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OVERVIEW OF AFRICA'S FINANCIAL SECTOR
Long term finance and capital markets[1]

Expanding on the general overview of the financial sector in Africa, this second article focuses on the development of the capital markets and the recent initiatives to attract long-term capital to the continent. Capital markets in Africa are still in their infancy and mirror the economic development of the continent. However, the evolution over the last decade prior to COVID-19 pandemic underscores the growth potential. The number of stock exchanges have grown from seven in the 1980s to 30 in 2020. The biggest ones are at a very advanced stage of interconnection that has increased liquidity and product diversification. Several development initiatives are promoting the integration and interconnection aimed at increasing liquidity and depth of the markets. The article profiles the ongoing efforts towards improving the available long-term financial resources with institutional investors.

Keywords: financial markets, stock markets, long term financing, shares.
JEL Classification: G10, G20.

1. Introduction

Capital markets play an extremely important role in channelling financial resources towards investment projects of all kind. Particularly noteworthy is the channelling of long-term finance, as this type of financing has the greatest impact on countries' economic growth, especially for large infrastructure projects, which ▷

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stimulate and enable the growth of all economic sectors.

While considerable progress has been made over the past decade on access to financial services, especially mobile financial services, as well as on the development of financial markets, there is still a long way to go in developing long-term finance on the continent.

Total domestic and external financial resources have traditionally fallen far short of the African continent's financing needs. This resource gap in developing countries has been particularly exacerbated during the pandemic period worldwide. Beyond fiscal and external deficits, the gap is estimated taken into account the necessary expenditure to meet the Sustainable Development Goals (SDGs) of the 2030 Agenda. According to OECD (2020) estimates, the SDGs unmet financing needs annually before COVID-19 were US$2.5 trillion. On the other hand, the OECD has estimated that the pandemic has increased funding needs by an additional US$1 trillion, of which US$0.3 trillion is for the African continent. Given that the pandemic has reduced the availability of private funds from abroad by US$0.7 trillion, the gap caused by the pandemic has increased to US$4.2 trillion.

While there is consensus on the need to continue reinforcing local financial markets as the main mean of intermediation, most countries and international institutions are exploring new mechanisms to increase the long term finance flows to developing countries.

Traditionally, African domestic savings are very low, estimated at 20% on average, and the economies have been largely dependent on external flows (ODA, FDI and more recently remittances). In addition, the continent also faces challenges in channelling the low savings to finance real sector needs. On account of the structural adjustment policies in the 1980s and 90s, countries' efforts shifted towards domestic revenue mobilization, in particular taxes as the most stable source of funding for economic development. However, the potential of financial markets as major source of long-term finance was until recently largely overlooked. The focus of this article is therefore on the mobilization of long-term capital through financial markets.

Capital markets in Africa are still at a very early stage of development, but there has been considerable progress. Market capitalization in African Stock Markets (ASMs) grew from $113 billion to more than $1,130 billion from 1992 to 2018 whilst stock market capitalization as a percentage of GDP has risen steadily over the years to its peak of 84.9% in 2017 and a decrease to 74.9% as at 2019.[2] The African bond market also grew up to $500 billion in 2019 and non-local currency debt issuance amounted to a value of $167 billion from 536 issuances from 2016 to 2020.

In spite of these improvements, capital markets in Africa are still underdeveloped, with the exception of South Africa, making it necessary to improve financial channels and sources to stimulate economic growth.

There are several public initiatives that contribute indirectly to the development of financial markets through knowledge dissemination, capacity building and a proactive dialogue with institutional investors at national and international level. First, it is worth to note the Africa Long Term Finance Initiative (ALTFI), that has developed a scorecard general framework and a database that captures and updates information about the sources and uses of financing in order to identify gaps and propose specific ▷

[2] See: https://altf.afdb.org/scoreboard/build/panel/depth-of-ltf/2/category/capital-markets/5/indicator/stock-market-capitalization/35

measures. The OECD has also engaged a similar analysis although focused on all developing countries.

Both institutions have engaged in a dialogue with institutional investors, mainly pension funds and insurance companies. These investors are key players in financial markets, as they hold more than US$100 trillion of Assets under Management (AuM) at the end of 2019.

This work is complemented by a reference to the development of new initiatives to promote long-term financial flows. In this respect, OECD has over the past five years instituted new standards for blended finance aimed at increasing the contribution of private investors to financing the SDGs.

This article is a follow up to the introduction on a general view to the recent evolution of African financial sector, which was the first collaboration between Africa, Mediterranean and Europe Network (AMENET) and Making Finance Work for Africa (MFW4A). This paper seeks to provide a more detailed description of African capital markets, after the general view put forward in the first article released at BICE. Section 2 presents and overview of securities market. It is followed by the description of debt markets in section 3. The fourth section is focused on the ongoing initiatives to develop long-term finance and the dialogue with institutional investors with a particular attention on infrastructure, where progress in mobilization has been stronger over the past decade.

2. Overview of African Stock Markets (ASMs)

With the exception of just a few stock exchanges, most ASMs have emerged recently during the late 1990s and the XXI century and they are still small and fledging in comparison to their counterparts in other regions.

Table 1 presents the various stock exchanges in Africa and the year they came into existence.

It shows that as at 1987, there were only seven stock exchanges established in Africa (Egypt, South Africa, Morocco, Zimbabwe, Kenya, Nigeria and Tunisia). However, 14 more exchanges were added in the late 1980s and the 1990s (Mauritius, Botswana, Ghana, Swaziland, Namibia, Sudan, Angola, Malawi, Algeria, Uganda, Côte d'Ivoire, Nigeria, Tanzania and Mozambique). Currently, there are 27 national stock exchanges and two regional stock exchanges; namely: Bourse Régionale des Valeurs Mobilières (BRVM) which serves eight member countries in West Africa (Senegal, Togo, Niger, Mali, Cote d'Ivoire, Guinea Bissau, Burkina Faso and Benin) and Bourse des Valeurs Mobilières de l'Afrique Centrale (BVMAC) with six member countries (Cameroon, Central Africa Republic, Chad, Congo, Equatorial Guinea and Gabon).

The evolution of financial markets mirrors the economic development of the region. The market capitalisation of the JSE (Johannesburg Stock Exchange) alone accounts for more than 80% of the entire ASMs, while the rest of the stock exchanges are characterized by low market capitalisation, few domestic companies, small size of listed firms and low levels of liquidity with few shares mostly dominating total trading activity. However, the prospect for potential growth is significant.

2.1. Size and depth

In terms of both market capitalisation and the number of listings, most ASMs, ▷

TABLE 1
OVERVIEW OF NATIONAL EXCHANGES IN AFRICA

Country name	Name of exchange	Code	Location	Estab-lished
North Africa				
Algeria	Algiers Stock Exchange	SGBV	Algiers	1997
Egypt	The Egyptian Exchange	EGX	Cairo	1883
Libya	Libyan Stock Market	LSM	Tripoli	2007
Morocco	Casablanca Stock Exchange	CSE	Casablanca	1929
Sudan	Khartoum Stock Exchange	KSE	Khartoum	1994
Tunisia	Bourse de Tunis	BVMT	Tunis	1969
West Africa				
Cabo Verde	Bolsa de Valores de Cabo Verde	BVC	Mindelo	2005
Ghana	Ghana Stock Exchange	GSE	Accra	1990
Nigeria	Nigerian Stock Exchange	NSE	Lagos	1960
Sierra Leone	Sierra Leone Stock Exchange	SLS	Freetown	2009
Benin, Burkina Faso, Guinea Bissau, Cote d'Ivoire, Mali, Niger, Senegal and Togo	Bourse Régionale des Valeurs Mobilières	BRVM	Abidjan	1998
Central Africa				
Rwanda	Rwanda Stock Exchange	RSE	Kigali	2005
Cameroon, Central Africa Republic, Chad, Congo, Equatorial Guinea and Gabon	Bourse des Valeurs Mobilières de l'Afrique Centrale	BVMAC	Libreville	2003
East Africa				
Kenya	Nairobi Securities Exchange	NSE	Nairobi	1954
Mauritius	Stock Exchange of Mauritius	SEM	Port Louis	1988
Seychelles	MERJ Exchange Limited	MERJ	Victoria	2012
Somalia	Somali Stock Exchange	SSE	Mogadishu	2015
Uganda	Uganda Securities Exchange	UTILIZA	Kampala	1997
Tanzania	Dar es Salaam Stock Exchange	DSE	Dar es Salaam	1998
Southern Africa				
Angola	Bolsa de Dívida e Valores de Angola	Bodiva	Luanda	2012
Botswana	Botswana Stock Exchange	EEB	Gaborone	1989
Eswatini	Eswatini Stock Exchange	ESE	Mbabane	1990
Lesotho	Maseru Securities Exchange	MSM	Maseru	2016
Malawi	Malawi Stock Exchange	MSE	Blantyre	1995
Mozambique	Bolsa de Valores de Mozambique	BVM	Maputo	1999
Namibia	Namibia Stock Exchange	NSX	Windhoek	1992
South Africa	JSE Limited	JSE	Johannesburg	1887
Zambia	Lusaka Stock Exchange	LuSE	Lusaka	1994
Zimbabwe	Zimbabwe Stock Exchange	ZSE	Harare	1948

Source: Authors compilation based on the websites of stock exchanges.

excluding South Africa, are relatively small.[3] The market capitalisation of the top four exchanges in Africa (South Africa, Morocco, Egypt and Nigeria) is over $30 billion whereas most of the exchanges market capitalization are lower than $6 billion as at 2020. However, market capitalization in Africa hasincreased significantly over the last two decades. The ▷

[3] Although the ASMs have a low capitalization they do not compare unfavourably to other regions. Out of the around 200 exchanges in the World there are only 16 with a market capitalisation over USD 1 trillion and around 60 with more than 1 billion.

mean market capitalization excluding South Africa increased from US$ 2.03 billion to 24.23 billion (A more than tenfold increase) from 1995 to 2020. ASMs are still dominated by few large firms exposed to price appreciation when there are relatively large orders. Sare *et al*., (2019) observe that, capital markets in Africa are generally influenced by its initial conditions.

Table 2 shows market capitalization as percentage of GDP of African stock markets. The JSE in South Africa is more capitalized as a percentage of GDP relative to other ASMs. Market capitalization to GDP ratio in South Africa was even higher than that of the United States of America (149%) and the average of the high-income countries (119%) as at 2020.

The other highly capitalized stock market in terms of GDP are Mauritius and Morocco. The size of these two markets is comparable to that of South Asian, Latin American and the Caribbean economies but are lower than high-income and East Asia and Pacific countries.

The number of companies listed on ASMs is generally small, with the exceptions of South Africa, Egypt and Nigeria. The mean of domestic companies listed on ASMs increased from 88 in 1995 to 115 in 2020.

2.2. *Liquidity*

Constrained liquidity is a key challenge for many ASMs. Liquidity can be measured using two indicators: (i) value of trading as a percentage of GDP and (ii) turnover. The first one tracks the trading activity in relation to economic activity and the second one measures the total trading in relation to the total market capitalisation. Both indicators show ▷

TABLE 2
CAPITALIZATION AS A PERCENTAGE OF GDP IN AFRICA

Country name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
North Africa										
Algeria	0.10	0.08	0.08	0.08	0.09	0.26	0.21	0.21	-	-
Egypt	20.70	21.20	21.37	22.93	16.76	10.02	19.75	16.82	14.58	11.39
Morocco	59.28	53.41	50.39	47.92	45.39	55.73	61.13	51.72	54.65	58.10
Tunisia	21.09	-	18.60	18.36	20.43	20.22	22.42	20.94	21.69	21.85
West Africa										
Cote d'Ivoire	24.74	-	37.79	33.11	27.27	25.78	24.20	14.57	13.84	11.95
Ghana	7.88	-	-	-	-	-	-	-	-	12.78
Nigeria	9.64	12.34	15.85	11.48	10.27	7.36	9.90	7.94	9.80	13.09
East Africa										
Kenya	24.32	-	-	-	-	-	-	-	26.24	21.65
Mauritius	68.11	61.53	73.72	68.35	61.91	61.87	73.48	69.44	61.34	56.44
Southern Africa										
Namibia	0.01	-	-	-	-	21.80	22.61	18.00	20.76	17.45
South Africa	189.48	229.03	257.02	266.15	231.71	321.00	352.16	234.96	300.58	348.28
Median	23.46	41.56	33.90	30.65	26.54	25.32	24.20	20.94	26.24	21.75
Mean	40.06	62.93	62.43	62.18	55.22	62.28	70.21	52.50	63.71	62.33
Mean excluding South Africa	23.46	29.71	30.00	28.19	25.81	25.32	29.93	26.44	29.87	26.59

Source: Word Development Indicators (2020).

TABLE 3
NUMBER OF DOMESTIC LISTED FIRMS IN AFRICA

Country name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
North Africa										
Egypt	231	234	235	246	250	251	252	250	246	240
Morocco	75	76	75	74	74	74	73	75	74	75
Tunisia	57	59	71	77	78	79	81	82	81	80
West Africa										
Cote d'Ivoire	39	37	37	38	39	43	45	45	46	46
Ghana	29	29	29	-	-	-	-	-	33	31
Nigeria	196	189	188	188	183	169	166	164	180	177
East Africa										
Kenya	58	60	61	65	64	65	64	-	59	60
Mauritius	63	60	63	66	71	75	74	99	95	93
Southern Africa										
Namibia	6	7	8	8	8	8	10	10	11	13
South Africa	347	338	322	322	316	303	294	289	274	264
ASM median	69	68	73	77	78	79	81	106.17	88	86.5
ASM mean	118	116.89	116.89	130.75	130.5	128	126.75	138.43	117	114.78
Mean excluding South Africa	89.38	89.25	91.25	103.43	104	103	102.86	113.33	97.38	96.13

***Source:* Word Development Indicators (2020).**

that ASMs do not have adequate liquidity (Tables 4 and 5). Nevertheless, these two measures can serve as rough measure of overall trading activity when comparing to the size of the economy and the stock market (Allen *et al.*, 2011).

The value of shares traded as a percent of GDP of ASMs are low in most cases as seen from Table 4 with the exception of South Africa, Egypt and to some extent Morocco.

Also, JSE remains the most liquid exchange in Africa followed by Cairo and Alexandria Stock Exchange (CASE) in Egypt. The rest of ASMs have a low turnover ratio with an average of 5% from 2012 to 2020. This confirms the illiquidity of ASMs. Table 5 shows how liquidity in ASMs has been increasing steadily until its significant drop in 2019 and 2020, which was due to withdrawal of capital by global investors from emerging and frontier markets propelled by Turkey's currency and debt crisis in the second half of 2018, leading to a contagion to Africa markets (RisCura, n.d.).

Senbet and Otchere (2010) attributed the very low liquidity of ASMs to the concentration of few equities and the dominance of few large companies in the exchanges. In order to improve depth and liquidity in the ASMs, it is important for exchanges to become attractive to domestic businesss in the form of reducing listing fees, streamlining regulatory issues, and implementing tax benefits. In addition, consolidation of small exchanges to form a regional exchange can contribute as well to improve in depth and liquidity. With this respect, examples are the regional exchanges Bourse Régionale des Valeurs ▷

TABLE 4
VALUE OF SHARES TRADED AS A PERCENT OF GDP IN AFRICA

Country name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
North Africa										
Egypt	6.74	6.12	4.42	8.65	4.48	3.03	6.12	5.80	3.68	4.43
Morocco	4.04	3.55	3.03	2.76	2.88	3.08	3.85	3.30	2.72	3.20
Tunisia	2.29	2.78	1.00	1.86	-	-	-	-	-	-
West Africa										
Cote d'Ivoire	0.46	0.65	1.17	1.13	1.14	-	-	-	0.26	0.28
Ghana	0.65	0.12	0.31	-	-	-	-	-	-	0.05
Nigeria	0.96	0.90	1.22	0.94	0.84	0.37	0.59	0.65	0.61	0.57
East Africa										
Kenya	2.19	2.00	3.28	1.65	1.07	1.18	-	-	0.49	0.49
Mauritius	4.43	2.54	2.65	3.62	3.94	2.61	3.39	3.21	2.66	2.85
Southern Africa										
Namibia	0.10	0.46	0.28	0.56	-	-	-	-	0.78	0.34
South Africa	54.23	57.24	63.31	70.02	73.67	135.80	117.21	80.10	81.04	97.32
ASM median	2.48	2.42	2.34	2.76	2.88	2.82	3.85	3.30	2.24	1.70
ASM mean	8.40	8.41	8.83	11.26	14.48	24.34	26.23	18.61	13.14	13.66
ASM mean excluding South Africa	2.67	2.31	2.02	2.86	2.64	2.05	3.49	3.24	1.82	1.70

***Source:* Word Development Indicators (2020).**

Mobilières (BVRM) and Bourse des Valeurs Mobilières de l'Afrique Centrale domiciled in Abidjan and Douala respectively. Similar plans are expected to be implemented in Anglophone West African countries, Southern African countries and Eastern African countries according to Allen *et al.* (2011).

2.3. *Cost of trading*

African stock markets are characterized by high transaction costs, which include clearing and settlement fees, brokerage commissions and exchange fees. Whilst transaction costs in other developing countries are mostly below 1% (e.g. 0.68% in Indonesia, 0.57% in Thailand and 0.46% in Peru) and far lower in developed markets (e.g 0.32% in Germany and 0.26% in United States), that of ASMs are well over 1% (UNECA, 2021). The Bright Africa Report provides a clear graphic analysis of total transaction costs for investing a share in some selected ASMs (RisCura, n.d., p. 71). The figure shows trading cost is above 4% in Zimbabwe and Uganda. However, transaction costs are lower in Egypt, Seychelles, South Africa and Mozambique when comparing to other emerging markets (RisCura, n.d.).

The high transaction cost is a factor that contributes to the low liquidity in ASMs, since investors consider trading cost in their investment decisions. Soumaré *et al*. (2021) suggests that the use of technology can help to reduce transaction costs by moving away from manual trading system of clearing and settlement to automated and electronic trading systems. These new systems speed up trading ▷

TABLE 5
TURNOVER RATIO IN AFRICA STOCK MARKETS

Country name	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
North Africa										
Egypt	32.54	28.88	20.66	37.73	26.74	39.21	30.71	34.47	25.26	38.89
Morocco	6.81	6.66	6.01	5.76	6.36	6.27	6.30	6.39	4.98	5.50
Tunisia	10.87	-	-	-	-	-	-	-	5.38	-
West Africa										
Cote d'Ivoire	1.85	-	3.11	3.41	4.18	5.27	-	-	1.86	-
Ghana	8.20	-	-	-	-	-	-	-	-	0.35
Nigeria	9.92	-	-	8.18	8.17	5.36	5.87	8.20	6.19	4.39
East Africa										
Kenya	8.99	-	-	-	-	-	-	-	1.88	2.26
Mauritius	6.50	4.12	3.59	5.29	6.37	4.36	4.61	4.62	4.33	5.05
Southern Africa										
Namibia	1,107.23	-	-	-	-	-	-	-	3.76	1.95
South Africa	28.62	24.99	24.63	26.31	31.79	38.37	25.74	34.09	33.13	27.94
Median	10.40	14.69	10.09	11.21	10.04	10.03	11.87	13.42	5.38	5.27
Mean	135.52	16.16	13.73	16.65	15.89	18.71	14.64	17.55	10.61	10.79
Mean excluding South Africa	148.88	13.22	10.09	14.24	11.91	13.80	11.87	13.42	7.40	8.34

***Source:** Word Development Indicators (2020).*

and can allow large transactions at the same time thereby improving operational efficiency and transparency.

While liquidity in ASM is low on the back of higher transaction costs, there are critical policy initiatives being implemented with the aim of improving the workings of the stock markets. For instance, the African Securities Exchanges Association (ASEA) is promoting cross-border trading of securities in Africa and the connection to other Stock Exchanges outside the continent through the African Exchanges Linkage Project (AELP). This initiative is contributing to enhance the liquidity and depth of capital markets while attracting new investors.[4]

[4] The African Exchanges Linkage Project (AELP) is led by the African Securities Exchanges Association (ASEA) with support from the African Development Bank and the Korea-Africa Economic Cooperation.

2.4. Performance

In spite of its low liquidity, ASMs continue to perform significantly well in terms of both absolute returns and risk-adjusted returns. Also, it is important to understand the extent to which ASMs are affected by global shocks. It is estimated that stock markets that are more integrated into the global economy will be seriously affected as compared to those that are less integrated (Allen *et al*., 2011). Senbet and Otchere (2010) provided evidence to the fact that markets such as South Africa and Nigeria, that are highly integrated to the global economy, were seriously hit by the global financial crisis. However, countries that are less integrated like Ghana, Malawi and Namibia rather had positive returns in the wake of the global financial crisis. Boako and Alagidede ▷

TABLE 6
ANNUAL RETURNS OF ASMS 2011-19 (%)

Country name	2011	2012	2013	2014	2015	2016	2017	2018	2019	Media
North Africa										
Egypt	-65.11	38.28	20.98	26.62	-23.48	53.76	19.51	30.01	6.65	11.91
Morocco	-15.28	-13.74	0.74	-4.83	-16.10	23.92	14.78	17.55	6.37	1.49
Tunisia	-8.02	-3.47	-4.30	14.53	-0.92	8.23	13.00	12.67	-2.01	3.30
West Africa										
Ghana	-3.06	20.70	56.36	5.06	-12.13	-16.13	41.18	20.33	-8.25	11.56
Nigeria	-17.33	29.41	37.47	-17.06	-18.48	-6.17	34.32	24.10	-15.30	5.66
East Africa										
Kenya	-32.92	24.65	17.03	3.59	-22.80	-23.03	14.86	16.41	-6.43	-0.96
Mauritius	-3.99	-8.37	18.47	-1.02	-13.13	-0.14	19.17	5.37	-1.83	1.61
Southern Africa										
Botswana	8.12	7.22	18.11	4.68	10.62	-11.66	-5.76	4.26	-4.51	3.45
South Africa	-0.98	19.84	15.92	7.10	1.78	-0.08	15.67	29.73	7.68	10.74
Median	-15.28	12.72	18.47	4.30	-12.13	-0.08	18.53	17.55	-2.01	11.91
Mean	-15.40	12.72	20.09	4.30	-10.51	3.19	18.53	17.83	-1.96	5.42
Mean excluding South Africa	-17.20	11.83	20.61	3.95	-12.05	3.60	18.88	16.34	-3.16	4.75

Source: Word Development Indicators (2020).

(2018) find that the Southern African regional market was the most influential in amplifying shocks to other African markets. In addition, given their relative size of their stock markets, South Africa and Nigeria markets were identified as the most responsive to regional shocks contagion during the crisis. The post global financial crisis annual returns of ASMs are presented in Table 6. It shows that the annual returns of most ASMs have been inconsistent for the past 10 years. However, the average annual return for these selected markets over the decade was 5% with an average median of about 12%.

3. African Debt Markets (ADMs)

Overall, African countries have also made substantial progress in developing their debt markets on the back of new products, regulatory improvements and more responsive economic policy. At the country level, policies designed to strengthen public sector capacity are gradually improving transparency.[5] ▷

[5] The recent development of debt markets has benefited from the support of the African Development Bank (AfDB) and a group of African Central Banks. The African Financial Markets Initiative (AFMI) launched in 2008 contributed to improve the accessibility and reliability of information that was regularly updated through a network of liaison officers in 30 African Central Banks. Through this initiative, the Banks developed the African Financial Markets Database (AFMD) and launched the first ETF (Exchange Traded Fund). The collaboration of central banks has continued once the initiative phased out and the exchanges of information has positive impact on the market expansion and innovation. The AfDB and other Development Finance Institutions (DFIs) have continued to provide support to countries debt management offices to enhance disclosures, establish a credible yield curve and increase the take-ups of local institutional investors. Many African countries continue to expand their local debt markets and to promote innovation. The first debt issue sold exclusively through phone banking in Kenya (M-Akiba, https://www.m-akiba.go.ke/) happened in 2017. The expansion of the local debt markets has been an encouraging sign of modernization that accelerated after the financial crisis of 2008. This progress enabled Central banks to support the States in the mobilization of financial resources at a reasonable cost during the Covid pandemic since April 2020. A good example was the launch of the "COVID-19 Bonds" by the BCEAO, the Central Bank of the WAEMU region. Most governments in the region tested the market with success and most issuances in the regional bond markets were oversubscribed.

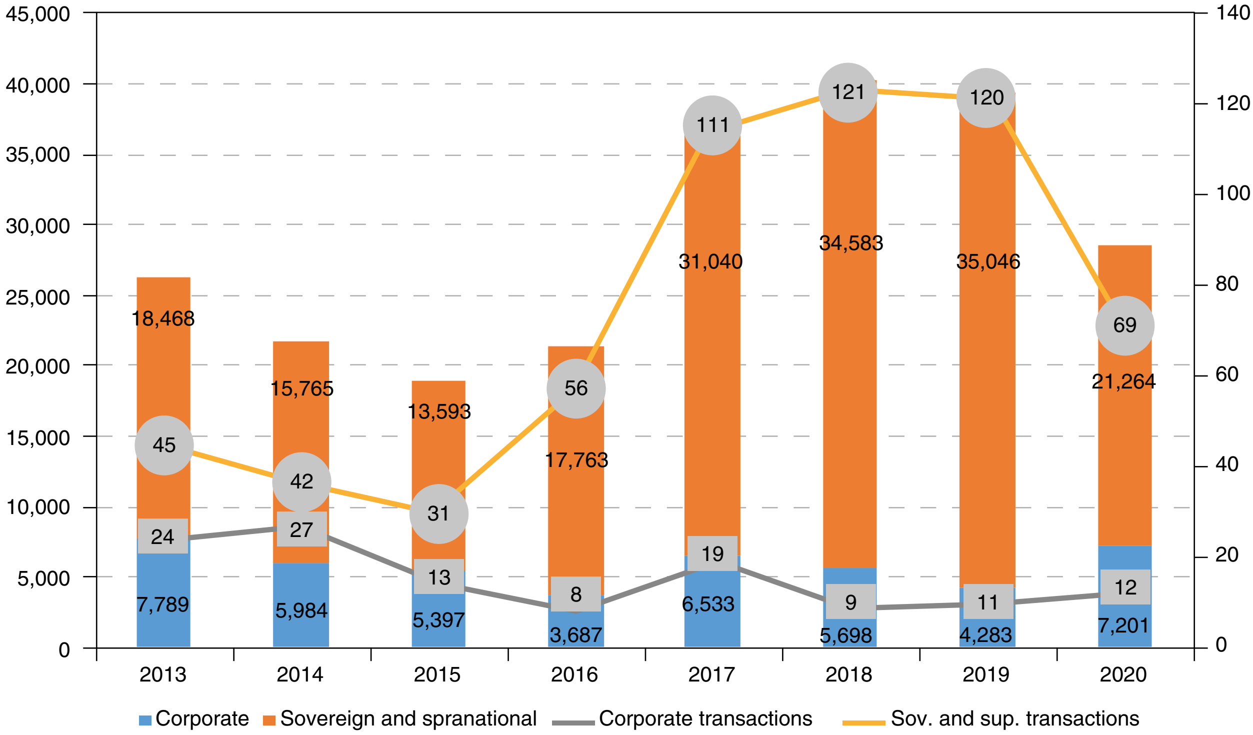
There is still a long way to go to achieve a well-developed capital debt market. Currently, debt markets in Africa only represents a small fraction of the financial assets. There are just a few countries in Africa with a secondary debt market: South Africa, Nigeria, Ghana and Botswana.

African debt capital markets are dominated by government, corporate investment grade and corporate high yield debt. Government bonds represent the majority of long-term securities issued on the ADMs), accounting for more than 80% of all debt issuances in 2019. African governments issued over $200 billion sovereign bonds in 2019 alone (RisCura, n.d.).

The total value of outstanding government bonds in Africa as at July 2019 is reported to be over $0.5 trillion (denominated in either local or foreign currency). The local denominated currency accounts for 78% of the total value of the outstanding sovereign bond. When these total outstanding debts are carefully examined, it can be seen that they are concentrated in only five countries: South Africa (35%), Egypt (28%), Nigeria (8%), Morocco (7%) and Kenya (5%) (RisCura, n.d.; UNECA, 2021).

The corporate bonds market is nascent and remain undeveloped in many African countries. with the exception of South Africa that accounted for over 40% of corporate bond issuance in 2019 (UNECA, 2021; Soumaré *et al*. 2021). The maturity of listed corporate and sovereign bonds in African domestic markets average around 11 and 8 years respectively. Government bonds in Africa are dominated by T-bills, which have a maturity period of less than a year. ▷

FIGURE 1
TRENDS IN ASMS DEBT MARKET, 2013-20200
(Left axis: value in millions US$. Right axis: volume)



Source: PWC African Market Watch 2020.

Figure 1 shows the value and number of transactions of debt instruments issued in African domestic debt market. From 2016 onwards, a jump in both variables can be seen, although the year 2020 recorded a drop, probably as a consequence of the pandemic.

The recent decade has also witnessed the proliferation of Eurobonds issued by African countries. The largest issuer of Eurobonds from 2010 to 2021 is Egypt, followed by South Africa, Ghana and Nigeria.[6] An issue of concern is the high cost associated with issuance of these bonds with a number of existing studies arguing that, bonds issued by African sovereigns attract higher-than-normal coupon rates (see Olabisi and Stein, 2015; Presbitero *et al*., 2016). Figure 2 depicts the average coupon rate of Eurobonds issued by African countries from 2010 to 2020. The average coupon rate ranges from 3.5% in Morocco to 10.14% in Zambia[7] (Soumaré *et al*., 2021).

Between 2007 and 2020, 21 African countries entered the Eurobond debt markets. In 2021, the stock of African Eurobonds had reached $140 billion. Investors were attracted by expanding economies, low debt levels after debt relief, much improved macroeconomic policies, and the opportunity to diversify their portfolios. The Eurobond market enabled government to scale-up their funding while avoiding cumbersome negotiations and conditionality of official lenders. The visibility gained was also useful to attract other capital flows to the private sector as they provide a benchmark of country risk.

The move has resulted in greater transparency and rigor of debt management. Behind the scenes, African finance ministries got regular credit ratings and equipped their debt management offices to manage the new types of borrowing. Eurobond issuance also coincided with much better coverage of African economies in global financial media and it was a very transparent form of debt, with all the terms and conditions published by the exchanges the bonds are listed on. African countries have built a good repayment track-records gradually shifting to more active debt management.

Another important characteristic of the African debt market is the low ratio of outstanding debt to GDP. Most African countries bond outstanding to GDP is below 40%. The higher debt-to-GDP ratio signifies a greater exposure to credit risk. Although, there is no optimal debt-to-GDP ratio, IMF suggests a higher ratio can lead unsustainable debts levels.[8] As highlighted in the Bright Africa Report (RisCura, n.d., p. 97), three countries have relatively higher outstanding debt GDP ratio in the selected countries. These are Egypt, South Africa and Mauritius with outstanding debt GDP ratios of 60%, 51% and 47% respectively.

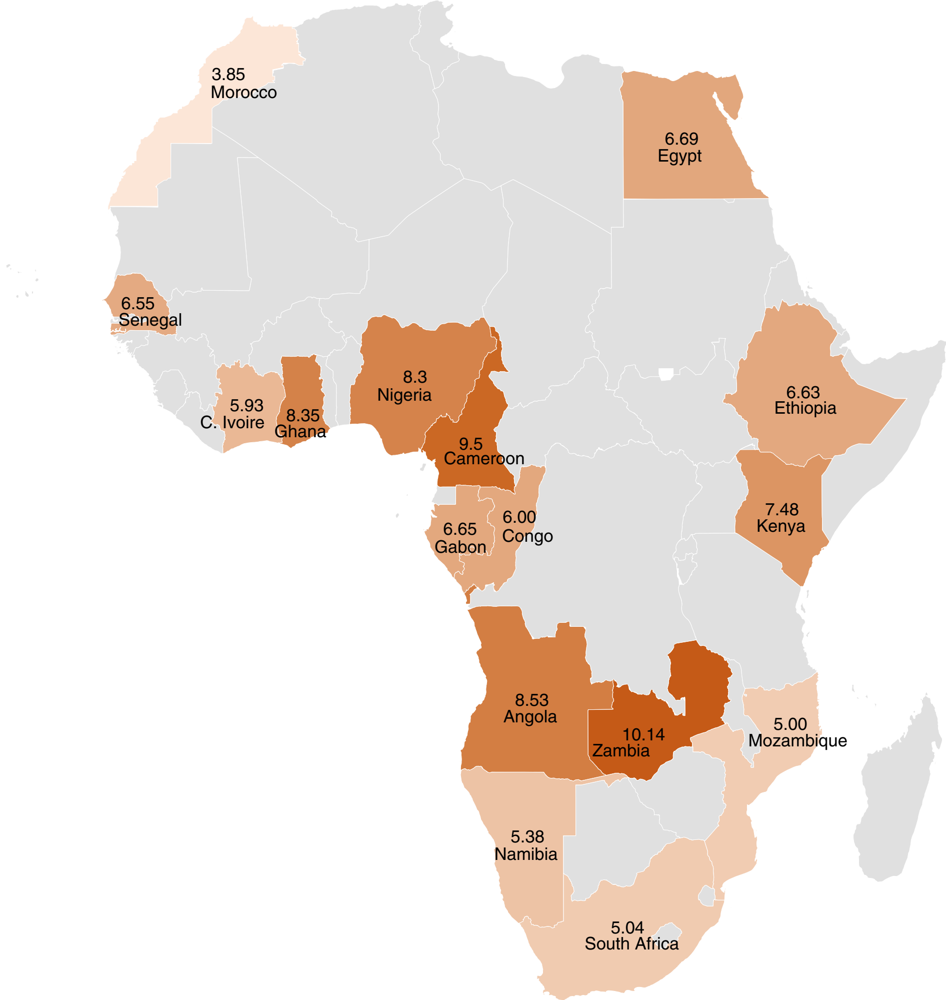
Since investors analyses a country's credit risk before committing funds in any economy, an indication that credit ratings of a country are crucial. Only two countries in Africa currently have an investment grade rating (above Baa3 by Moody or BBB– by S&P and Fitch). These are Botswana and Mauritius with South Africa just downgraded to ▷

[6] See Bond radar: https://www.bondradar.com/

[7] Note that Ghana issued $1 billion sovereign bond in October, 2015 at an all-time higher coupon rate of 10.75%.

[8] It is imperative to note that, based on their debt sustainability framework (DSF), IMF-World Bank has three debt burden thresholds: 35% of GDP, 55% of GDP and 70% of GDP and combined with debt-carrying capacity categories, one is able to tell whether a country's debt is sustainable or not. See https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/39/Debt-Sustainability-Framework-for-Low-Income-Countries#:~:text=The%20DSF%2C%20therefore%2C%20classifies%20countries,the%20state%20of%20the%20global

FIGURE 2
AVERAGE COUPON RATE OF EUROBONDS IN AFRICA (2010-2020)



***Source:* Soumaré et al. (2021).**

non-investment grade in March 2020 (RisCura, n.d.; UNECA, 2021).[9]

Finally, and taking into account the global debt in Africa, there have been also widespread concerns about rising debt levels that became more evident in 2019. The problem was identified before the pandemic and although the sovereign defaults that were feared in 2020 and 2021 did not materialized, the concern about the erosion of debt sustainability remains, leading in part, to the institutionalization of the Debt Service Suspension Initiative (DSSI).[10,11] ▷

[9] In the late 1990s and early 2000s there were several initiatives to support countries in getting their sovereign credit rating (SCR) as a means to reinforce their efforts to mobilize resources from private capital markets. By the end of 2003, 14 African countries had been assigned a SCR and in 2021, 32 countries had been assigned a credit rating by the three international credit rating agencies. However, only four African countries obtained an investment grade. The downgrade of more than 50% of the African during the pandemic has triggered a debate about the revision of rating approaches for developing countries and the need to incorporate other non-financial sustainability criteria. This discussion follows the criticism on CRA after the financial crisis and the more critical analysis of their methodology and the impact of their ratings. The Credit Rating Research Initiative illustrates well this general trend. The UNPRI (Principles for Responsible Investment) is facilitating a dialogue between credit ratings agencies (CRAs) and investors to promote the adoption of ESG criteria into their assessment of creditworthiness.

[10] In a recent book published in 2021 Greg Smith provides a comprehensive description of the African debt market that analyzes the challenges and opportunities as emerging market fund manager, M&G. He authored recently an article in the IMF's F&D Magazine.

[11] See https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

4. Long-term finance

The above description of the evolution of the current financial markets infrastructure confirms that, despite the positive evolution over the past two decades, the size and performance is still not sufficient to meet the financing needs, particularly as regard to long term finance.

But the picture would not be complete without a description of a few public initiatives aimed at broadening and diversifying the sources of long term finance available in the continent beyond the efforts to expand and reinforce traditional financial markets. These initiatives target two main objectives. First is to improve the knowledge about flows and drivers of long-term finance at the global level and engaging into a proactive dialogue with major investors. Second is to develop new mechanisms to attract new sources of long-term capital.

4.1. Institutional investors

Institutional investors such as pension funds, sovereign wealth funds (SWFs), and insurance companies hold the necessary resources to enable the MDBs to scale-up from "billions to trillions" at a global level. Institutional investors, together with commercial banks, collectively have about US$120 trillion in assets-under-management (AUM), which are expected to grow at 5% annually until 2020. Only about 0.1% of the global assets and 12% African institutional investors' assets would be needed to bridge the continent's annual US$107 billion infrastructure gap (OECD, 2020).

The African Development Bank (AfDB) started working on long term finance with a focus on institutional investors during the preparation of their first African Investment Forum held in 2018. In the survey published in 2019, they reported on the discussions with a representative group of institutional investors that focused on mapping out institutional and operational challenges and risks related to investing in Africa. They also analysed the collaboration with development partners and identified some examples that could be replicated and scaled up (Juvonen *et al.,* 2019).

Most issues that hinder institutional investors from entering the African market were associated with the lack of information on appropriate investment opportunities and their limited capacity to assess and mitigate risks related to their investments given the high transaction costs. The report concluded that Multilateral Development Banks (MDBs) could play an important role as catalysts for private investments connecting potential investment opportunities they identify and meeting investors' needs and expectations through the development of solutions adapted to investors' needs and different de-risking mechanisms (Juvonen *et al*., 2019).[12]

The OECD has engaged on a similar exercise at a global level for all developing countries that have arrived to similar conclusions.[13] ▷

[12] Many investors admitted that they do not have sufficient in-house capacity to assess complex investments in Africa given the small size of projects and high development and transaction costs. Most investors appreciate MDBs expertise and "political clout" in investments that are perceived as risky by private sector actors. The report list some of the de-risking mechanisms already available such as GuarantCo, AfDB's Partial Risk Guarantee (PRG), EIB's External Investment Plan (EIP) and the co-investment platforms with private and public stakeholders, such as the Global Infrastructure Facility (GIF), Africa50 Infrastructure Fund, Emerging Africa Infrastructure Fund (EAIF), and IFC's Managed Co-Lending Portfolio Program (MCPP).

[13] Their latest biennial Global Outlook on Financing for Sustainable Development published by the end of 2020 identifies the main sources and used of long term finance and provides a comprehensive overview of all development finance with a particular focus on long term funding. The OECD follows the mandate of the 2030 Agenda for Sustainable Development, adopted and the Addis Agenda adopted in 2015. The target is not just on increasing development finance but on the broader alignment of private investments to the SDGs. The report finds that shifting 1.1% of the total financial assets held by banks, institutional investors or asset managers (USD 4.2 trillion) would be enough to fill the growing financing for sustainable development gap (OECD, 2020).

The OECD has also engaged on a dialogue with key global institutional investors – such as pension funds and insurance companies – that are key

The OECD is also developing new standards on new instruments to attract funding to development objectives (blended finance and de-risking). Their analyses and regular monitoring of the involvement of institutional investors at large scale in blended finance operations is limited so far (OECD, 2021).[14] However, the development of standards had started only in 2017 and the dialogue with investors is now more regular and leading to more specific conclusions while disseminating the best practices. The tools and mechanisms have been slowly developing with some promising, although still anecdotic examples.[15]

4.2. *The Africa Long-Term Finance Initiative (ALTFI)*

In Africa, most financial assets are heavily concentrated in banking that have limited outreach and are unwilling to expose themselves to longer-term risk. Institutional investors, mainly pension funds that are growing in size although still heavily concentrated (in a few countries in Southern Africa and Nigeria and few institutions, mostly Government Pension Funds) hold a significant portion of their assets as term and savings deposits with banks given the limited opportunities for risk diversification. Most pension funds find investment in government securities more secure and attractive, particularly in markets where interest rates are high. The capacity of local markets for longer-term securities is also limited.

MFW4A, along with FSD Africa, GIZ and the AfDB launched the Africa Long-Term Finance Initiative (ALTFI) in 2017 to take a more comprehensive approach to LTF.[16] Information and data on the availability of long-term finance in Africa has been scarce, spread across numerous sources, or simply unavailable. ALTFI brings together existing sources of information as assembled by third parties and augments the availability of data as regards long-term finance through collection of primary data. Their Scoreboard provides benchmarking that facilitates comparison of how countries are performing relative to others, thereby engendering interest in long-term productive finance and applying peer pressure among country stakeholders.

4.3. *Financing infrastructure, capital markets and private equity*

The African infrastructure deficit is well documented. However, there is still not much information on the concrete initiatives.

Most of the African countries have a deficit of basic infrastructure in transport, telecommunications, energy and water supply; which are essential to enhance the economic and ▷

participants in financial markets, holding more than USD 100 trillion of assets. Since 2011, they publish an annual survey of large pension funds and public pension reserve funds. Since the 2019 edition the questionnaire included an addendum seeking additional information on the volumes and distribution of institutional investors' assets in developing countries (OECD, 2021).

[14] Pension funds and insurance companies accounted for USD 2.5 billion or 4% of the total capital in blended finance funds and facilities. According to OECD statistics, official development finance interventions by bilateral and multilateral development finance providers mobilised approximately USD 253 billion of private finance for development outcomes between 2012 and 2019. Private mobilisation generally followed an upward trend since 2012, its highest level so far having been reached in 2018 with USD 50.7 billion.

[15] One of the most successful examples of these tools is the IFC's MCPP which is a platform for institutional investors to participate in impact-focused credit opportunities in IFC's pipeline. In eight years, MCPP has raised over USD 10 billion, enabling 11 insurers and other partners to join IFC in contributing to the achievement of the SDGs. MCPP provides an efficient, low-cost way to make a large capital allocation and then leverage IFC origination to create a diversified pool of new loans over time, offering portfolio diversification to institutional investors.

[16] The Africa Long Term Finance Initiative is a joint effort of the AfDB, the Financial Sector Deepening Trust for Africa (FSDA), the German Federal Ministry of Economic Cooperation and Development (BMZ, implemented by GIZ), and the Making Finance Work for Africa (MFW4A) Secretariat (https://altf.afdb.org/).

social development of the region. These needs are clearly identified and there is a broad pipeline of investment projects. Funds coming from the region are limited, but there is great interest from international investors, who have funds to finance all needs and are able to participate in these projects. However, the interest of the investors is not reflected in the real participation in the financing of the projects. This is what is known as the African infrastructure paradox (Lakmeeharan *et al*., 2020) or the African infrastructure gap (Juvonen *et al*., 2019 and Institutional Investor Highlights Opportunities in Africa—an Interview with Aymeric Saha, 2021).

> *The gap between the continent's infrastructure spending and the amount required to ensure electricity, water, and sanitation access alone stands at about $3.3 trillion. This amount far surpasses the budgets of all the world's aid agencies and donor resources combined, but it's just a small fraction of the world's more than $89 trillion in assets under management.* (Institutional Investor Highlights Opportunities in Africa—an Interview with Aymeric Saha, 2021)

This investment paradox cannot be solved solely with the efforts of African governments through public investment, since the funds generated by their public finances are limited and the ratios of public debt to GDP are increasing in recent years. The reasons why international investors are not more involved in project financing are linked to the perception of project risks and their improvable design and implementation. Lakmeeharan *et al*. (2020) point to six specific reasons that explain the paradox of African infrastructures: (i) Limited deal pipeline or selection of low impact projects, (ii) weak feasibility study and business plan of the projects, (iii) delays in obtaining licenses, approvals, and permits, (iv) Inability to agree on risk allocations, (v) Inability to secure offtake agreements and guarantees and (vi) poor program delivery.

African capital markets are not currently able to offer an adequate framework to channel the capital necessary to meet the potential demand for the development of infrastructure projects. However, there is a way for venture capital from foreign capital and institutional investors to provide resources to finance infrastructure projects. According to the latest available data (AVCA, 2021), the number of projects financed with venture capital in Africa has increased in 2020. About 319 projects have been financed in 2021, although there has been a decrease in the volume financed.

If jointly analyzing the period between 2014 and 2020 (AVCA, 2021), the volume of funds that venture capital has invested in Africa amounts to US$5 billion, of which 22% comes from capital outside Africa. It is also relevant to note that 21% of the total projects in that period correspond to investments in companies located in the South African area, with the Republic of South Africa standing out as the main recipient country. Indeed, private equity, which also presents an important source of development finance continues to steadily grow in Africa. Available data from RisCura (n.d.) also suggests that, total private equity surged from US$ 2.3 billion in 2017 to US$ 2.7 billion in 2018 with South Africa, having the largest share of private equity transactions.

5. Conclusions

There are three main ideas that could be retained from the above description. The first ▷

one is that, although still small and not deep and broad enough, most ASMs are relatively young but have developed considerably in just two decades. There are several initiatives to reform and improve the size and efficiency of financial markets.

Secondly, debt markets in Africa only represent a small fraction of the financial assets and are dominated by government bonds but the successful deployment of Eurobonds have enabled governments to improve their capacities for active debt management and build a good repayment track-record.

Finally, the COVID crisis had a negative impact but has also stressed the international attention on SDGs. Several institutions, mainly AfDB and OECD, have engaged on a proactive dialogue with global institutional investors to understand the main drivers of their portfolio management and to develop new instruments that could make their investment in Africa more attractive and mitigate the negative perception of risks. These efforts, combined with the revision of credit rating methodology to incorporate sustainability aspects, are expected to have a positive impact to reduce the SDGs funding gap.

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