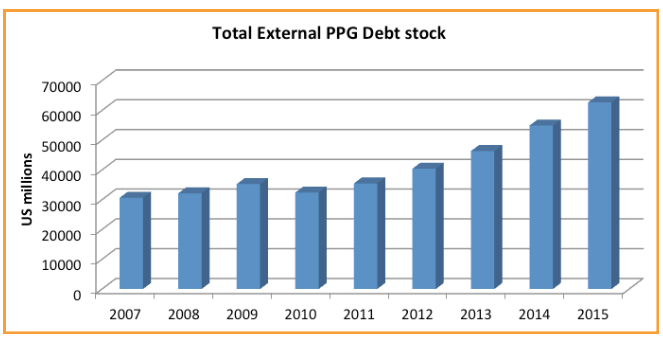
Table 1: Total Debt Stock for East Africa Countries (US$ millions)

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Burundi	1276	1234	394	382	363	411	398	404	408
Comoros	276	266	260	251	246	224	117	113	103
Congo, Dem. Rep	10905	10862	10880	4597	4022	4103	4470	4149	4155
Djibouti	653	680	737	622	651	642	673	820	1169
Eritrea	856	957	1013	1002	1014	952	896	829	782
Ethiopia	2571	2829	4819	6547	7945	9941	11886	15846	19467
Kenya	6244	6400	6731	6989	7771	9024	9830	13355	15324
Madagascar	1411	1717	1836	1982	2093	2191	2263	2294	2486
Rwanda	566	650	716	759	971	1045	1553	1877	2121
Somalia	1979	1983	1987	1990	1992	1985	1977	1913	1876
Tanzania	3181	3711	4640	5601	6438	7366	9112	9911	10690
Uganda	1571	1780	2247	2673	2963	3478	4064	4213	4873
Totals	**31489**	**33070**	**36260**	**33395**	**36469**	**41362**	**47238**	**55723**	**63454**

- *Data for Seychelles and South Sudan not available*

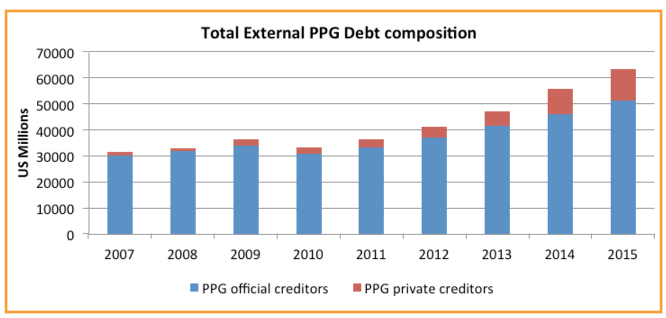
Source: Compilation based on World Bank data 2017

Figure 2: Total External Debt Stock for East Africa (public and publicly guaranteed), 2007-2015 (US$ millions)



Source: Compilation based on World Bank data 2017

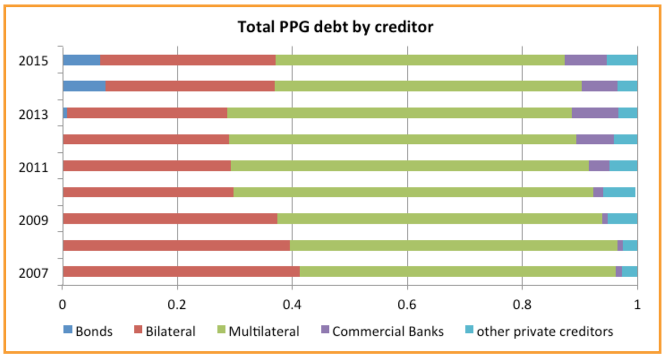
Figure 3: Regional Composition of Total External Debt (public and publicly guaranteed) 2007-2015 (US$ millions)



Source: Compilation based on World Bank data 2017

Figure 3 above shows a significant increase in the use of private creditors by East African countries from 2012 and beyond. In 2012 private creditors constituted 13% of total PPG and by 2015 this ratio had increased to 22% signalling the increase in commercial credit and the emergence of bond issuance from 2013 onwards.

Figure 4: Share of public and publicly guaranteed external debt, 2007-2015 in percentage



Source: Compilation based on World Bank data 2017

As shown above in Figure 4, the regional external debt has mainly been concentrated in form of multilateral credit since 2007. The emergence of bond issuance only surfaced in 2013 with Rwanda and Tanzania being the first East African countries to tap in the international market with Kenya and Ethiopia subsequently issuing their first bonds in 2014.

3.1 Selected member countries' debts

In selecting countries for further debt analysis debt ratios which indicate potential debt related risks were used. Debt ratios are considered in conjunction with key economic and financial variables such as expected growth and interest rates, which determine their trend in medium-term scenarios. For the purposes of this debt profile 3 debt ratios, i.e. debt-to-exports, debt service-to-exports and debt-to-Gross National Income (GNI) ratio were considered.

The debt-to-exports ratio is the ratio of total outstanding debt at the end of the year to the economy's exports of goods and services. Debt to exports has the advantage that exports provide the basis for debt repayments. Debt to exports has the advantage that it is less volatile than other ratios hence allows a more meaningful inference of trends. This ratio is adopted as a measure of sustainability because an increasing debt-to-exports ratio over time, for a given interest rate, implies that total debt is growing faster than the economy's basic source of external income, signalling that the country may have problems meeting its debt obligations in the future. A growing ratio when the level of debt is already high indicates a greater burden of servicing the debt and may suggest that a country is on an unsustainable path.

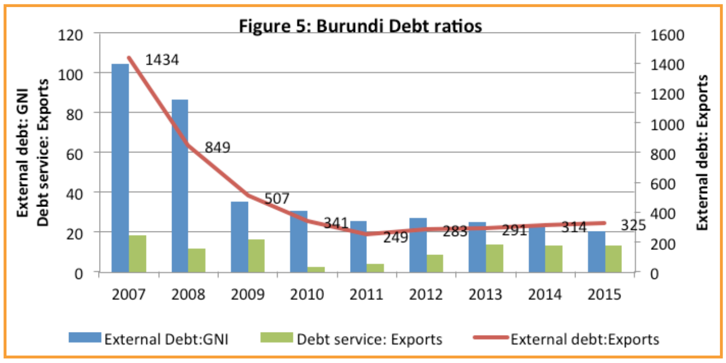
The debt service to exports ratio is used as an indicator of debt sustainability because it indicates how much of a country's export revenue will be used up in servicing its debt and how vulnerable the payment of debt-service obligations is to an unexpected fall in export proceeds. The higher the share of short-term credit is in the overall debt, the larger and more vulnerable the annual flow of debt service obligations. Debt service ratios may rise due to a fall in exports; fall in commodity prices, increased borrowing and higher interest rates.

The external debt to GNI indicator measures the liabilities of the public sector for external debt of a country in relation to its total income (GNI). Although external borrowing is a method of supplementing savings and financing the investment gap in a country, an unsustainable debt burden will ultimately hinder development.

For individual country analysis, the analysis was based on countries whose debt ratios are signalling that debt service difficulties are likely to occur. These are countries whose external debt: to exports is above 150%, external debt to GNI is above 50% and debt service to exports is above 5%. In most cases countries with high external debt to exports ratio and external debt to GNI ratios have a rising debt service ratio which is regarded as a sign of an imminent debt crisis.

Debt sustainability analysis using the above external debt ratios revealed that Djibouti and Burundi are currently high risk debt distress countries. Although countries such as Kenya and Tanzania have been experiencing a steep upward trend in their external debt since 2007 this is financing infrastructure development which addresses bottlenecks and will ultimately boost sustainable economic growth. Most of the East African countries exhibited low and moderate risk debt scenarios.

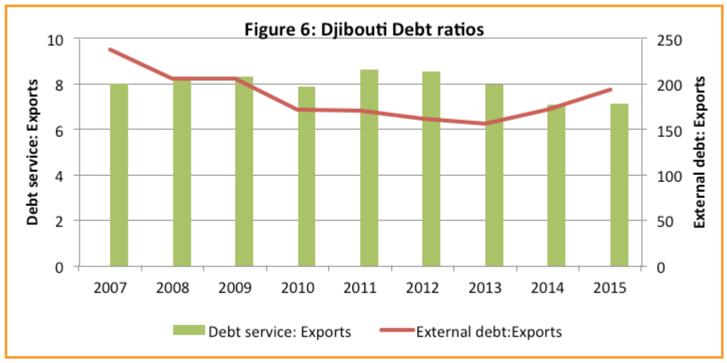
3.1.2 Burundi



Compilation based on World Bank data 2017

Despite benefiting from debt cancellation under the HIPC Initiative and MDRI which immensely reduced its external debt by more than 70% from $1,276 billion in 2007 to $363 million in 2011, Burundi continues to be a high-risk debt distress country. External debt in 2007 representing 1434% of exports has however been falling gradually over the years to a low of 248.6% in 2012 owing to the numerous debt reliefs that the country received. External debt to GNI reduced from 104.4% in 2007 to 20.3% in 2015. Burundi`s high risk of debt distress has mainly been exacerbated by the country`s extremely narrow export base (estimated at $165million in 2015) and prospects for graduating from the high-risk debt distress are hinged on the country`s ability to improve its export performance.

3.1.3 Djibouti



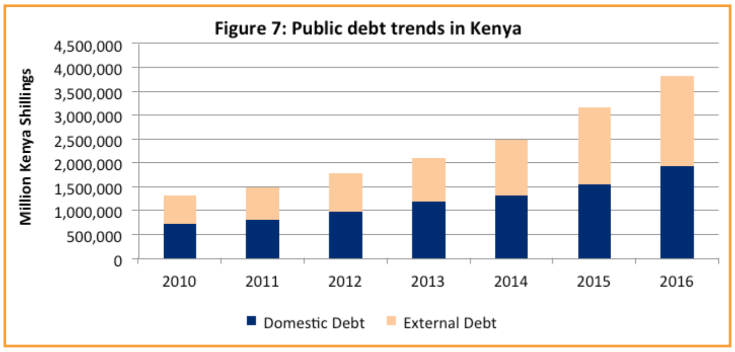
** Data for Debt: GNI not available*
Compilation based on World Bank data 2017

External debt in Djibouti has been on a growth trajectory since 2010 post debt relief from the Paris Club which slightly reduced its PPG external debt from $737million in 2009 to $622million in 2010. Debt service to exports subsequently fell slightly in 2010 to 7.9% from 8.3% in 2009. In 2007 external debt to exports was 237.7% which has gradually been falling over the years to 155.5% in 2013. This has mainly due to the improvements in GDP growth over the years. In 2013 the government contracted two large loans for the total amount of about US$900million which represented 60% of GDP and the external debt to exports has been rising since 2013 and stood at 193.4% in 2015. The loans were provided by the Export-Import Bank of China to finance investments projects of the construction of the Addis Ababa–Djibouti railway and a water pipeline from Ethiopia. The contraction of the non-concessional loans in 2013 resulted in the increase in debt risks and further non-concessional borrowing will exacerbate the country`s already high risk of debt distress.

3.2 Domestic Debt

According to World Bank and IMF (2001), extensive use of domestic borrowing can have severe repercussions on the economy. Increased borrowing requirements to finance investment in public infrastructure coupled with the stagnant foreign support to the budget has seen most countries in East Africa increasing their domestic debt stocks although there are disparities among countries.

Kenya's domestic debt is relatively of large size compared to other sub-regional countries and has been constituting a large part of its total public debt. Similarly to external debt, domestic debt has been rising gradually over the years since 2010 when it was 720.2 billion Kenyan shillings and constituted 54% of total public debt. Figure 7 below provides an overview of the public debt trends in Kenya. At the end of 2016 domestic debt stood at 1.930 trillion Kenyan shillings ($18.7 billion) and accounted for about 50% of total public debt and about 26% of GDP.(Central Bank of Kenya). Kenya has been borrowing from the domestic market mainly to cover its budgetary deficits.

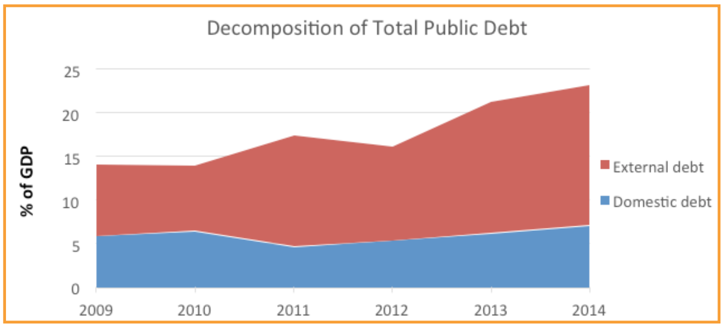


Source: Compiled from Kenya Central Bank data

Uganda introduced treasury bonds in 2004 and since then the stock of domestic debt has been on the rise due to the need to mop up excess liquidity from the banking system to avoid inflationary pressures. Domestic debt stood at 1.262billion Ugandan shillings in 2004 but had risen to 6.178 billion Ugandan shillings by 2010. Between 2012 and 2016 domestic debt increased by 76% to reach a high of 14.401 billion Ugandan shillings in 2016. Domestic debt at 8.170 billion Ugandan shillings in 2012 represented 13.3% of the country`s GDP, and by the end of 2016 the domestic debt to GDP ratio had slightly increased and stood at 17%.

**Rwanda`s** domestic debt has been rising although on a slower pace compared to external debt (Figure 8).In 2009 domestic debt was $311.2 million which represented 5.9% of the country`s GDP and 29.7% of public debt. By the end of 2014 domestic debt had risen by 80.7% to 562.6 million, 23.2 % of GDP. The country`s domestic debt has been increasing due to the Government's cash flow needs, and funding of the Energy, Water and Sanitation Authority (EWSA) projects funded through loan facility with Bank of Kigali.

Figure 8: Decomposition of Debt Stock for Rwanda, 2009-2014



Source: Compiled from the National Bank of Rwanda

3.3 Drivers of Public Debt Accumulation

The key drivers of public debt accumulation in the region are declining official development assistance especially grants, increased budget deficits and the need to finance infrastructure developments. Traditional sources of credit are shrinking and new options with harder terms are emerging, such as new bilateral lenders. Commercial lenders have increased especially sovereign bonds issuances. The new bilateral lenders are attractive because they provide relatively larger amounts of financing without policy and other related conditionality.

A number of EAC countries issued large Eurobonds and these are drastically increasing external debt, which may compromise the gains on debt sustainability. By end of 2014, Ethiopia, Kenya, Rwanda and Tanzania, had issued Eurobonds worthy US$4Billion dollars, as shown in Figure 9.None of the East African countries issued international bonds in 2015 and 2016.

Figure 9: East African Countries Cumulative Sovereign Bond Issuance 2013–2014 USD Millions

Country	2013	2014	TOTAL
Ethiopia	-	1,000	1,000
Kenya	-	2,000	2,000
Rwanda	400	-	400
Tanzania	600	-	600
TOTAL	**1, 000**	**3,000**	**4,000**

Source: Compilation from Bloomberg, Dealogic, Financial Times et al

The preparation period for bonds issuance can be long, usually more than 1 year, requiring considerable resources for global advertising and road shows. Repayment costs might also rise if the currency depreciates. East African countries are issuing bonds mainly to finance infrastructure investments, restructure debt, and establish sovereign benchmarks to help develop the sub-sovereign and corporate bond market. Ethiopia, Rwanda and Tanzania used the bond proceeds for infrastructure development projects whilst for Kenya besides infrastructure investments used part of the proceeds for budgetary purposes and paying off syndicated loans. There has been debate in Kenya with regards to the lack of transparency and accountability on the prudent use of the bond proceeds.

Sovereign bond carry significant risks. These include exchange rate, interest rate and liquidity risk. Different types of bonds carry different types and levels of risk. Exchange rate risk is high for bonds denominated in "hard currency" – such as US dollars, Euro, Japanese Yen or GB pounds - and low for those in local currency. Interest rate risk is high for bonds issued with floating interest rates and low for those with fixed interest rates. This is because for bonds with floating interest rates if the rate increases payments increase. All bonds that have been issued to date have high exchange rate risk because they are denominated in hard currency (US dollars).

4. REGIONAL OUTLOOK FOR DEBT SUSTAINABILITY

Figure 10: Debt sustainability analysis in East Africa Community countries – Assessing risks of debt distress 2015/16

Low Risk	Moderate Risk	High Risk
Tanzania Kenya Rwanda Uganda	Comoros Ethiopia South Sudan	Burundi Djibouti

Source: Joint World Bank-IMF Low Income Countries Debt Sustainability Analysis

According to debt sustainability assessments done jointly by World Bank and IMF for low income countries in 2015/2016 the majority of East African countries were classified as having either low or moderate risk of debt distress as shown in Figure 10 above. The high risk countries in the region are Burundi and Djibouti. AFRODAD debt sustainability results also yielded similar results to those of the World Bank and IMF.

Policy Recommendations

Implementing sound fiscal policies: There is need for governments in the region to strengthen and implement prudent debt management strategies to mitigate the effects of the rising debt on the economy. For countries such as Tanzania and Kenya with rapidly rising external debt there is need for containment of the fiscal deficit and further medium-term consolidation efforts are also needed to limit and eventually reverse the rise in public debt.

Developing and maintaining strong institutions to control spending and manage debt: Government for Kenya need to strengthen and enhance transparency and accountability in loan contraction and debt management. Countries associated with problems abound from responsible borrowing and debt management should put structures that promote prudent use of public loans and foster transparency and accountability in the management of public resources.

Debt levelling: Given that higher domestic borrowing by Governments has crowding-out effects to private sector growth through higher interest rates there is need for countries with higher domestic debt to level up their borrowings. Kenya, with the highest Eurobond issuance in East Africa should moderate contraction of commercial loans and explore alternative means of financing its development. These alternative financing modes include borrowing from concessional and semi-concessional sources.

Export diversification: For countries such as Burundi with a narrow export base there is need for the economic and hence export diversification in order to widen the revenue base and reduce public sector borrowing for the country to move out of debt distress.

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