EAST AFRICA

Regional Debt Profile

2018

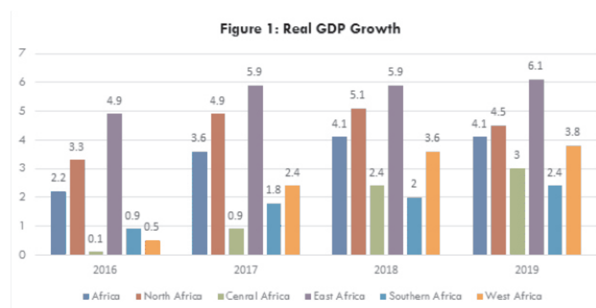
1. INTRODUCTION

The United Nations Economic Commission for Africa (UNECA) classifies the East African sub-region to comprise of the following 14 countries: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Ethiopia, Eritrea, Kenya, Madagascar, Rwanda, Seychelles, Somalia, South Sudan, Tanzania and Uganda. The East African region is also home to one of the fastest growing regional economic blocs in the world, that is, the East African Community (EAC). The EAC is an intergovernmental organisation composed of six countries, namely: Burundi, Kenya, Rwanda, South Sudan, Tanzania and Uganda. EAC is an organisation mandated to front the East African economic, social and political integration. As one of the fastest growing regional economic blocs in the world, the EAC is widening its economic, political and social integration.

2. ECONOMIC OVERVIEW OF EAST AFRICA

According to the African Economic Outlook (2018), East Africa continues to be the fastest economic growing region in Africa in 2017 with an estimated growth rate of 5.9% in 2018 and a projected lead growth in 2019 of 6.1%. Growth in East Africa growth in economies such as Ethiopia, Kenya and Tanzania which continue to experience strong domestic expenditure and high capital investment. Economic growth of the EAC region has been faster than in the rest of Sub-Saharan Africa since 2005 and almost doubled the rates achieved in the previous 15 years (IMF, 2011). Figure 1, shows the region registering high growth rates for 2016 (4.9 %), 2017 (5.9%) and 2018(5.9%).

Figure 1: Africa Real GDP Growth by region 2016– 2019



Compilation based on African Development Bank Statistics

The rapid economic growth is due to strong performance in industry, construction, services, and information and communication sectors. Countries such as South Sudan have continued to record low growth rates but large support from donors has helped secure progress in peace and state building. Despite the high economic growth in the region, public debt still remains one of the main economic policy challenges facing governments and could plunge the region into economic crisis.

3. REGIONAL DEBT TRENDS

A public debt refers to credit owed to both external and internal parties by Governments of independent countries. External debt is money owed to external creditors who are multilateral creditors (International Financial Institutions) or bilateral creditors who are essentially other countries and commercial creditors (World Bank 2015).On the other hand, domestic debt is money owed to holders of Government securities such as treasury bills and treasury bonds. It is one of the

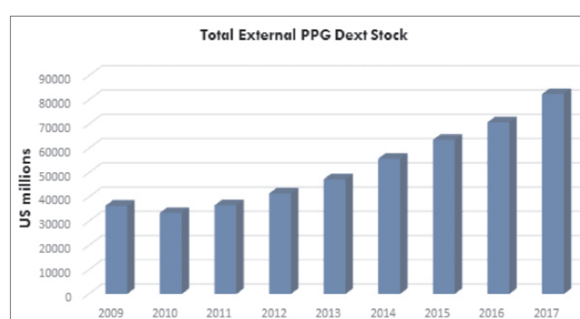
macroeconomic indicators that forms a country's image in the international market and is an inward foreign direct investment flow determinant (Iberia et al, 2012).

The regional total debt stock as presented in Table 1 and Figure 2 below, shows an incremental trend from 2009 to 2017. A slight decline in external debt between 2009 and 2010 was due to the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI).

Public and publicly guaranteed (PPG) external debt was at $33,395 billion in 2010 and increased by approximately 147% to $82,351 billion in 2017. Since 2009 the sub-regional debt stock has been rising steeply mainly driven by Ethiopia, Kenya and Tanzania who have been borrowing heavily from international and domestic markets.

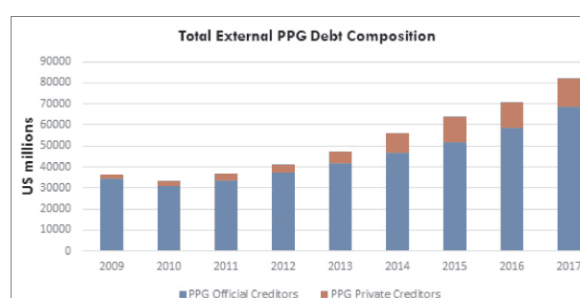
At the end of 2017 the bulk of the sub-regional PPG external debt was owed by Ethiopia which held 31% of the debt while Kenya held 27% and Tanzania with 15%. The least amount of external debt was held by Comoros which constituted about 0.01% of the total debt.

Figure 2: Total External Debt Stock for East Africa (public and publicly guaranteed), 2009-2017 (US$ millions)



Source: Compilation based on World Bank data 2018

Figure 3: Regional Composition of Total External Debt (public and publicly guaranteed) 2009-2017 (US$ millions)



Source: Compilation based on World Bank data 2018

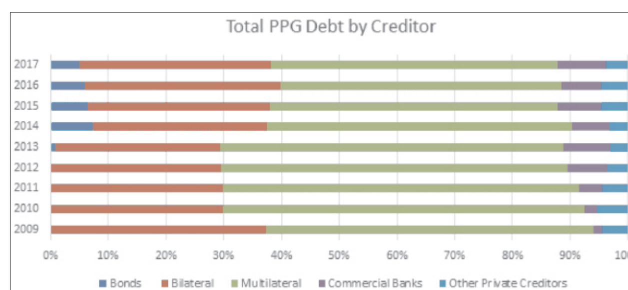
Figure 3 above shows a significant increase in the use of private creditors by East African countries from 2009 and beyond. In 2009 private creditors constituted 6% of total PPG and by 2017 this ratio had increased to 17% signalling the increase in commercial credit and the emergence of bond issuance from 2013 onwards.

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

	2009	2010	2011	2012	2013	2014	2015	2016	2017
Burundi	394	382	363	411	398	404	408	409	425
Comoros	260	251	246	224	117	113	103	131	139
Congo, Dem. Rep	10880	4597	4022	4103	4470	4149	4155	3856	4043
Djibouti	737	622	651	642	673	820	1169	1608	1950
Eritrea	1013	1002	1014	952	896	829	782	748	769
Ethiopia	4819	6547	7945	9941	11886	15846	19467	22533	25721
Kenya	6731	6989	7771	9024	9830	13355	15324	18323	22275
Madagascar	1836	1982	2093	2191	2263	2294	2486	2466	2736
Rwanda	716	759	971	1045	1553	1877	2121	2353	2821
Somalia	1987	1990	1992	1985	1977	1913	1876	1859	1907
Tanzania	4640	5601	6438	7366	9112	9911	10690	10963	12659
Uganda	2247	2673	2963	3478	4064	4213	4873	5450	6906
Totals	**36260**	**33395**	**36469**	**41362**	**47238**	**55723**	**63454**	**70699**	**82351**

Data for Seychelles and South Sudan not available. Source: Compilation based on World Bank data 2018

Figure 4: Share of public and publicly guaranteed external debt, 2009-2017 in percentage



Source: Compilation based on World Bank data 2018

As shown above in Figure 4, multilateral creditors continued to be the largest creditor group, however their share of long-term external debt declined to 50 percent at end 2017, from 57 percent in 2009. The majority of external support received therefore carries conditionalities that the countries have to fulfil. The emergence of bond issuance only surfaced in 2013 with Rwanda and Tanzania being the first East African countries to tap in the international market with Kenya and Ethiopia subsequently issuing their first bonds in 2014.

3.1 Selected member countries' debts

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

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

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

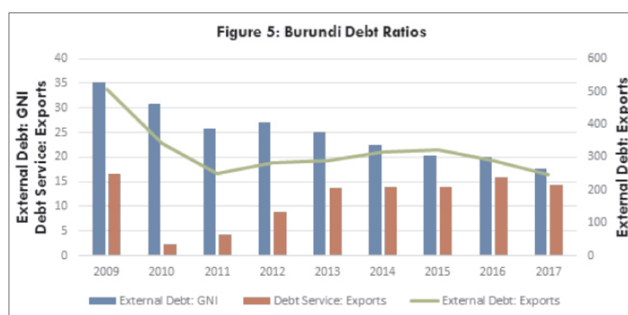
The debt service to exports ratio is used as an indicator of debt sustainability because it indicates how much of a country's export revenue will be used up in servicing its debt and how vulnerable the payment of debt-service obligations is to an unexpected fall in export proceeds. The higher the share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

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

Debt sustainability analysis using the above external debt ratios revealed that Djibouti and Burundi are high risk debt distress countries. Although countries such as Kenya and Tanzania have been experiencing a steep upward trend in their external debt since 2009 this is financing infrastructure development

which addresses bottlenecks and will ultimately boost sustainable economic growth. Most of the East African countries exhibited low and moderate risk debt risk debt scenarios.

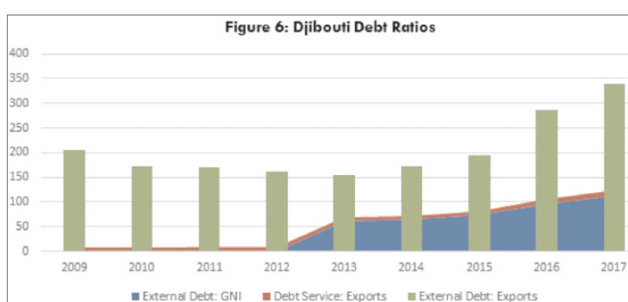
3.1.2 Burundi



Compilation based on World Bank data 2018

Despite benefiting from debt cancellation under the HIPC Initiative and MDRI which immensely reduced its external debt by more than 70% from $1,276 billion in 2007 to 363 million in 2011, Burundi continues to be a high-risk debt distress country. External debt in 2009 representing 502.7% of exports has however been falling gradually over the years to a low of 245.5% in 2017 owing to the numerous debt relief that the country has received. External debt to GNI reduced from 35.2% in 2009 to 17.7% in 2017. Burundi`s high risk of debt distress has mainly been exacerbated by the country`s extremely narrow export base and prospects for graduating from the high-risk of debt distress are hinged on the country`s ability to improve its export performance.

3.1.3 Djibouti



**Data for Debt: GNI not available*
Compilation based on World Bank data 2018

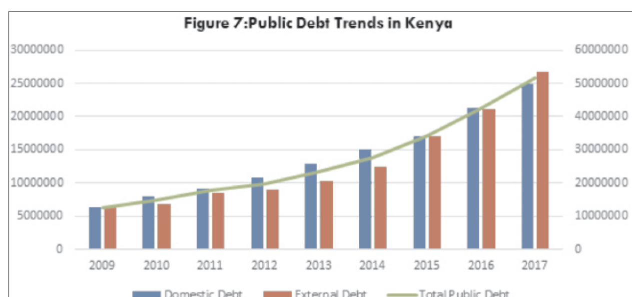
External debt in Djibouti has been on a growth trajectory since 2010 post debt relief from the Paris Club which slightly reduced its PPG external debt from 737million in 2009 to 622million in 2010. Debt service to exports subsequently fell slightly in 2010 to 7.9% from 8.3% in 2009. In 2009 external debt to exports was 205.6% which has gradually been falling over the years to 155.5% in 2013. This was mainly due to the improvements in GDP growth over the years. In 2013 the government contracted two large loans for the total amount of about US$900million which represented 60% of GDP and the external debt to exports has been rising since 2013 and stood at 338.5% in 2017. The loans were provided by the Export-Import Bank of China to finance investments projects of the construction of the Addis Ababa–Djibouti railway and a water pipeline from Ethiopia. The contraction of the non-concessional loans in 2013 resulted in the increase in debt risks and further non-concessional borrowing will exacerbate the already high risk of debt distress.

3.2 Domestic Debt

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

Kenya's domestic debt is relatively of large size compared to other sub-regional countries and has been constituting a large part of total public debt. Similarly to external debt, domestic debt has been rising gradually over the years since 2010 when it was 720.2 billion Kenyan shillings and constituted 54% of total public debt. Figure 7 below proved an overview of the public debt trends in Kenya. Since 2009 up to 2016 domestic debt has been outweighing external debt, save for 2017 where domestic external debt

outweighs domestic, representing 52% of the total public debt against the 48% for domestic (Central Bank of Kenya). Kenya has been borrowing from the domestic market mainly to cover its budgetary deficits.

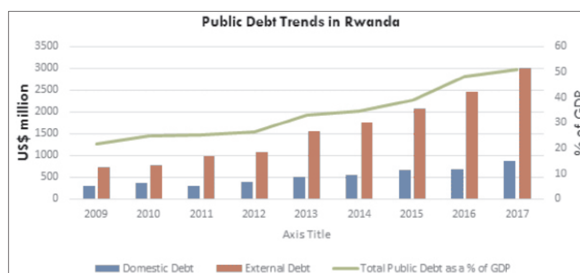


Source: Compiled from Kenya Central Bank data

Uganda introduced treasury bonds in 2004 and since then the stock of domestic debt has been on the rise due to the need to mop up excess liquidity from the banking system to avoid inflationary pressures. Domestic debt stood at 1.262billion Ugandan shillings in 2004 but had risen to 6.178 billion Ugandan shillings by 2010. Between 2012 and 2016 domestic debt increased by 76% to reach a high of 14.401 billion Ugandan shillings in 2016. Domestic debt at 8.170 billion Ugandan shillings in 2012 represented 13.3% of the country`s GDP, and by the end of 2016 the domestic debt to GDP ratio had increase and stood at 17%. Uganda's current debt ratio of 40.6% to GDP ratio is likely to grow and will soon hit the threshold of 50%, hence it become unsustainable. The external borrowing is also becoming less concessional, which erodes fiscal discipline since Uganda is moving away from multilateral debt and embracing China loans, Sh10.8 trillion ($2.9 billion) from China's Exim Bank, to finance the Standard Gauge Railway.

**Rwanda`s** domestic debt has been rising on a slower pace compared to external debt as shown in Figure 5 below. In 2009 domestic debt was $311.2 million which represented 5.9% of the country`s GDP and 29.7% of public debt. By the end of 2017 domestic debt had risen by 178% to $864.5 million, representing more than 20% of GDP threshold. The country`s domestic debt has been increasing due to the Government's cash flow needs, and funding of the Energy, Water and Sanitation Authority (EWSA) projects funded through loan facility with Bank of Kigali.

Figure 5: Decomposition of Debt Stock for Rwanda, 2009-2014



Source: Compiled from the National Bank of Rwanda

3.3 Drivers of Public Debt Accumulation

The key drivers of public debt accumulation in the region are declining official development assistance especially grants, increased budget deficits and the need to finance infrastructure developments.

Traditional sources of credit are shrinking and new options with harder terms are emerging, such as new bilateral lenders. Commercial lenders have increased especially sovereign bonds issuances. The new bilateral lenders are attractive because they provide relatively larger amounts of financing without policy and other related conditionality.

Prior to 2009 issue of sovereign bonds for sub-Saharan African countries had been negligible. This trend was reversed from 2008 when issues started to surge. In 2010 to 2012 issues were moderate with between $1.5 and $2.5 billion being issued annually but by 2013 and 2014 issues grew further, exceeding $5.1 billion and $6.25 billion respectively. These trends have been driven by changes in both issuer (supply) and investor (demand) factors. Investors demand has been affected by factors relating to both international and country specific factors.

A number of EAC countries issued large Eurobonds and these are drastically increasing external debt, which may compromise the gains on debt sustainability. By end of 2014, Ethiopia, Kenya, Rwanda and Tanzania, had issued Eurobonds worthy US$4 billion dollars, as shown in Figure 6 below. None of the East African countries issued international bonds in 2015 and 2016.

Figure 6: East African Countries Cumulative Sovereign Bond Issuance 2013–2014 USD Millions

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

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

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

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

4. REGIONAL OUTLOOK FOR DEBT SUSTAINABILITY

Figure 7: Debt sustainability analysis in East Africa Community countries – Assessing risks of debt distress 2017/18

Low Risk	Moderate Risk	High Risk
Tanzania	Comoros	Burundi
Rwanda	Kenya	Djibouti
Uganda	South Sudan	Ethiopia
	Democratic Republic of Congo	
	Madagascar	

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

According to debt sustainability assessments done jointly by World Bank and IMF for low income countries in 2017/2018- the majority of East African countries were classified as having either low or moderate risk of debt distress as shown in Figure 7 above. The high risk countries in the region are Burundi and Djibouti. South Sudan was the only country classified to be in debt distress. AFRODAD debt sustainability results also yielded similar results to those of the World Bank and IMF.

5. POLICY RECOMMENDATIONS

There is need for governments in the region to strengthen and implement prudent debt management strategies to mitigate the effects of the rising debt on the economy, especially countries classified as moderate risk(Comoros, Kenya and D.R.Congo) and high risk (Burundi and Djibouti)

Africa needs more development financing. But the build-up of debt should be consistent with countries' development needs and capacities to service the loans. Therefore, all stakeholders are not passive actors in these issues but should ensure that debt is deployed in productive investments that yield income streams for self-financing and grow the economy.

For countries such as Tanzania and Kenya with rapidly rising external debt there is need for containment of the fiscal deficit and further medium-term consolidation efforts are also needed to limit and eventually reverse the rise in public debt.

East African countries' governments need to strengthen and enhance transparency and accountability in loan contraction and debt management. Countries associated with problems abound from responsible borrowing and debt management should put structures that promote prudent use of public loans and foster transparency and accountability in the management of public resources.

Given that higher domestic borrowing by Government has crowding-out effects to private sector growth through higher interest rates there is need for countries with higher domestic debt to level up their borrowings. Countries such as Burundi and Djibouti should develop strategies to manage the external debt burden aimed at restoring debt sustainability.

Large portion of the African debt, Eastern Africa region not an exception, is foreign currency dominated debt, hence, the debt dynamics are susceptible to fiscal policy slippages, tighter financing conditions and external exchange rate shocks. On that note, there is a call for prudent fiscal policy to rein in public debt.

There has been a significant rise in domestic debt across African countries and domestic debt now constitutes a large share of total debt. Domestic debt is much more expensive than external debt as it consumes a large percentage of government revenue given that domestic interest rates are higher than foreign ones. This has significant negative implications for private investment, fiscal sustainability, economic growth and poverty reduction. Governments need to formulate and implement prudent domestic debt management strategies to mitigate the effects of the rising debt on the economy.

The international issuance needs to be put into a broader debt management/debt sustainability analysis context. Countries should avoid tapping international markets based on opportunistic views. While short-term cost is an important consideration, it is essential to evaluate the medium-term impacts for the cost-risk trade-offs of the debt composition, as well as to ensure that the financing will not threat the debt sustainability of the country.

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