PRACTICAL ISSUES IN ASSURING DURABLE MARKETS FOR NEW AND INFREQUENT ISSUERS

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Presenters: Johan Krynauw and Ben Hlatswayo | Liability Management Division , National Treasury | **30 June 2011**

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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WHY LOCAL CURRENCY BOND MARKET?

- Local currency bond markets contribute to financial intermediation, financial stability and sustained economic growth
- Liquid local currency markets = improved macroeconomic fundamentals
- Liquid local currency markets important to absorb ever increasing global savings

WHY LOCAL CURRENCY BOND MARKET?

- CONTINUED

- Debt dominated in local currency – provides a buffer against external volatility
- Diversification for the domestic investor base - pension, insurance and mutual fund industry- less depending on Bank funding
- Local Currency Markets improve effectiveness of Monetary Policy by sterilizing large and temporary capital inflows

COMPONENTS OF LOCAL CURRENCY DEBT MARKETS

Creating a supply of instruments and competitive market-based placement mechanisms

- Selecting instruments (bills and bonds) that enable issuers to lengthen the maturity of issued debt
- Consistent and predictable issuance policies (funding strategy and auction calendar)
- Establish competitive placement mechanisms – auctions, PD system
- Liquidity and efficient price discovery in all market conditions

COMPONENTS OF LOCAL CURRENCY DEBT MARKETS - CONTINUED

Creating the conditions for stable domestic demand

- Issuer's maturity profile and type of debt much cater for demand needs
- Primary Dealers role in primary and secondary market
- Encouraging active participation in secondary market (role of trading platform)
- Policies to diversify investor base – pension and insurance reforms

COMPONENTS OF LOCAL CURRENCY DEBT MARKETS - CONTINUED

Enabling environment for secondary market trading

- Public issuer plays essential role in establishing conditions for developing secondary market
- Primary Dealer:- market-making obligations
- Establishing rules and frameworks to ensure efficient price discovery
- Supporting of robust infrastructure (trading, clearing and settlements and payments systems)
- Ensuring level playing fields for all participants

COMPONENTS OF LOCAL CURRENCY DEBT MARKETS - CONTINUED

Sterilization of capital flows

- Separation of monetary and fiscal policies
- Excess liquidity is direct consequence of capital inflows
- Central Banks mop up liquidity with a mix of tools – non – marketable (reserves and deposits) and marketable (repos, short term bills and bonds)

SOUTH AFRICAN EXPERIENCE

- Domestic Market gradually become deeper and more liquid driven by sound macroeconomic policies
- Supply of long term bonds doubled in last three years – demand still adequate
- Robust domestic investor base – cover for 74% of debt holdings
- Foreign holdings increase to 26% of debt holdings
- Maturity reaching up to 30 years
- Well diversified investor base

SOUTH AFRICAN EXPERIENCE - CONTINUED

- Diversified instruments in all markets (Treasury bills, Domestic bonds, Foreign Capital loans and Retail Savings Bonds)
- Ability to manage capital flows – effectiveness of sterilization
- Manage cash of the Government and Provinces daily
- Investor relationship
- Introduce Market -, Credit-, Country Risk Management capabilities

WHY ISSUE FOREIGN DEBT

- To finance budget deficit
- Diversify funding sources
- To create bench marks in the foreign markets, to enable state owned entities and other local corporates to access international capital markets

TYPES OF BONDS ISSUED IN INTERNATIONAL CAPITAL MARKETS

Foreign Bonds

- Issued outside the issuer’s home country
- Registered in the country where issued
- Foreign bonds issued by governments are often referred to as “Sovereign Bonds”

TYPES OF BONDS ISSUED IN INTERNATIONAL CAPITAL MARKETS - CONTINUED

Global Bonds

- A global bond is a bond which is issued in several countries at the same time. By offering the bond to a large number of investors, a global issuance can reduce borrowing cost

Eurobonds

- Bonds issued in the "Off-Shore" market similar to the eurocurrency market
- They can be categorised according to the currency in which they are issued.(For example, Euro yen and Eurodollar bonds are denominated in Japanese yen and American dollars respectively)

EXTERNAL FUNDS

Two broad categories of potential sources of external funds can be identified, namely official sources and private sources

1) Official financing

- Inflows can be bilateral or multilateral
- Bilateral flows are government to government transactions, whereas
- Multilateral sources are international organizations like the World Bank

EXTERNAL FUNDS - CONTINUED

- These sources provide recipients in general with more favourable terms than private or commercial sources
- However, they are often subject to certain conditions

- There are two types of private sources of funds:-
  - Foreign commercial banks
  - Issuing bonds in the international markets

EXTERNAL FUNDS - CONTINUED

2) The private sources

- The private sources of foreign funds normally work on commercial principles
- Hence the cost of borrowing will be higher here

PROCESS TO ISSUE A FOREIGN BOND

- The amount of foreign debt planned to be incurred for the fiscal year will be set out in the funding strategy
- The funding strategy gets approved by the Minister of Finance
- The funding strategy forms the basis for Chapter 6 in the Budget Review
- It is appropriate to enter the global capital markets when the risks are the lowest – that is a time when no major economic releases are expected and when cash is expected to be high

PROCESS TO ISSUE A FOREIGN BOND

- CONTINUED

The process then is:

1) **Appoint lead managers**
2) **Appoint lawyers**
3) **Press release**
4) **Road show**
5) **Pricing**
6) **Allocation**
7) **Closing**

THE IMPORTANCE OF A CREDIT RATING

- Borrowers generally seek credit ratings in order to ease their access to international capital markets where rated securities are generally preferred over unrated ones
- This is in particular true for the U.S. Bond Market, where credit ratings are a de facto requirement
- Also in international bond markets ratings have developed into a prerequisite for broad market acceptance

THE IMPORTANCE OF A CREDIT RATING
- CONTINUED

- Ratings are an important part of the Bond Market
- They help to reduce investor's uncertainty about risk exposures
- In this context of particular importance are sovereign ratings, because credit ratings agencies use them normally as a reference point for rating other issuer's from the same country like corporates
- The main determinants of a country's credit rating are from a general point of view its economic and political fundamentals

THANK YOU