Monetary and Capital Markets Department

Rwanda

Non-concessional and Non-traditional Sources of Financing

Some Lessons and A Framework

Oct 28, 2010

Outline

- **Financing Needs and Options**
  - Current Market Conditions and Options
- **Accessing International Market**
  - Some Recent Examples
- **Medium-Term Debt Management Strategy**
  - Strengthening domestic capacity
- **Role of the IMF staff**

Current Market Conditions and Options

Africa's Infrastructure Poses A Critical Development Impediment

Transport as % of trade costs:
-World average: 6.0%
- Africa: 12.6%

Lack of power cited as one of top three constraints by businesses

GDP could grow 2 % more w/o infrastructure deficits

Current Market Conditions

- Several financing options but also many risks
- Complexity and time line of financing options differs considerably, but generally underestimated
- Mixed experience with access to international capital markets
- Best evaluated within a macro-consistent investment strategy; not an interest cost-driven evaluation alone

'Money is not a problem; high quality and economically viable projects are'

Challenges for Policy Makers

- More needed on the underlying factors to promote non traditional finance.
  - Selection and preparation of projects
  - Governance and management
  - Policy and regulatory framework
  - Stakeholder confidence
  - Local capital market development

A bottom-up approach that meets rigorous test of economic, financial, and social policies

Several Key Considerations

- Purposes for which funds are needed?
- How best to account for macroeconomic and other financial costs ?
- Can local or regional capital markets be part of the solution?
- Is a public-private partnership part of the solution?
- What is the viability of other options, such as new bilateral creditors ?
- How do we create capacity and systems for sustainable access to non-concessional funding?

A Framework for Policy Makers

- **Macroeconomic:**
  - Address policy tradeoffs between growth and vulnerabilities
  - Financing options need to maintain the sustainability of the repayment schedule
  - DSA can also help guide growth enhancing financing choice but needs feedback from projects to growth to do so.
- **Institutional:**
  - Local capacity in project selection/management and debt management
  - Ability to prepare a medium-term debt strategy (MTDS)
  - An IRP (investors relations program) to deal with rating agencies, and analysts
- **Governance:**
  - Quality of financial and project management capabilities
  - Assure that money raised is indeed directed to the projects
  - Accountability and transparency

Non Concessional, Non Traditional Sources of Financing: Options

- **Three broad approaches to funding**:
  - Equity type approaches (traditional PPPs, infrastructure funds)
    - Implicit rates of return high (e.g. > 20% in South Africa)
    - But, complex, and often create fiscal risk (guarantees/take-over of PP by the government)
  - Debt capital market
    - Public external debt (bonds; syndicated bank loans)
    - Public domestic debt (bonds; local bank loans)
  - Debt and Equity (incentive stakes)
    - BOT
    - Management contracts with equity reward
    - Often more feasible than PPPs

Practical Lessons from Some Recent Examples in Africa

Recent Experiences
Ghana ($750 million; 5% GDP; 2007)

- Market pressure for augmentation (500=>750)
  - Expenditure up by 4% of GDP; deficit up by **5%**:
    - Capital spending up **only 1.3%**;
    - Wages up 1.2%
    - Interest cost up 0.8%
    - Grants down 1.4%
  - External debt: 17.2 % of GDP (2006) to 29.2% (2008)
  - Current account: 9.9% of GDP (2006) to 19.3% (2008)
    - Nominal exchange rate depreciated about 33 percent
    - REER depreciated by 8% => costly
- Follow-up MTDS mission in 2010

Recent Experiences
Senegal ($200 million; 1.5% GDP; 2009)

- US $ 200 million
- Limited size (may cost 1-1.5% extra interest)
- Project lined up => little carry cost
- Used for project with 23% return
- Carefully considering a return to the international market
- Requested an MTDS mission

Key Lessons

- **Size could reduce rate, but**
  - Expenditure and deficit increased (as in Ghana)
  - Risks inappropriate use of funds
  - Cost of carry & roll-over risk increase with size
- **Not an interest rate issue alone!**
  - Identify high productivity projects
  - Cash generating projects
  - Help avoid other macroeconomic costs (crowding out / Dutch disease)

Minimize cost of interest incl. cost of carry/roll-over risk

Build solid debt management capacity with market orientation

Securing High Return Projects ?

- **Involve debt office early in financing options/MoF**
  - Financing terms, macro implications/DSA
  - Selection (gate keeper): Project pipeline (better selection)
  - Ready to go when financing is tapped; limit risk of finance driven projects
- **Select hurdle rates**
  - Minimum cash rate of return (CRR)
  - CRR>financing cost (incl. carry cost/roll-over risk/project execution risk)
  - Minimum economic internal rate of return (IRR) = CRR plus implicit cost of raising taxes

Common Mistakes of First-time Bond Issuers

- Too large issue size
- Poor use of proceeds
- Rushing to the market without preparation (2 year process)
- Poor selection of instruments
- Not getting independent second opinion
- Choosing the lead manager on the basis of fees only
- Not embedded in a medium term debt management strategy

*Guidance given in IMF WP/08/261 "**Strategic Considerations for First-Time Sovereign Bond Issuers**"*

Accessing Alternative Sources of Financiang

Links to DSA/MTDS

Link Financing Choices to DSA

- **DSA for Rwanda**
  - Overall Assessed as "moderate," but vulnerability of Rwanda's debt indicators to an export shock
  - Suggests that there is space (NPV public debt/GDP = 16.9%; primary balance about zero)
- **DSA and project analysis/financing**
  - Demonstrate additionality of projects in terms of debt sustainability

    => If micro is sound, macro should be too
  - Link growth and revenue projections to projects selected
  - Important to build good capacity in overall DSA, project assessment and the interlinkages

Link to Medium-Term Debt Management Strategy (MTDS)

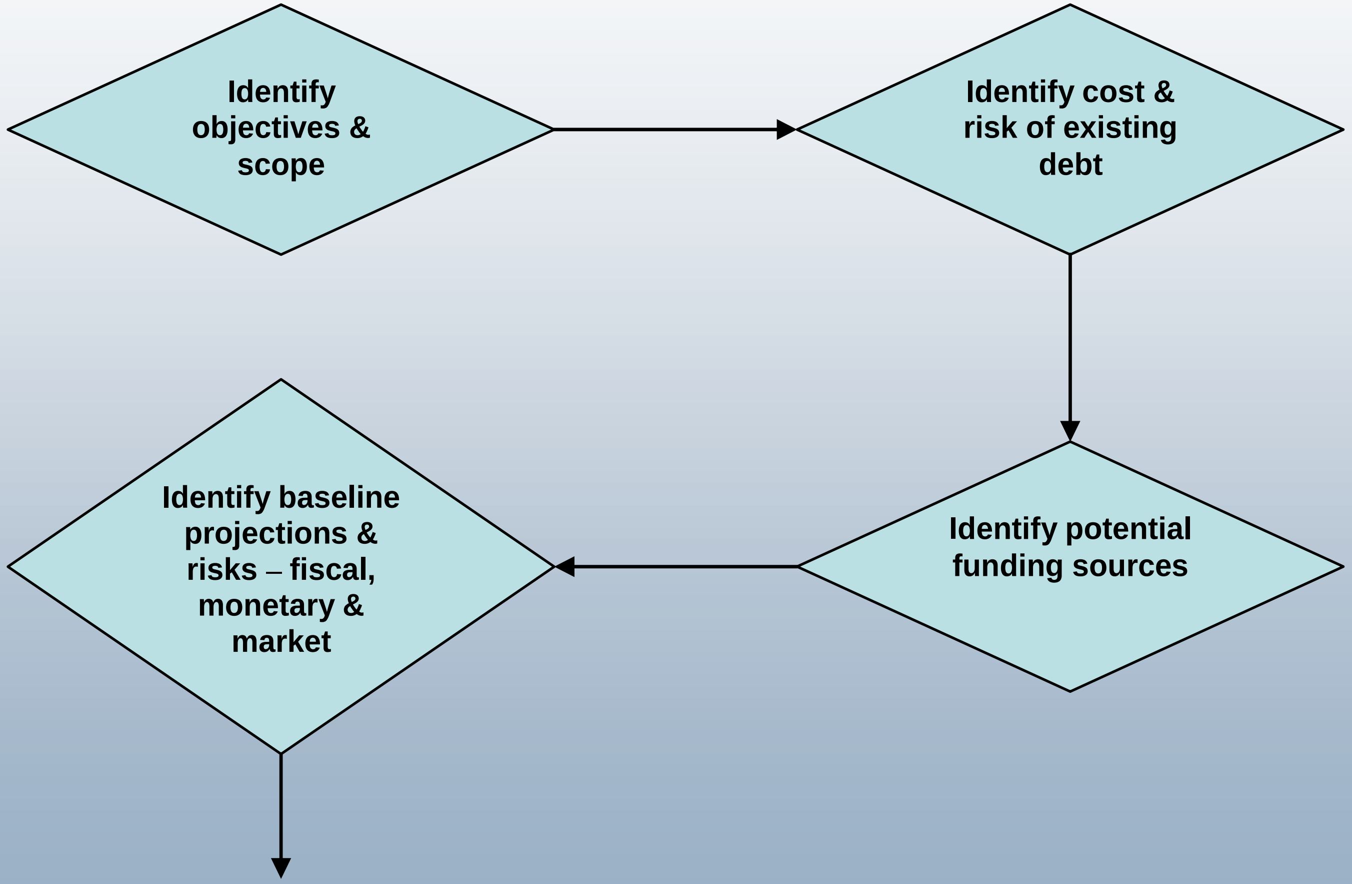
- Rwanda has a Debt Strategy (Nov 2008)
  - This is focused on debt sustainability
  - Not yet a *Debt Management Strategy* that focuses on the composition of debt:
    - Currency composition
    - Maturity structure/ Roll-over risk
    - Type of instruments (concessional, semi-concessional, commercial)

- Key questions for a debt strategy:
  - Focus on external or domestic borrowing?
    - Can domestic resources be tapped without crowding out domestic investment
    - What is the scope to develop the domestic savings market
  - How to assess new bi-lateral credits?
    - Currency appreciation risk
    - Cost of tied aid—assess cost of limiting the options of purchase/choice of investment

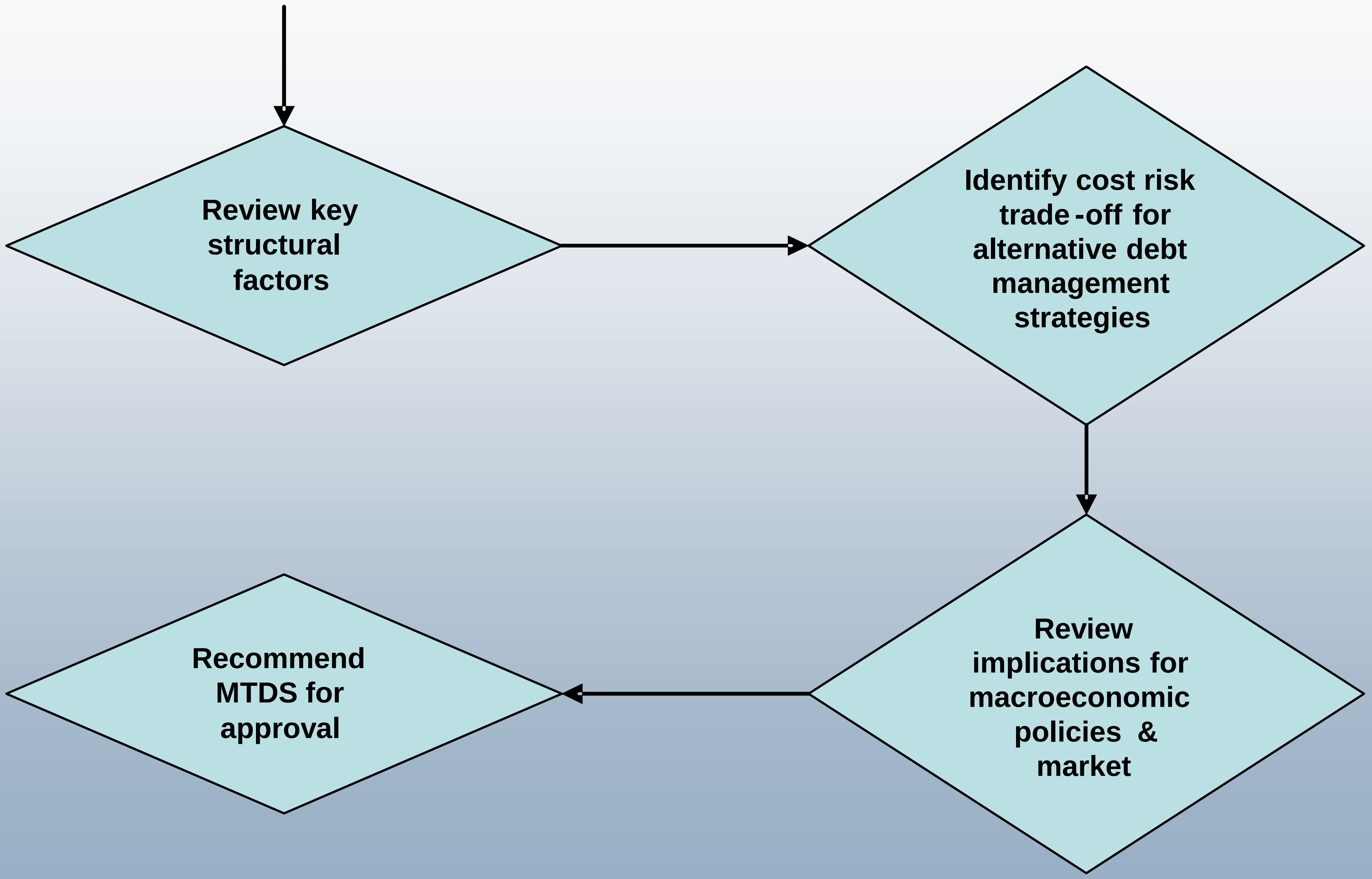
Link to Medium-Term Debt Management Strategy (MTDS)

- MTDS = Medium Term Debt Management Strategy
  - Joint Fund-World Bank developed framework
  - Embeds borrowing decisions in framework
  - Requires cost/risks analysis at portfolio level
  - On that basis draws conclusions on debt composition=borrowing strategy
  - 8 step process
  - Culminates in
    - Debt Management Strategy Document with quantitative and qualitative considerations
    - Annual borrowing plan

Annex: MTDS process



MTDS process



Role of the IMF Staff

- **Assist**
  - In MTDS development (with World Bank)
- **Help**
  - Build institutional debt management capacity
    - strengthen the policy and institutional preconditions for long-term non-traditional financing
- **Guide**
  - Sovereign interface with the private sector, including technical and practical steps on market access

ANNEX

Annex 1: Recent debut bond issues

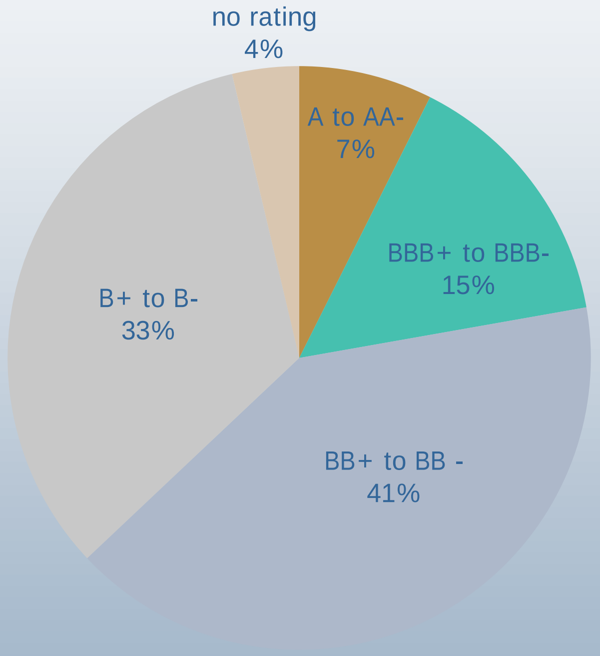
Country	Date	Size ($ mln)	Size (% GDP)	Maturity	Spread at issue	Yield at issue	Rating at Issue	Currency
Pakistan	Feb-04	500	0.52%	5	370	6.86	B/B2	USD
Indonesia	Mar-04	1000	0.39%	10	277	6.97	B+/B/B2	USD
Vietnam	Oct-05	750	1.42%	10	268	7.25	BB-	USD
Ecuador	Dec-05	650	1.75%	10	623	11.06	B-/CCC+/Caa1	USD
Fiji	Sep-06	150	5.00%	5	225	7.25	…	USD
Seychelles	Sep-06	200	28.64%	5	470	9.3	B	USD
Ghana	Sep-07	750	4.99%	10	387	8.5	B+	USD
Sri Lanka	Oct-07	500	1.85%	5	397	8.47	BB-/B+	USD
Gabon	Dec-07	1000	9.80%	10	426	8.2	BB-	USD
Georgia	Apr-08	500	6.46%	5	474	7.5	BB-/B+	USD
Senegal	Dec-09	200	1.50%	5	691	9.25	B+	USD
Belarus	Jul-10	600	2.04%	5	727	9.21	B+/B1	USD
Belarus	Aug-10	400		5		8.41	B+/B1	USD
Montenegro	Sep-10	254	6.10%	5	666	8.0	BB/Ba3	EUR

Source: Bloomberg, Dealogic

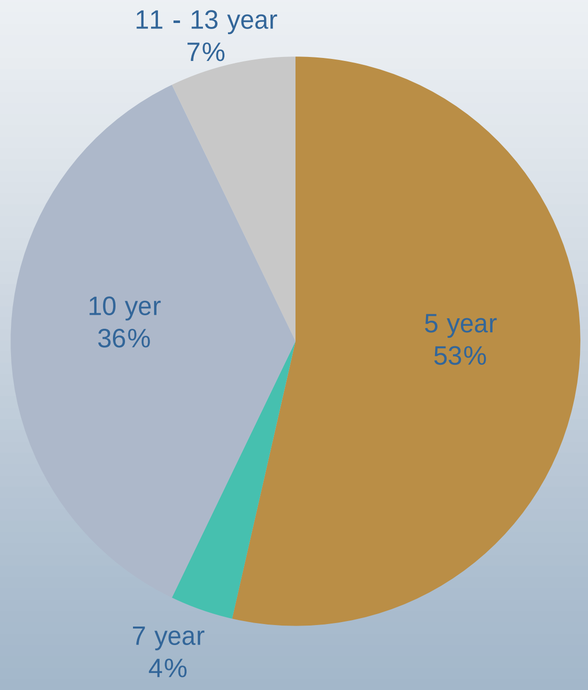
Repeated Periods of Market Closure

Annex 2: Characteristics of first-time issuers

a. Sovereign Rating



b. Maturity (years)



Source: Bloomberg, Dealogic

Annex 3: Selection of a project

Step-by-step approach

- **Step 1**: Technical Analysis – Engineering / environmental / legal / cost-benefit analysis (feasibility -- cash flow projection, capital budgeting) studies (the government hires advisors/ firms to do these studies)

- **Step 2**: Technical selection of projects – Prioritization based on technical analysis / political characteristics (the government forms a competent (cross-ministerial) committee with independent advisors for this selection). Early involvement MoP, MoF to question alternatives, assumptions, ensure sound economic studies

- **Step 3**: Economic Analysis -- prioritization of projects from pipeline based on cost/benefit, DSA / reserve adequacy / growth studies / overall cash flow impact on budget (the MoF / Central Bank / Economic Think Tank with help from IFIs or external advisors do these studies). MoF has gatekeeper role.

Annex 3: Selection of a project (cont.)

Step-by-step approach

- **Step 4**: Government selection of projects -- Based on economic and cash flow analysis, the Prime Minister/Council of Ministers with the suggestion of the Minister of Finance decides on the priority project(s)

- **Step 5**: Financing options of the project(s) -- Government (often the MoF) hires financial/legal advisors to provide available funding options and costs entailed for each option (at this stage the MoF may ask for an independent evaluation of the funding options from IFIs)

- **Step 6**: Government selection of the funding option -- Based on the recommendations of its advisors and possible input from IFIs, the MoF decides on the preferred funding option

Annex 3: Selection of a project (cont.)

Step-by-step approach

- **Step 7**: Government selection of the syndicated banks or bond underwriters -- Financial / legal advisors help the country's preparations (economic/external environment/legal jurisdiction in case of bond financing) and in the competitive selection of the banks or underwriters by the government – MoF.

- **Step 8**: Discussion with the selected banks or underwrites – The government (MoF) with the help of its financial/legal advisors discuss the characteristics and terms of the financing, including size, maturity, coupon, tranches, investor base, fees etc Upon agreement between the government (MoF) and the banks or underwriters, the funding process starts – if a bank syndication is selected, signing is done and disbursements proceed, while if bond financing is selected, signing is done and road shows start.