

Issuing International Sovereign Bonds

Opportunities and Challenges for Sub-Saharan Africa



Mauro Mecagni, Jorge Ivan Canales Kriljenko, Cheikh Anta Gueye,
Yibin Mu, Masafumi Yabara, and Sebastian Weber

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Introduction and Summary

This chapter examines the rise in international sovereign bonds issued by African frontier economies and recommends policies for potential first-time issuers. Maintaining prudent fiscal frameworks consistent with debt sustainability is crucial for deriving lasting benefits from additional financing. Beyond that, first-time international sovereign bond issuers should focus on improving the composition and profile of their public debt under an appropriate debt management framework, adhering to best operational practices for first-time issuance, and locking in low interest rates while smoothing the maturity profile of the entire public debt portfolio. International sovereign bonds may not be the best option for financing infrastructure investment, and other funding options may need careful consideration.

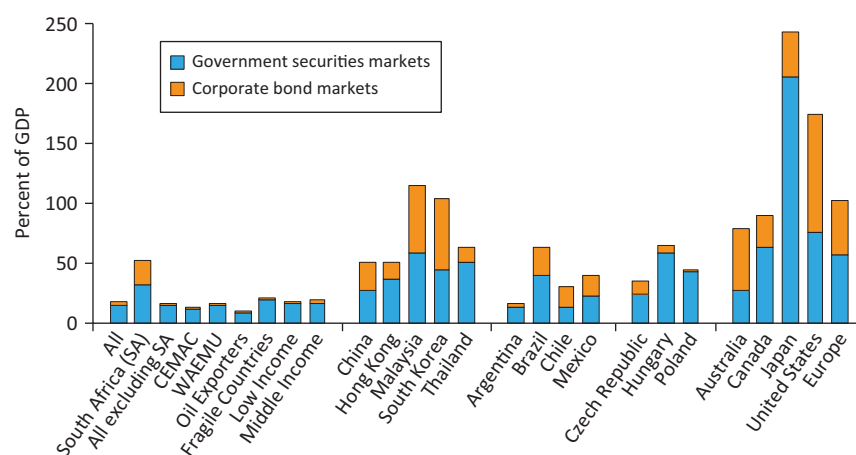
Sub-Saharan Africa's access to capital markets is picking up significantly. Easy global financial conditions—low interest rates in advanced economies and low global risk aversion leading to portfolio reallocation in search of risk-adjusted yields and diversification opportunities—are facilitating access of sub-Saharan African countries to international capital markets. First-time or repeated issuance by those countries is also seen by many observers as recognition of sub-Saharan Africa's high return potential, owing to its natural resource wealth and improved macroeconomic policies and development prospects.

Access to international bond markets brings opportunities to investors and sub-Saharan African countries, but risks exist. By increasing their exposure to Africa, even from a relatively low base, foreign investors can diversify their portfolios, and sub-Saharan African sovereigns can broaden the investor base for their public debt instruments. For issuers, the first impact is to enhance the available fiscal financing envelope, including longer-term project financing. The process also brings financial innovation to the continent, such as infrastructure bonds to bond enhancements and guarantees for local currency bond market (LCBM) products. In addition, access to external financing and LCBM development (Box 1) helps sub-Saharan African economies better shield consumption and investment spending from the impact of exogenous

Box 1. Sub-Saharan Africa: Local Currency Bond Markets

Deep and liquid local currency bond markets (LCBMs) are widely recognized as playing an important role in promoting the effectiveness of macroeconomic policies, the implementation of development programs, and mitigating the impact of financial crises and external shocks on the domestic economy. Their presence allows a country to differentiate its channel of financing, allowing for improved shock absorption capacity at times when access to external financing is limited, or complementing these external financing sources in the realization of investment programs.

Bond Market Comparisons (2010)



Source: Staff estimates.

Note: CEMAC = Economic and Monetary Community of Central Africa; WAEMU = West African Economic and Monetary Union.

In sub-Saharan African countries, LCBMs are still at a nascent stage of development. The outstanding stock of government securities was 14.8 percent of GDP in 2010, much lower than in other developing, emerging, and advanced economies (see figure). The difference is even greater for corporate bonds. On average, the outstanding stock of corporate bonds was 1.8 percent of GDP—much lower than for other developing and emerging economies (with the exception of Poland). Moreover, the low level of development of the bond market is particularly apparent compared with more advanced economies, where for corporate bonds, the outstanding stock ranges from 26.5 percent of GDP for Canada to 98.6 percent of GDP for the United States (Mu and others, 2013).

LCBMs are dominated by government securities. Government securities represent 89.2 percent of total outstanding local currency denominated bonds, compared with 10.8 percent for corporate bonds. This contrasts with the situation in other regions of the world (Figure 1).

A number of structural constraints are impairing the development of LCBMs in sub-Saharan Africa. A limited and undifferentiated investor base, mostly concentrated in

Box 1. (concluded)

domestic banks; undeveloped secondary markets; and illiquid debt instruments have impeded the development of domestic bond markets, making it difficult for countries to raise affordable long-term financing in their shallow domestic markets (except for South Africa). Therefore, despite the implied currency and other risks, funding via international debt instruments is being pursued as one alternative way to overcome lack of long-term local currency financing.

Nonetheless, a number of sub-Saharan African countries are committed to addressing these impediments to the development of LCBMs, recognizing that shallow domestic bond markets expose governments to higher interest and rollover risks, affect monetary policy effectiveness, impede banks from pricing long-term lending, and prevent benchmarking for the development of corporate financing instruments.

This box was prepared by Yibin Mu.

shocks.¹ That said, the availability of debt instruments may also generate new macrofinancial and debt vulnerabilities that need to be monitored carefully, and may in some cases reduce access to concessional financing.

Building on previous IMF staff analysis, this chapter covers the following topics: (1) the experience with international sovereign bond issues in sub-Saharan Africa to date and the range of likely first-time issuers, (2) reasons for the renewed global investor interest in sub-Saharan Africa, (3) opportunities and risks in issuing international bonds, (4) operational considerations in issuing international sovereign bonds instruments, and (5) capacity-building processes to support a successful issuance, especially for first-time issuers, and to mitigate vulnerabilities that could arise in international sovereign bonds.

To make the most of the renewed global investor interest in frontier markets, the following recommendations are provided for first-time sub-Saharan African sovereign issuers:

- Develop a sound macroeconomic framework and strive to maintain prudent fiscal policies that safeguard fiscal and public debt sustainability.
- Improve the composition and profile of public debt under an appropriate medium-term debt management strategy.

¹ There may consequently be a temptation on the part of some sub-Saharan African countries to increase the level of debt in an environment of favorable financing conditions. Such considerations would need to be evaluated in the context of fiscal and external sustainability and the need for and potential return of investments financed by higher borrowing. Such an analysis is being addressed in country-specific Article IV reports.

- Adhere to best practices in terms of information disclosure and outreach to potential investors.
- Lock in low interest rates with modest amortization over long maturities, while smoothing the maturity profile of the entire public debt portfolio to minimize rollover risks.
- Carefully consider the overall borrowing costs in light of the impact of the normalization of monetary policy in advanced economies and the ongoing reassessment of emerging countries' and of frontier markets' risks by international investors.
- Review capacity and secure appropriate technical assistance to prepare for issuing international sovereign bonds.

Finally, a sovereign bond issue may not in all cases be the best financing option. Countries need to carefully consider alternative options to fund public infrastructure projects; in many cases, more tailored financing options can either be less expensive or less risky. For example, bond financing may not be efficient if it is not possible to mitigate carry-costs by matching the funding requirements of the project over time through consecutive bond issues.

Experience with Sovereign Bond Issues in Sub-Saharan Africa

Although on the rise, most sub-Saharan African countries' experience with international sovereign bonds is still limited.² Eleven countries in sub-Saharan Africa have accessed international sovereign bond markets in the last decade (Figure 1 and Table 1).³ At end-2011, sub-Saharan Africa's total international bonds outstanding reached about ¼ percent of the stock of outstanding international bonds issued by 34 emerging and developed countries, but only 0.02 percent when South Africa is excluded. As an example, outstanding sub-Saharan African bonds amounted to 20 percent of outstanding international bonds issued by Brazil, but only 1.3 percent when South Africa is excluded (Bank for International Settlements, 2012).

The 11 sub-Saharan African international sovereign bond issuers are diverse. They include resource-intensive and more diversified economies, as well as countries from different income groups and debt levels. They are the Republic of Congo, Côte d'Ivoire, Gabon, Ghana, Namibia, Nigeria, Senegal, Seychelles, South Africa, Tanzania, and Zambia.⁴ Following their participation in the World Bank and IMF's Highly Indebted Poor Countries (HIPC) Initiative, the debt outlook improved for some of these countries, including the Republic of Congo, Côte d'Ivoire, and Senegal, facilitating their access to international bond markets.

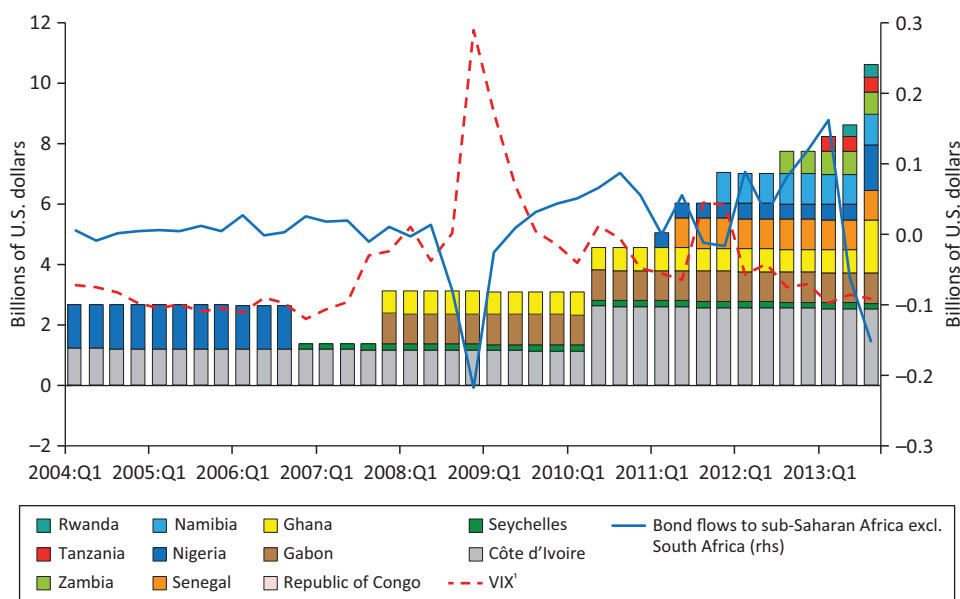
Sub-Saharan African governments have issued international sovereign bonds for a variety of reasons. These include deficit financing (including for increasing public infrastructure spending), benchmarking (including for expanding international market access for firms), and public debt

²The sole exception is South Africa.

³In this report, international sovereign bonds are defined as government bonds issued in foreign currency in international jurisdictions.

⁴In 2012, Angola received a seven-year loan (US\$1 billion) from the Russian bank VTB. VTB issued a corresponding sinkable loan participation note with a coupon rate of 7 percent.

Figure 1. Sub-Saharan Africa: Recent Sovereign Issuances



Sources: Bank for International Settlement Quarterly Review; Bloomberg; EPFR.

Note: Data corresponds to flows of investment in bonds issued by entities of the corresponding sub-Saharan African countries by global exchange traded funds and mutual funds, expressed in U.S. dollars. A negative value corresponds to a reduction in the holdings. EPFR data is available for Botswana, Côte d'Ivoire, Democratic Republic of Congo, Gabon, Ghana, Nigeria, and Zambia.

¹ VIX is the Chicago Board Options Exchange Market Volatility Index.

management (including debt restructuring). On some occasions, this involved increasing public spending and in others, replacing public debt falling due.

- *Infrastructure spending.* Three countries issued bonds with the stated intention to use the money raised for building public infrastructure. In 2007, Ghana issued bonds to fund several projects, mainly in energy and transport. Senegal issued sovereign bonds in 2009 and 2011 to help finance energy and road projects. In 2012, Zambia issued sovereign bonds also to fund several projects in the energy and transport sectors (Box 2).
- *Benchmarking.* Nigeria and South Africa have issued international sovereign bonds to provide a benchmark for (other) government and corporate bond markets. Accordingly, international sovereign bond issues complemented domestic bond instruments in providing information for assessing the yield spread at which their foreign currency debt is traded, and served as a reference for international corporate bond issues. In Nigeria, Eurobond trading in the secondary market has been used as a

Table 1. Sub-Saharan Africa: Sovereign Bond Issues

	Date	Year	Yield at issue	Tenor	Spread (in bps.)	Size (\$ mn.)	S&P (rating at issue)	Currency	Governing laws	Bond type ¹	Coupon type ²
Seychelles	9/27/2006	2006	9.466	5	470	200	B	USD	England	Bullet	Funged
Ghana	9/27/2007	2007	8.500	10	387	750	B+	USD	England	Bullet	Fixed
Gabon	12/6/2007	2007	8.250	10	426	1,000	BB-	USD	United States	Bullet	Fixed
Republic of Congo ³	12/7/2007	2007	8.770	22	458	480	Not rated	USD	Luxembourg	Sink called	Step-up
Senegal	12/15/2009	2009	9.473	5	691	200	B+	USD	England	Bullet	Fixed
Seychelles ³	1/14/2010	2010	5.000	16	393	168	Not rated	USD	England	Sinkable	Step-up
Côte d'Ivoire ³	3/15/2010	2010	17.354	22	372	2,330	Not rated	USD	France	Sinkable	Flat trading
Nigeria	1/21/2011	2011	7.126	10	583	500	B+	USD	England	Bullet	Fixed
Senegal	5/6/2011	2011	9.125	10	336	500	B+	USD	Luxembourg	Bullet	Fixed
Namibia	10/27/2011	2011	5.835	10	384	500	Not rated	USD	England	Bullet	Fixed
Zambia	9/13/2012	2012	5.625	10	600	750	B+	USD	England	Bullet	Fixed
Tanzania	2/27/2013	2013	6.746	7	499	400	Not rated	USD	England	Sinkable	Floating
Rwanda	4/16/2013	2013	6.375	11	1,500	BB-	USD	USD	England	Bullet	Fixed
Gabon	12/4/2014	2013	6.375	11	1,500	BB-	USD	USD	England	Sinkable	Fixed

Sources: Dealogic; and Bloomberg.

¹ Bullet = entire face value of bond is paid at maturity; Sink called = issuer exercises the right to buy back outstanding bonds from investors at a pre-agreed rate using funds set aside for this purpose; Sinkable = bond backed by a fund, which sets aside money on a regular basis to ensure investors are paid principal and interest.

² Fixed = fixed percentage of face value paid in interest; Flat trading = a bond that is trading without the accrued interest, since it is usually part of the bond purchase price. Bonds that are in default trade flat; Floating = variable percentage, often calculated as fixed spread above London Interbank Offered Rate; Funged = a bond that has been funged into another bond and taken on that bond's characteristics; Step-up = bond with increasing coupon rates in later years.

³ Issued in the context of debt exchange/restructuring.

⁴ Seychelles and Côte d'Ivoire issued small amounts of bonds in 2007 and 2012, respectively, which are not presented.

Box 2. Zambia: Accessing International Sovereign Bond Markets

Zambia undertook extensive preparatory work including conducting road shows, hiring legal advisors and book runners, and acquiring ratings by several rating agencies well in advance of planned issuance. The proceeds from the bond were earmarked for particular investment projects and the repayment of a short-term external loan. Zambia's 10-year bond issuance with bullet structure was oversubscribed more than 15 times and led Zambia to increase the initially planned amount of US\$500 million to US\$750 million, with the excess funding allocated to additional investment projects. At about the same time, Angola, despite having a better credit rating than Zambia,

	Zambia
Sovereign rating	B +
Issue date	13-Sep-12
Issue type	Euro-dollar
Rank	Unsecured
Structure	Bullet
Prospectus/roadshow	Yes
Maturity at issuance	10 years
Currency	USD
Amount	750 m
Coupon	5.375
Yield at first trading	5.173

Source: Bloomberg.

neither had a road show nor a public offering of bonds organized, but opted for a bank loan, which, as opposed to a bullet structure, has the flexibility of allowing for some amortization over the loan period.

This box was prepared by Sebastian Weber.

benchmark (Box 3). This benchmark contributed to the development of Nigeria's subnational and corporate bonds, with some successful examples of recent international corporate issuances.⁵

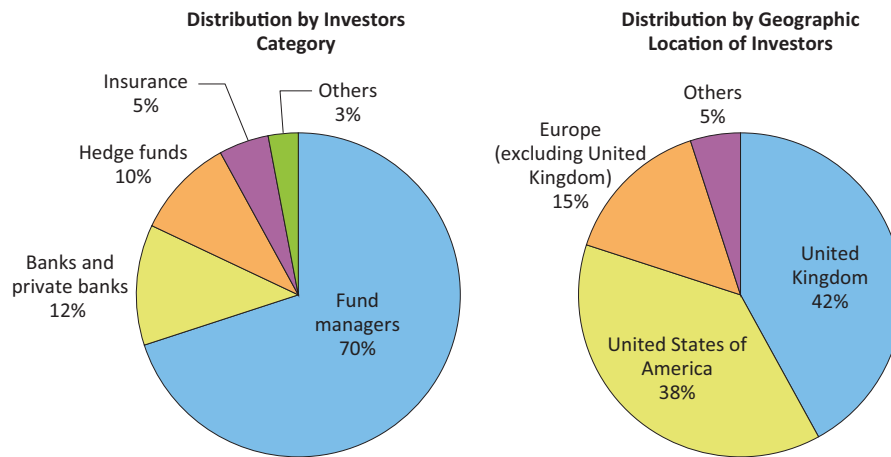
- *Debt restructuring.* Four countries issued international bonds in the context of debt restructuring. Seychelles issued its first bond in 2006, clearing arrears to multilateral and commercial creditors. In 2007, Gabon's

⁵ Including the US\$500 million five-year Eurobond offered by Guaranty Trust Bank of Nigeria in May 2011.

Box 3. Nigeria: Issuing a Sovereign Bond

On January 28, 2011, Nigeria issued a 10-year, U.S. dollar-denominated bullet Eurobond of \$500 million. The issuance had three strategic objectives: (1) ensuring Nigeria’s presence in the international market, (2) helping to attract foreign direct investment by increasing information disclosure, and (3) providing a benchmark for sovereign, subnational, and corporate issuances. In accordance with its B and BB– ratings (respectively by Standard & Poor’s and Fitch’s), the coupon was set at 6.75 percent a year. The bond has been listed on the London Stock Exchange since January 31, 2011.

Nigeria: Investor’s Distribution, 2011



Source: Debt Management Office, Nigeria.

Way ahead of issuance, Nigerian authorities ensured that necessary reforms and technical steps were implemented. Following multiyear strategic plans between 2006 and 2012, the authorities strengthened the debt management framework, in particular the capacity of the Debt Management Office (DMO), equipping the DMO with a front-middle-back office configuration in line with international best practices. To support the institutional infrastructure of the issuance, a legal framework was set up between 2008 and 2010. This framework reinforces the National Assembly oversight responsibility on the DMO’s activities and results; steps were also taken to ensure the National Assembly’s early approval of the issuance. This was followed by the appointment, on a bidding basis, of legal advisers, financial advisers, and joint lead managers.

Effective road shows facilitated the building of a strong network of potential investors. Two teams were set up: one headed by the minister of finance and the other by the minister/vice chairman of the National Planning Commission. The teams embarked on road shows in Europe and the United States to woo potential investors and tell them about Nigeria’s economic prospects and the government’s economic policy agenda.

Box 3. (concluded)

Investors' response was strong. Fund managers and banks across the United Kingdom and the United States subscribed to the bond; it was oversubscribed by some 160 percent. The 70 subscribers were from 18 countries. Fund managers and banks subscribed 82 percent of total issuance; 80 percent of investors were located in the United Kingdom and the United States.

Nigeria's bond is performing well (see figure). Although the proceeds from the bond represented a relatively minor source of capital financing, the Eurobond's trading in the secondary market has created a benchmark for future borrowing by the sovereign, subnationals, and firms. Accordingly, Nigeria's subnational bonds market has grown rapidly, becoming the largest in Africa with US\$2.8 billion in outstanding domestic debt at end-2012 compared with US\$1.6 billion in South Africa. Some recent successful Nigerian corporate international issues include the US\$500 million five-year Eurobond offer by Guaranty Trust Bank, Nigeria, in May 2011.

This box was prepared by Cheikh Anta Gueye.

Eurobond proceeds were used to buy back at a discount of 15 percent the country's outstanding debt to Paris Club creditors. In the Republic of Congo (2007) and Côte d'Ivoire (2010) (Box 4), debt restructurings took place in the context of the HIPC Initiative. Côte d'Ivoire (2010) and Seychelles (2010) issued international bonds in exchange for defaulted bonds they had issued before, as part of commercial debt restructuring (Figure 2). Most of these issuances were preceded by Paris Club agreements to seek comparable debt relief from private creditors.

The main effect of bond issuances to date has been on the composition of public debt, rather than levels. Except in Nigeria, all countries' primary fiscal balances slightly deteriorated (Figures 3 and 4). For the non-restructuring cases, the immediate impacts on the size of total debt are modest, although Ghana, Namibia, and Senegal saw their debt ratios rising after their bond issuances (Figure 3). For the debt-restructuring cases, debt ratios declined significantly with the new international sovereign bonds replacing debt in default or restructured.

Yet currency risks may have increased and require careful monitoring. Most sub-Saharan African countries find it difficult to issue debt instruments denominated in their own currency in international capital markets. As a result, except for the debt restructuring cases, "dollarization" of public debt increased following the sovereign bond issues, in turn affecting vulnerabilities. The share of public debt denominated in foreign currencies increased by 5 to 10 percentage points after bond issuance in most

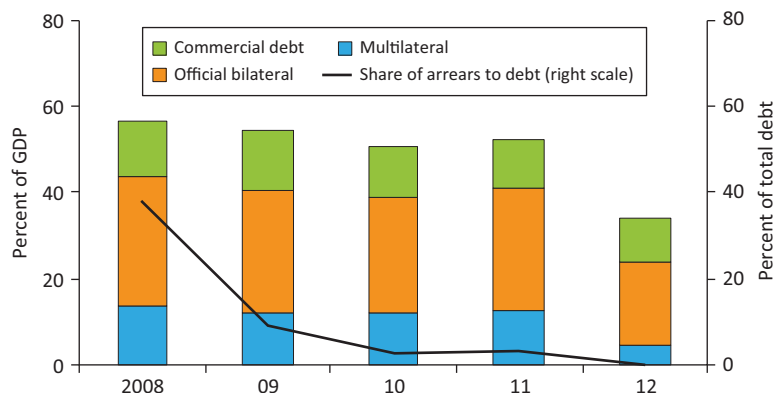
Box 4. Côte d’Ivoire: Bond Issuance for Debt Restructuring

Côte d’Ivoire’s debt restructuring was implemented under the framework of the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. The country reached the decision point for the enhanced HIPC initiative in March 2009, following adoption of the Poverty Reduction Strategy and satisfactory performance under its IMF-supported program.¹ An agreement with Paris Club creditors followed in May 2009, leading to the immediate cancellation of US\$0.85 billion and rescheduling of US\$3.8 billion in debt. Regarding commercial debt, the government and the coordination committee of Brady bondholders reached a preliminary agreement in September 2009 on restructuring debt outstanding (including arrears) of about US\$2.8 billion.²

The debt exchange operation for the Brady bonds was successfully completed in April 2010. The government offered to exchange the Brady bonds for new U.S. dollar–denominated bonds, with a discount of 20 percent, a term of 23 years, and a six-year grace period, initially bearing a low fixed interest rate of 2.5 percent a year and stepping up thereafter to 5.75 percent a year beginning at end-2012. The offer was accepted by virtually all creditors, accounting for 99.98 percent of total Brady bonds outstanding, and the government issued a US\$2.3 billion principal amount of Eurobonds (due in 2032). Cruces and Trebesch (2011) estimate the implied haircut at 55.2 percent.

Côte d’Ivoire resumed its efforts at debt restructuring after the crisis. Following post-election turmoil in 2010, Côte d’Ivoire accumulated arrears to Paris Club creditors (and the 2009 agreement lapsed) as well as to Eurobond holders in 2010–11. In November 2011, further debt relief (including on arrears) was agreed at the Paris Club,³ and Eurobond holders consented to a repayment plan proposed by the government for the missed interest payments.⁴ The approved proposal also provided for the issuance

Côte d’Ivoire: Public External Debt (Percent of GDP)



Sources: Ivoirien authorities; African Development Bank; World Bank; and IMF staff estimates.

Box 4. (concluded)

of additional bonds up to \$186.76 million in exchange for the remaining arrears to other commercial creditors (after a partial cancellation in line with their share of HIPC completion point relief). These settlements are the result of the authorities' discussions with creditors conducted in a manner consistent with IMF policy on lending into arrears, in particular regarding information disclosure, intercreditor equity, and dialogue (IMF, 2012). The bonds are currently trading at a yield of about 6.8 percent at end-March 2013.

Côte d'Ivoire's debt profile has improved significantly through the debt restructurings, including the bond issuance. External public debt outstanding has declined, particularly after reaching the enhanced HIPC Initiative completion point at end-June 2012, from 56.8 percent of GDP (US\$13.3 billion) at end-2008 to 34.3 percent of GDP (US\$8.4 billion) at end-2012. The bond exchange operation led to a reduction in commercial external debt outstanding, from 13.2 percent of GDP (US\$3.1 billion) at end-2008 to 10.7 percent of GDP (US\$2.6 billion) at end-2012. External arrears were completely eliminated, including those to commercial creditors. This positive evolution in debt sustainability created space for some non-concessional borrowing for infrastructure and energy sector development under the current IMF-supported program.

This box was prepared by Masafumi Yabara.

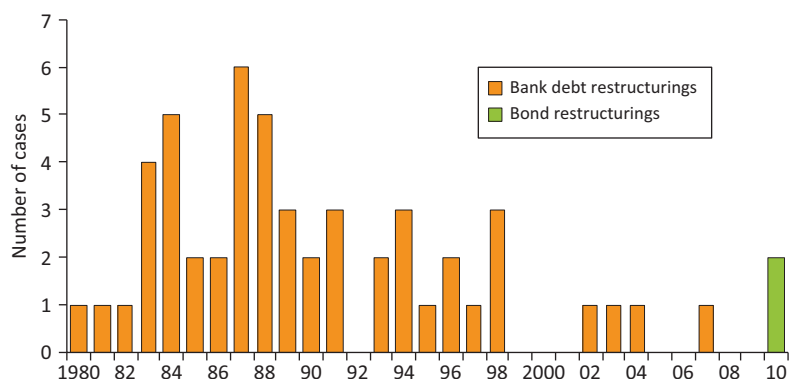
¹ Côte d'Ivoire reached the HIPC completion point in June 2012.

² The Brady bonds were issued in 1998 to restructure the country's external commercial debt, which had been in default since 2000, following a coup in 1999.

³ The agreement led to the immediate cancellation of \$0.4 billion and rescheduling of \$1.4 billion in debt.

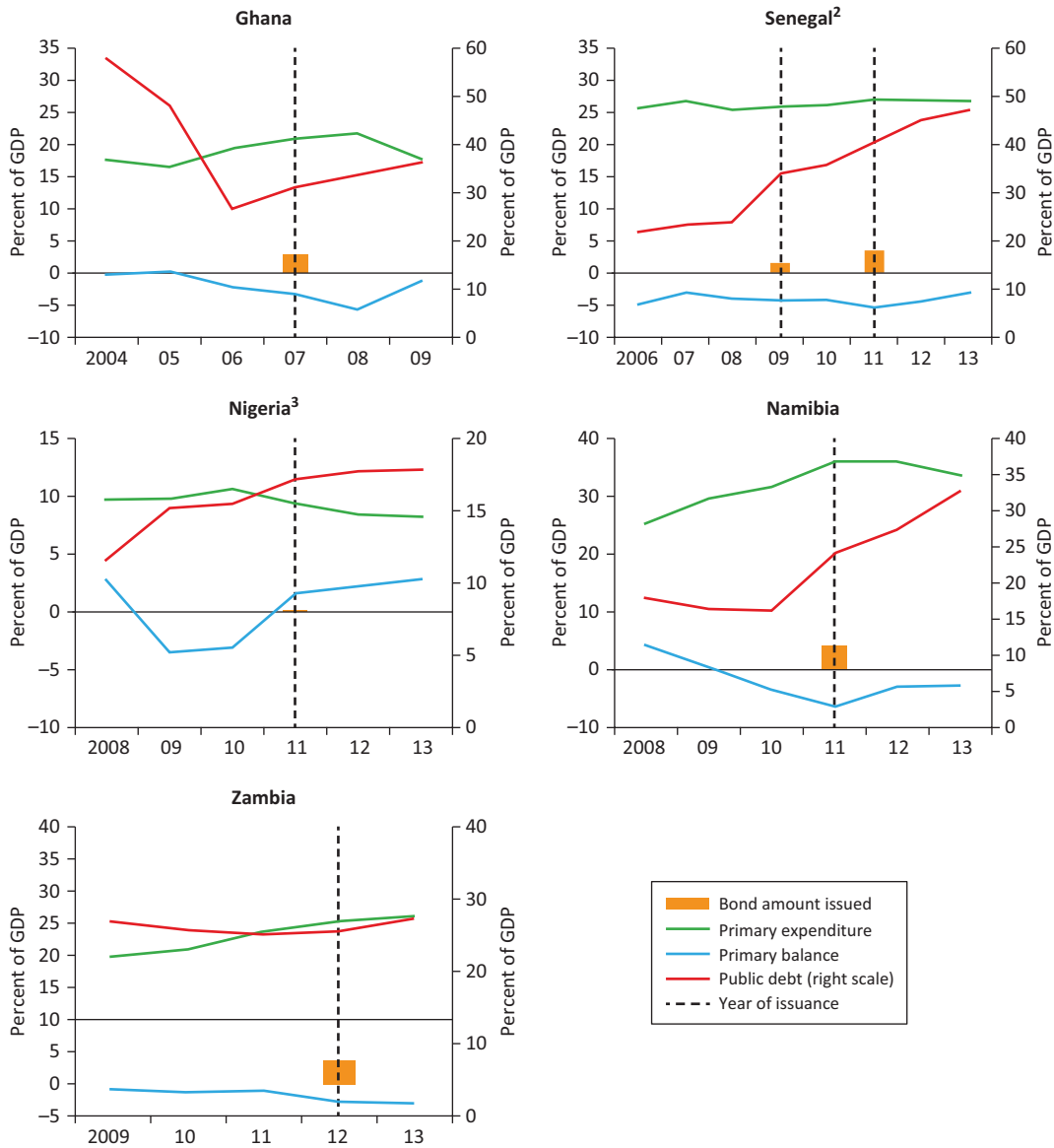
⁴ The plan is to repay the missed three coupons of December 2010, June 2011, and December 2011 over the period beginning December 2012 and ending December 2014.

Figure 2. Sub-Saharan Africa: Sovereign Debt Restructurings with Private Creditors, 1980–2010



Source: Cruces and Trebesch (2011).

Figure 3. Sub-Saharan Africa: Primary Fiscal Balance, Expenditure, and Public Debt-Cases other than Debt Restructuring¹



Sources: IMF, African Department Database; and IMF staff estimates and projections.

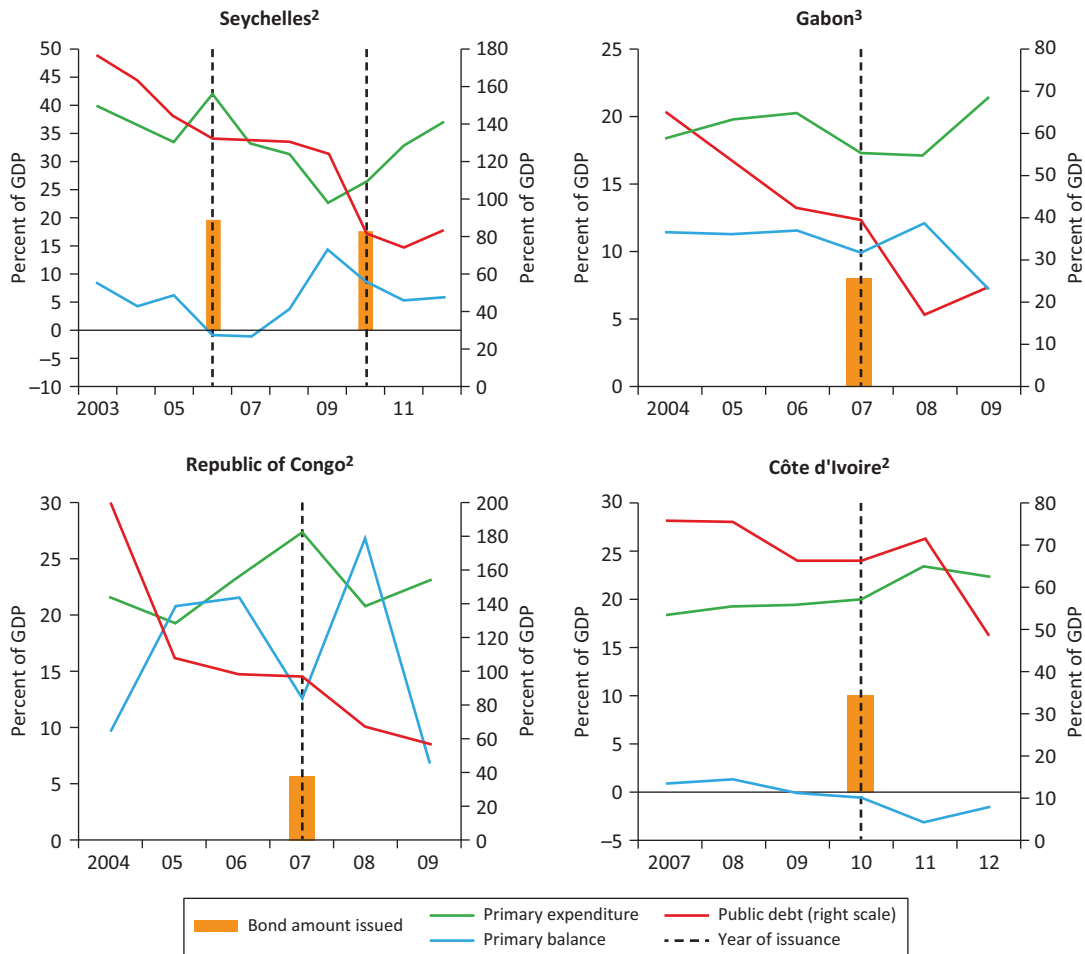
¹ South Africa is not included.

² Part of the proceeds from the bond issued in 2011 was used to exchange and repurchase the bond issued in 2009.

³ Nigeria's bond amount issued in 2011 is 0.2 percent of GDP.

cases, except in cases of debt restructuring and in Nigeria (Figure 5). In restructuring cases, sovereign bond issues to a large extent have replaced other types of foreign currency–denominated public debt, reducing the share in all but one case. In the past, vulnerabilities stemming from dollarization

Figure 4. Sub-Saharan Africa: Primary Fiscal Balance, Expenditure, and Public Debt-Cases Involving Debt Restructuring¹



Sources: IMF, African Department Database; and IMF staff estimates and projections.

¹ Seychelles and Côte d'Ivoire issued small amounts of bonds in 2007 and 2012, respectively, which are not presented in the figure. South Africa is not included.

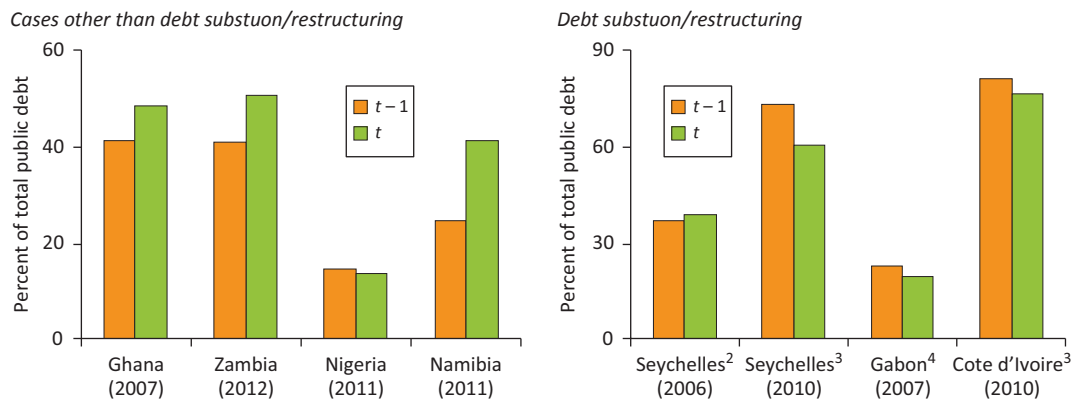
² In the case of Seychelles in 2006, the proceeds were used to clear external arrears to some multilateral and commercial creditors and to repay a collateralized loan. In the other cases, bonds were issued as exchange offers on their defaulted debts.

³ The proceeds were used to repay outstanding debt to the Paris Club.

of public debt may have contributed to the subsequent debt default and restructuring a few years after.

Countries that issued international sovereign bonds for infrastructure building did not experience a sizable increase in public investment (Figure 6). This could reflect a number of factors, such as business cycle considerations (for example, lower revenue from subdued domestic activity could lead to delays

Figure 5. Sub-Saharan Africa: Share of Public Debt Denominated in Foreign Currency¹



Source: IMF, African Department Database.

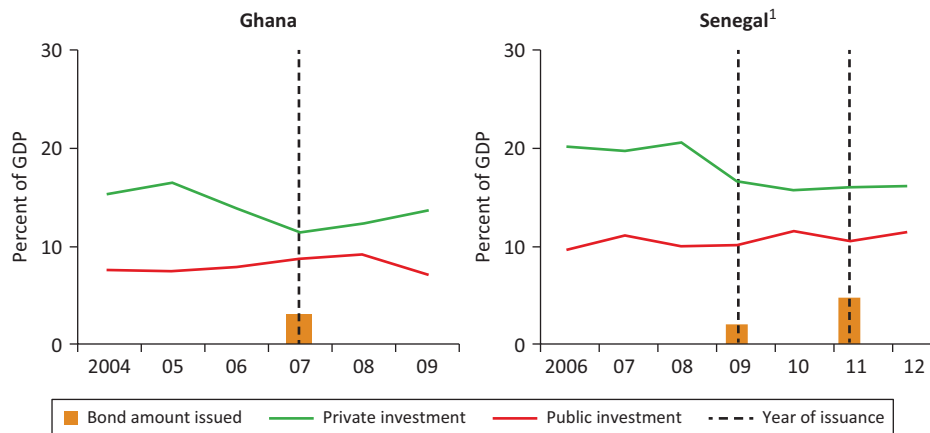
¹ *t* denotes the end of a year during which a country issued sovereign bonds. Data are not available for the Republic of Congo and Senegal. Seychelles and Côte d'Ivoire issued small amounts of bonds in 2007 and 2012, respectively, which are not presented in this figure. South Africa is not included.

² The proceeds were used to clear external arrears to some multilateral and commercial creditors and to repay a collateralized loan.

³ Bonds were issued as exchange offers on their defaulted debts.

⁴ The proceeds were used to repay outstanding debt to the Paris Club.

Figure 6. Sub-Saharan Africa: Public Investment after Bond Issuance

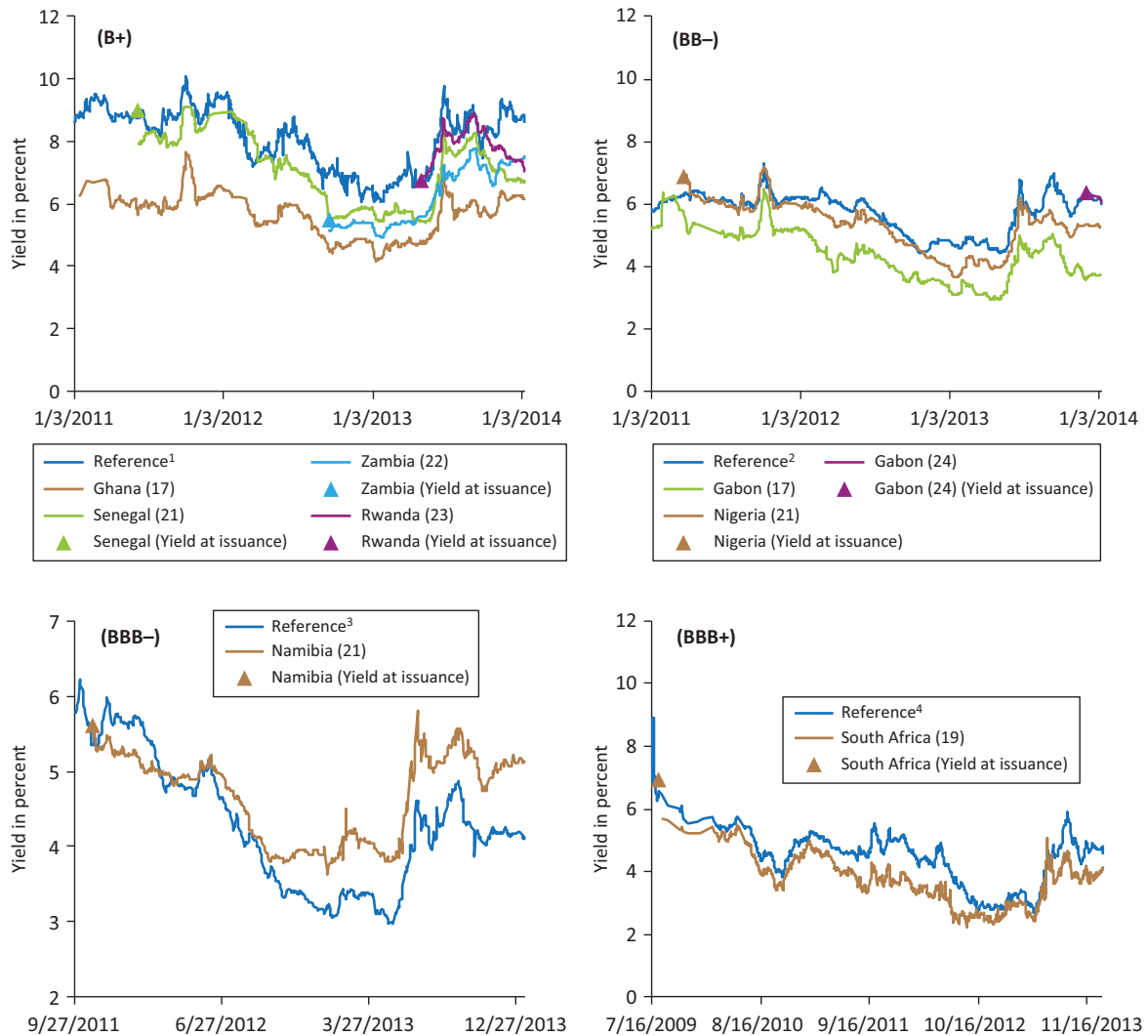


in implementing projects) or capacity constraints. That said, it suggests the impact of possible time lags between bond issuance and putting the proceeds into actual use. This also highlights the issue of fungibility of funds as the proceeds of additional debt may be used for other budgetary purposes.^{6,7}

⁶ In Ghana, the proceeds (US\$750 million) from the 2007 Eurobond were spent largely in 2008. Nevertheless, the recorded increase in public investment falls short of the amount, implying the possibility that the bond proceeds may have been allocated for other budgetary purposes.

⁷ Senegal saw some delays in the implementation of its energy and highway investment plans, to be partly financed by its Eurobond issued in 2011. Zambia's debut Eurobond in 2012 is earmarked for its priority energy

Figure 7. Sub-Saharan Africa: Sovereign Bond Issuance Terms



Sources: Bloomberg; and IMF staff calculations.

¹ Reference is the average of Egypt, Venezuela, and Vietnam.

² Reference is the average of El Salvador, Georgia, and Sri Lanka.

³ Reference is the average of Bahrain, Lithuania, and Russia.

⁴ Reference is the average of Croatia, Colombia, Indonesia, and Turkey.

With some exceptions, issuance terms have been in line with countries' credit ratings. For Namibia, Nigeria, and Senegal, the yields at issuance seem to have been too high: secondary market trading settled at significantly lower yields after issuance (Figure 7), suggesting some possible initial mispricing. However,

and road projects. Given the size and complexity of the projects, it may take time before disbursement of the bond proceeds are in full swing.

the debut premiums may have been higher given uncertainty in the market. Declining yields may have also reflected additional interest from global investors in secondary market transactions.

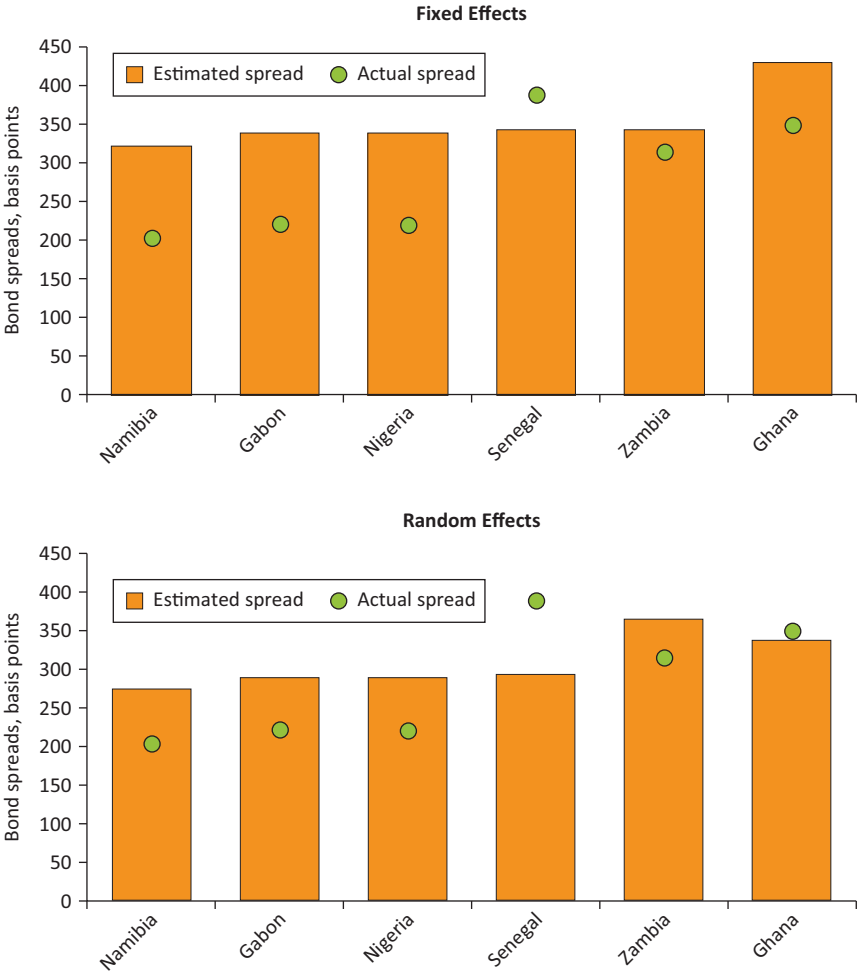
Sub-Saharan African international sovereign bonds until recently used to be priced relatively favorably. They were typically trading below a benchmark yield, computed as the average yield for sovereign bonds with the same rating, maturity, and currency denomination (Figure 7). This suggests that these bonds did not have to pay a sub-Saharan Africa-specific premium; on the contrary, these bonds were trading at a discount. To some extent, this reflected the relatively favorable prospects for these credits and these economies, compared with emerging economies in other regions. In addition, the limited correlation with advanced economies had increased incentives for diversification by global financial investors, promoting demand for these instruments, and—in the context of limited supply—had contributed to the relatively lower yields for sub-Saharan African bonds.^{8,9}

However, the sub-Saharan bonds markets are facing challenges. The recent start of normalization of monetary policy in advanced countries and the repricing of emerging market risks had already affected the pricing of sovereign bonds issued by a range of sub-Saharan African countries (see Figure 7), with a correspondent increase in yields. Thus, while further sub-Saharan African bond issuance is expected to take place in the near future, the terms of issuance of new bonds may be affected.

⁸ This benchmarking method is, however, limited by the small sample of reference debt instruments.

⁹ A model-based approach also confirms the finding that most sub-Saharan African international sovereign bonds have been currently trading below benchmarks. The model estimates the relationship between secondary markets' sovereign spreads and “push” and “pull” factors (Gueye and Sy, 2010). The results are confirmed for all the fixed-effect and random-effect methods (Figure 8).

Figure 8. Sub-Saharan Africa: Market Performance for Selected Countries



Sources: Gueye and Sy (2010); and Bloomberg.

Sub-Saharan Africa's Candidates for Debut Sovereign Bonds

The combination of favorable global conditions and sub-Saharan African regional considerations may foster a further wave of first-time issuers in sub-Saharan Africa.¹⁰

Additional sub-Saharan African countries could issue international sovereign bonds in the next one to two years. These may include Angola, Cameroon, Kenya, and Rwanda as first-time issuers, and Ghana, Namibia, Nigeria, Senegal, South Africa, and Zambia as repeated issuers. These countries have the following characteristics:

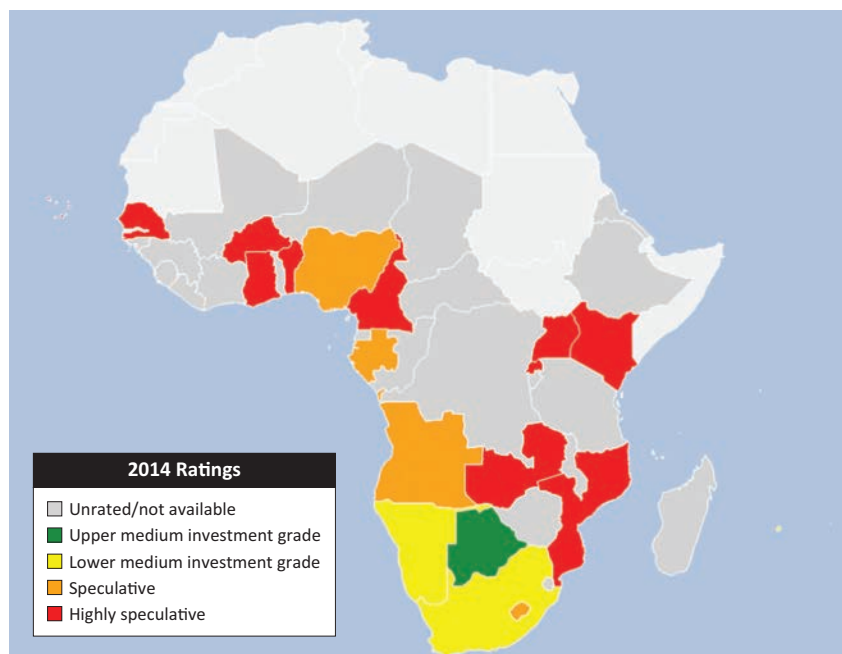
- They belong to the group of about 20 sub-Saharan African countries with a credit rating, a condition favoring issuance (Figure 9 and Table 2).
- They have moderate public debt levels, but they are large enough to include more than one standard-sized sovereign bond of US\$500 million. They have room to substitute other contractual forms of debt (Figure 10). They have been developing institutional capacity in the area of public debt management, including a dedicated debt management office.

In addition, some of these countries have in the next five years amortization coming due in excess of US\$500 million, indicating the possibility of diversifying their investor base without compromising debt sustainability (Table 3).

The success of prospective further issuances will depend on the impact of monetary policy normalization and related international financial conditions on investors' appetite for African frontier markets. Terms of

¹⁰These positive developments help offset in part a history of external sovereign debt default and restructuring in many sub-Saharan African countries (see Das, Papaioannou, and Trebesch, 2012, for a list of all debt restructuring).

Figure 9. Sub-Saharan Africa: Sovereign Bond Ratings, 2012



Source: Bloomberg.

Table 2. Sub-Saharan Africa: Sovereign Credit Ratings, January 2014

Country	Moody's	Fitch	S&P
South Africa	Baa1	BBB	BBB
Botswana	A2		A-
Mauritius	Baa1		
Namibia	Baa3	BBB-	
Angola	Ba3	BB-	BB-
Gabon (17)		BB-	BB-
Gabon (24)		BB-	BB-
Nigeria	Ba3	BB-	BB-
Lesotho		BB-	
Senegal	B1		B+
Kenya	B1	B+	B+

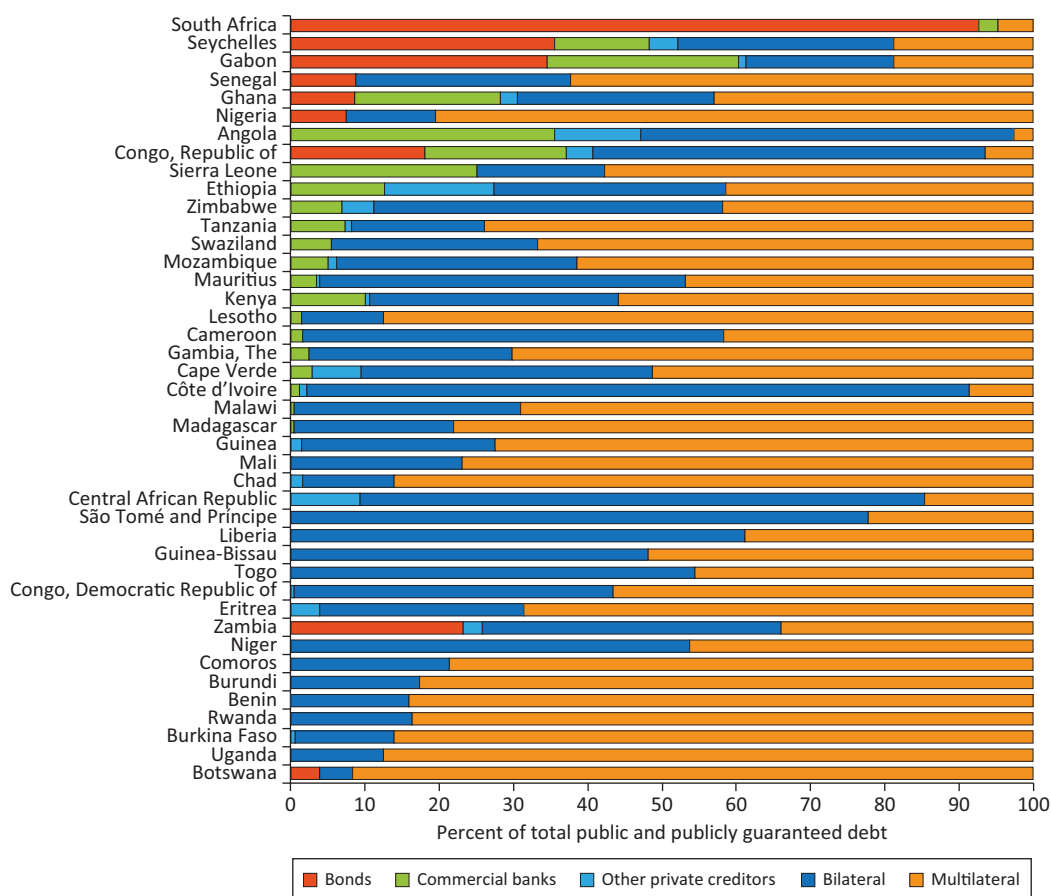
(Continued)

Table 2. (Continued)

Country	Moody's	Fitch	S&P
Cape Verde		B+	B+
Zambia	B1	B+	B+
Ghana	B1	B+	B
Mozambique		B	B+
Uganda		B	B+
Cameroon		B	B
Rwanda		B	B
Seychelles		B	
Burkina Faso			B
Benin			B

Source: Bloomberg.

Figure 10. Sub-Saharan Africa: Total Public External Debt by Creditor, 2012



Source: World Bank.

Table 3. Sub-Saharan Africa: Maximum Amortization in 2013–2017 Exceeding US\$500 Million

Country	Maximum External Amortization Projected in 2013–17 (US\$ millions)
Potential issuers	
Angola	7,603
Ghana	1,310
Kenya	1,132
South Africa	4,148
Others	
Côte d'Ivoire	617
Ethiopia	714

Source: IMF, *World Economic Outlook*.

Note: Figures include amortization of debt owed by state-owned.

issuance are likely to reflect tightening international financial conditions. In addition, vulnerabilities to external shocks may have increased owing to the weakening buffers to mitigate the impact of the global financial crisis, as well as deteriorating economic conditions for some frontier market countries such as Ghana. The size of investors' appetite for African financial instruments depends also on overall liquidity conditions and the search for yields, which may limit the amounts available to sub-Saharan African countries.

Opportunities and Risks of Issuing under Easy Global Financial Conditions

Issuing international sovereign bonds creates both opportunities and risks. These are, in principle, separate from those arising from changes in the level and composition of public debt, which reflect fiscal policy decisions and public debt management responses to the external environment. Countries may issue international sovereign bonds when public debt levels and ratios are falling, remaining unchanged, or increasing. They may issue foreign currency–denominated sovereign bonds at the same time that authorities manage to reduce the currency risk in their overall debt portfolio. For example, countries may issue foreign currency–denominated sovereign bonds in smaller amounts than public foreign currency–denominated external debt maturing in that year. This could result in a lower public debt level and lower foreign currency risk.

The main opportunities that issuing international sovereign bonds could bring are as follows:

- International sovereign bond issuance can provide a benchmark for pricing corporate bonds in international markets, over time expanding the yield curve, and help increase access for the private sector and parastatal companies.¹¹
- Accessing international markets through a sovereign bond can strengthen macroeconomic discipline and move forward transparency and structural reforms as a result of increased scrutiny by international market participants. For instance, Nigeria's fiscal and monetary discipline to date has continued to strengthen following its increased presence in international markets in recent years.
- Issuing sovereign bonds could provide access to long-term funding to help finance infrastructure, helping supplement low domestic saving rates in some countries. Ghana, Senegal, Tanzania, and Zambia are examples of countries that tapped international capital markets with the stated objective of financing capital projects. However, the normalization of monetary policy in advanced countries and the ongoing repricing of risks in emerging markets is affecting the cost of issuing sovereign bonds.
- In some cases, sovereign bond issuance can help lower debt servicing costs by substituting outstanding public external debt instruments (also denominated in foreign currency) contracted at higher interest rates with sovereign bonds with lower coupon rates, longer maturities, and no amortization for a significant time. For instance, Senegal issued a 10-year US\$500 million Eurobond in the first half of 2011, replacing a 5-year US\$200 million bond issued in 2009; this allowed it to achieve a significant maturity extension.

Advantages of sovereign bonds financing could be outweighed by a number of potential risks, especially in the context of changing international financial conditions. These risks include possible excessive fiscal expansion and public debt management problems that may impair macroeconomic stability.

- Given limited administrative capacity, weak fiscal institutions, low efficiency of public investment expenditure, and governance issues prevailing in some of the sub-Saharan African countries, there is a risk that increased

¹¹ Following Zambia's 2012 sovereign bond issuance, the state-owned Zambian railway operator, the Zambian Road Development Agency, and the municipal government of Lusaka are reported to intend raising additional funds via bond issuances. See also Box 3 on Nigeria's international bond issuance experience.

public spending or investment projects financed by bond issuance may be poorly selected or executed and therefore would not render value for money. Increased public investment spending may also be accompanied by a rise in recurrent primary spending, which may be hard to reverse.

- In terms of public debt management, it is possible that countries lengthen the maturity of public external debt and increase the share of public debt denominated in foreign currency. Although issuing sovereign bonds at still relatively low interest rates for longer maturities is generally advisable and could reduce rollover risks, countries need to factor in risks arising from changes in macrofinancial environments over time. Bonds, in particular those with a bullet repayment structure, may have to be repaid at a time of higher interest rates, or when the currency may be weaker. Tapping international bond markets may also in some cases lead to reduced access to concessional financing. A strong public debt management office would help mitigate the risks associated with public external debt.
- Although sovereign bond issues could help increase private sector and parastatal entities' access to international capital markets, sometimes corporate governance structures and debt monitoring capacity may not be in place to contain macroeconomic and structural vulnerabilities arising from increased private sector and parastatal external debt and currency risk exposure. Both the Asian crisis and the financial turmoil in Europe are reminders of the drawbacks of excessive private foreign debt.
- Similar to other forms of capital flows, international bond financing has potential repercussions for the conduct of monetary and exchange rate policy. A shift to larger foreign financing potentially implies appreciation pressure for the domestic currency (depending on the import content of the associated spending). This may harm export competitiveness and if addressed via the issuance of sterilization bills, may cause an interest burden to the monetary authority or the treasury.

The final choice needs to weigh advantages and disadvantages of alternative forms of financing in a country-specific context. Capacity and financing constraints are a decisive factor in determining how a country can use different financing options to reduce existing gaps, including in infrastructure. From the standpoint of costs and risks, concessional financing remains the best option. However, as sub-Saharan African countries are finding it increasingly harder to obtain concessional financing, they have to diversify their financing sources. In principle, in addition to the issuance of international bonds, there is a menu of financing options, including domestic bonds, syndicated loans, and public-private partnerships. In practice, large projects will often be financed by a combination of available resources. Some

countries in the region—for example, Senegal—have used and combined these options for infrastructure projects.

Scaling up investment and the best financing venue should be seen as a joint decision. Policymakers will need to consider carefully the implementation capacity and the speed with which the economy can absorb the desired “scaling up” of infrastructure expenditure. Once a sustainable path has been determined, policymakers need to assess the strengths and weaknesses of various financing options (Table 4). They will therefore have to weigh carefully the issuance of bonds against alternative forms of more tailored

Table 4. Comparison of Financing Sources

Financing Source	Advantage	Disadvantage
Bonds	Usually fixed coupon rate/Easy enforcement of accountability of governments in financing/Establish yield curve for corporate issuers	Rollover risk and potential carry-cost (due to bullet structure)
Local currency bonds	No foreign currency risk/Improve intermediation of savings/ Facilitate monetary policy implementation	Potential crowding out of private sector/Higher interest compared to international bond
International bonds	Diversification of lender base/ Access to competitive markets enhances the efficient pricing of bonds; market discipline from bond covenants, investors' due diligence, and market scrutiny	Foreign currency risk/High transaction costs owing to capital market access (underwriting and credit-rating agencies)/Long preparation period
PPP (if linked to investment)	Potential for cost savings through bundling the financing, design, construction, operation, and maintenance of infrastructure/ Contingent liabilities may be transferred to private sector	High financing costs reflecting the shift of project risks to private sector equity sponsors/Requires solid legal framework and project skills/Lower transparency and accountability
Loans	Low rollover risk and carry-cost (due to flexible amortization)/Crowd-in private sector investment	Variable rate (usually priced over London Interbank Offered Rate)/Limited competition on financing terms
Syndicated loans	Access to multiple lenders	
Collateralized loans	Lower interest compared to ordinary loans	Risk of mortgaging future export proceeds Inconsistency with negative pledge clauses of multilateral lenders
Donor financing	Low debt servicing cost/Transparency of financial arrangements for public scrutiny	Limited contribution to financial sector development/Scarce resources, long gestation period

Source: 2010 October REO, with staff's update.

financing, involving lower carry-costs in case bond proceeds cannot be allocated immediately to a specific high-return use.

Operational Considerations for Issuing an International Sovereign Bond

Important technical and operational considerations need to be considered for successful issuance of an international sovereign bond. Given these prerequisites, it will take time—at least one year—to issue a first-time bond, if all advisable best practice processes are followed.¹² The following steps can help build favorable terms and avoid excessive issuance costs. The issuer should (1) select legal and financial advisers and lead managers with an established presence in the targeted markets and investors' bases, (2) ensure that the process of receiving a sovereign rating is completed as a basis to help guide financial markets in pricing the bond, and (3) conduct road shows in key markets as part of a broad campaign to build a wide investor base and a robust demand book.

The financial characteristics of the sovereign bond instruments could also contribute to mitigating the potential risks involved.

- *Size.* Size of a bond should be carefully considered based on its impact on the issuer's debt profile. Accordingly, a prospective borrower needs to assess the impact of the new debt on debt sustainability and conduct a cost-benefit analysis of the corresponding investment program. It should avoid exceeding funding needs to minimize carry-costs, while being large enough to avoid an illiquidity premium.
- *Currency risk.* Currency mismatches between the structure of government revenue and its overall public debt obligations should be mitigated to the extent possible. Debut issuers have generally denominated their bonds in the major reserve currencies, including the U.S. dollar, euro, or yen. Although currency swap instruments¹³ may be used, U.S. dollar instruments have dominated because they offer the deepest and most liquid markets. The possibility of issuing bonds in domestic currencies

¹² For an in-depth description of operational issues, see Das, Papaioannou, and Polan (2008a, 2008b, and 2011) and Pedras (2012).

¹³ Currently, the International Finance Corporation (IFC) offers long-term currency swaps in the following markets: the Ghanaian cedi, the Zambian kwacha, the Ugandan shilling, the Tanzanian shilling, and the South African rand. IFC provides local currency debt financing in three ways: (1) loans from the IFC denominated in local currency, (2) risk management swaps that allow clients to hedge existing or new foreign currency-denominated liabilities back into local currency, and (3) structured finance that enables clients to borrow in local currency from other sources.

to tap international savings may be explored in some cases, and, in the longer term, a gradual program for local currency sovereign bond issuance could be planned.

- *Debt profile and structure of repayment.* The bond maturity is an important consideration because, all other things remaining equal, a longer maturity would lower rollover risks. Debut issuers may in some cases prefer short maturities, allowing time to showcase a strong performance lowering spreads. Meanwhile, a short maturity may increase rollover risks. The type of bond (bullet, sinking, amortizing bond) is also critical in minimizing rollover risk. The bullet structure is the most common (and most commonly traded), but may create bumps in the debt service profile.¹⁴ An amortizing bond would instead smooth the debt-service profile in countries with low public debt, perhaps at the price of higher servicing costs. A sequence of bullet bonds may achieve the same result in countries with higher public debt levels and more consolidated market presence. A bullet repayment combined with a sinking fund whereby the issuing country sets up a fund that is gradually built to reduce the rollover risk at maturity provides a midway approach.
- *Legal terms and information disclosure.* The prospective issuer needs to prepare well ahead. It should set up the legal framework and institutional capacity needed to support, monitor, and service international bonds. It should carefully consider, with the help of legal and financial advisors, the terms of the new bonds, most importantly the law that will govern these instruments and the market in which they are to be issued. The issuer may choose to issue a global bond and/or exotic bond, and select the modalities of the issuance (public offering versus private placement). In this context, the issuer should keep in mind that different types of bonds imply different costs and requirements regarding information disclosure and transparency to potential investors.¹⁵

Sound public debt management strategy and asset management capabilities are crucial for the success of a bond issuance. From a debt management perspective, the advisability of an international bond issuance should be assessed

¹⁴To mitigate the risks inherent in a bullet repayment, Gabonese authorities set up an account (at the World Bank) where they intended to deposit annually 10 percent of the principal for the repayment of their 10-year Eurobond. In addition, at times when the bonds were valued at substantial market discount, they used part of these funds to purchase back some of the outstanding bonds.

¹⁵The recent contrasting approaches of Zambia (issuing at favorable terms after following a best practice process of disclosure and investors' base preparation) and Angola (taking a commercial bank loan that was on-sold to the secondary market, trading immediately at a significantly lower yield than the coupon rate paid by Angola) is illustrative. Some analysts have also suggested that the features of Tanzania's recent issuance (absence of a rating, amortizing structure, and private placement) may have resulted in higher borrowing costs.

within the country's medium-term debt strategy framework. This would entail an evaluation of the implications for the country's debt structure, management, and sustainability. In particular, the size and terms of a bond issue should be consistent with the country's medium-term fiscal policy objectives. Also, developing in-house human capacity (including investor-relations programs) may help reduce funding costs and monitor price signals from secondary market transactions. An in-house capacity may be useful over time to assess proper levels of interest rates, in addition to the advice of investment advisers assisting with the issuance. Asset management capacity may become particularly useful when the amount borrowed exceeds the immediate financial needs.

In practice, outstanding sub-Saharan African sovereign bonds have many elements in common. Except for South Africa, all sub-Saharan African countries have denominated their sovereign bonds in U.S. dollars. Most of the bonds are traded in the London Stock Exchange, and most of them can be sold to U.S. investors without registering at the Securities and Exchange Commission because they have been issued under 144A Rules and U.S. Regulation S. Sizes and maturities have varied. The largest issues (excluding South Africa) have been associated, not surprisingly, with debt restructuring operations. Most sovereign bonds have exceeded the minimum threshold of US\$500 million, which is typically required for inclusions in global bond indices. Maturities have typically been about 10 years. The main exceptions have been the sovereign bonds issued by Senegal and Seychelles, which had lower maturities and amounts less than US\$500 million. This partly reflects the absorptive capacity of these economies, and conditions prevailing at the time at which the bonds were issued. For example, Senegal issued in 2009 under tight international market conditions.

Capacity Building

Countries considering issuing international sovereign bonds should review capacity needs and secure appropriate technical assistance and training.¹⁶ Fiscal policy and public debt management implications of issuing international sovereign bonds are covered as part of regular IMF surveillance consultations, but more hands-on guidance may be needed through technical assistance and training. There are a range of providers of relevant technical assistance, including the IMF, World Bank, other international financial institutions, and possibly bilateral donors.

¹⁶ In countries with an IMF arrangement, a closer look at the implications of a sovereign debt issue on the program objectives may be warranted. Countries with IMF-supported programs are subject to debt limits, which typically limit the scope for non-concessional borrowing. Under these circumstances, a sovereign bond issuance could potentially lead to a violation of the corresponding benchmarks of a performance criterion in some programs.

Specific capacity-building needs could include the following areas: (1) building macroeconomic frameworks reflecting the dimensions of the new bond issues—for instance, reserve adequacy exercises to help prevent debt-servicing problems and help identify carry-costs; (2) implementing improved prudential frameworks to monitor all relevant risks (such as foreign exchange risks, currency mismatch, and liquidity and interest rates risks), which may increase the capacity of the banking system to intermedate the inflows effectively; and (3) formulating and implementing a medium-term debt strategy—consistent with preserving debt sustainability—and strengthening debt management and monitoring capacity. As part of a medium-term debt framework, strengthening project evaluation capacity would generally also be necessary.

Conclusion

This paper showed that a range of macroeconomic, structural, and debt-management considerations need to be met for a successful issuance of sovereign bonds in international markets by sub-Saharan countries. In many cases, there will also be a need for substantial capacity-building efforts. It is advisable that sovereign issuances be carefully planned and prepared, and used as only one of a range of possible financing instruments. In particular, issuance of sovereign bonds should be one of several pillars of broadening government financing instruments, which should also include efforts to develop domestic debt markets and broaden options for infrastructure finance.

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