

# **OVERVIEW OF INVESTMENT IN BONDS AND OTHER SECURITIES IN EMERGING ECONOMIES**

Keynote Address by

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# SCOPE

- I. Nature OF EMEs
  - II. RANGE OF SECURITIES
  - III. TENSION IN INVESTMENT DECISION
  - IV. FOCUS ON THE MAIN SECURITIES
  - V. NIGERIA: WHERE IT STANDS
  - VI. CONCLUSIONS
- References

# I. NATURE of EMEs

## I.1 Definitions

- Nations with social or business activity in the process of rapid growth and industrialisation
- Countries in a transitional stage between developing and developed status
- Regions of the world that are experiencing rapid informationalization under conditions of limited or partial industrialization
- Newly industrialized countries whose economies have not yet reached first world status but have, in a macroeconomic sense, outpaced their developing counterparts

(Source: Wikipedia)

## I.2 Features

- Refers to countries previously referred to as “developing” or less developed who are migrating/transiting towards the “developed” status.
- Relatively recent concept (mid-1980’s) to recognise countries whose economies, as well as, political and social systems and institutions have set them apart from developing countries.
- Common features amongst these countries are:
  - High GDP growth
  - Significant natural resource base including human capital, low cost base and large population.
  - Major reforms and policy initiatives covering many aspects: as political systems, governance, financial systems, fiscal structure/policies, etc.

## I.3 List of Countries

- There is no universally accepted list of countries who fall in the category. The number and names vary depending on who is compiling the information. There are lists from Standard & Poor's, Dow Jones, FTSE, etc.
- Number of countries range from 19 in S&P (Dec; 2010) to 35 in Dow Jones (May, 2010)
- The countries are concentrated in Asia, Latin America and Europe. The names are China, India, Indonesia, Malaysia, Philippines (Asia), Brazil, Colombia, Chile and Peru (Latin America), Turkey, Poland, Hungary, Czech Republic, Russia (Europe).
- In Africa, South Africa, Morocco and Egypt (?) are the countries considered as emerging economies, while Nigeria has been included in the list of “Next 11” compiled by Goldman Sachs.
- BRIC (Brazil, Russia, India and China) represent the top names in this category.
- A popular group used in analyses is BRICS – BRIC plus South Africa

## I.4 Fundamentals of Emerging Market Economies

- Rapid growth: Have in recent years grown faster than the advanced countries.

	2007	2008	2009	2010
World (%)	5	3	-1	4
Advanced	2.5	Less than 1	-3	2
Emerging	8.5	6	3.5	7

- Increase in share of World GDP

	1960-1972 (%)	1973-1985 (%)	1986-2009 (%)	2008-2009 (%)
Advanced	80	74	65	57
Emerging	17	22	30	40

# **I.5 Investment Opportunities**

## **I.5.1 General**

- Large investment opportunities in various sectors such as industry, telecoms, agriculture, oil and gas and solid minerals.
- Opportunities are in the equities and fixed income securities market and Foreign Direct Investment (FDIs). FDIs have been fueled by privatisation and Public Private Partnerships initiative of many of the countries.

## **I.5.2 Investment Opportunities in Bonds**

- Many have fairly strong domestic bond markets
- Many are active issuers of bonds in the International Capital Market (ICM).
- A significant number have Bond Issuance Programmes through which they access the ICM several times each year.

## **II. RANGE OF SECURITIES**

### **II.1 The Main Securities**

- ✓ Domestic Debt Securities
- ✓ International Bonds & Notes
- ✓ External Bank Loans
- ✓ International Equity Issues



# II.2 Special Investment Securities

EMEs also tend to initiate special investment securities

✓ Sovereign Wealth Funds

- China
- Kuwait
- Russia
- Qatar
- Malaysia
- Chile
- Brazil
- Indonesia
- (Nigeria: being introduced)

✓ Global Sukuk (non-interest bonds)

- Indonesia
- Malaysia

✓ Infrastructure Bonds

- Malaysia
- South Africa
- China
- Indonesia
- Philippines
- Thailand

✓ Diaspora Bonds

- India

### **III. TENSION IN INVESTMENT DECISION**

#### **III.1 Why EME Bonds (and other Securities) Issued are Attractive**

- Returns are historically higher than bonds issued by the advanced economies for reasons of risk.
- The margin between the returns on bonds of emerging economies and those of the advanced countries have widened due to monetary policy actions of the United States and Eurozone to stimulate growth.
- The very low yields on fixed income securities in the advanced economies have made investors to look for yields elsewhere. There are funds in the ICM dedicated to investments in securities of emerging economies (Emerging Markets Fund).
- The weakening of the financial conditions of countries in Europe hitherto considered (Greece, Ireland, Iceland, Portugal and Spain) have shifted focus to Emerging Economies. Investors now consider diversification to be important.
- The Emerging Economies showed more resilience during the recent economic recession, most grew while the G7 countries shrank.
- The Emerging Economies now have stronger fiscal balance and debt ratios.

### III.2 ICM Bond Market Statistics: Comparative Yields on Sovereign Bonds

Average Yields on Sovereign Bonds (%) (10-year)

	2007	2008	2009	2010
Emerging Economies	5.6%	7.41%	7.55%	6.49%
Advanced Economies	3.33%	2.6%	1.99%	1.70%

*Source: Barclays Capital, Advanced Economies defined as G7 Economies*

## III.3 Risks of Investments in EME Securities

- Political Systems and Structure: Democratic systems are quite fragile in many EMEs
- Governance Challenges – issues of transparency and accountability tend to be prominent
- High level of dependence on primary commodities exports; increasing industrialization but not adequately so in many of the countries
- Legal, regulatory and institutional reforms ongoing but not yet reached comfortable/sustainable stages

## IV FOCUS ON THE MAIN SECURITIES

### IV.1 DOMESTIC BONDS

#### IV.1.1 Emergence of Local Bond Markets

- ✓ growing prominence of local bond issuance relative to borrowing from external sources in various forms
- ✓ Consequently: rapid development of domestic bond markets
- ✓ would appear to be a (natural) next stage following the emphasis on syndicated loans in the 1980s and international bonds in the 1990s( Daniel L.,2005)
- ✓ but there are explicit factors as well

## IV.1.2 Influencing Factors

### Supply Side

- ✓ awakening from unsustainable external debt crisis of the 1970s – early 2000s
- ✓ escape from externally-induced vulnerabilities, including those of adverse exchange rate movements
- ✓ attraction to a more predictable and quicker option for funding fiscal deficits

### Demand Side

- ✓ risk diversification by global investors and fund managers : have become an asset class and a source of diversification due to their low apparent correlation with other asset types (developed countries' bonds and equities)
- ✓ after-shock flight to safety and viable alternative after intense financial market crisis in more developed regions.( Re: Asian Financial Crisis, 1997-1998; Global Financial Crisis, 2007-2010)
- ✓ attraction to sustained higher yields

## IV.1.3 Advantages

- helps encourage development of domestic savings and investment behavior
- helps break financial dualism
- resultant improved homogenization of economic process is supportive of efficacy of fiscal and monetary policies; improves transmission of monetary policy
- enhances efficient financial systems, as local debt securities markets help to generate a yield curve that reflects the opportunity cost of a loan for a wide range of maturities(Daniel L., 2005)

## IV.1.4 Foreign Participation In Local EME Bond Markets

### ✓ **Trend**

Committee on Global Financial System (GFS) sources shows that although Foreign investors account for a small share of total holdings of EM public and private domestic bonds, the share has been increasing over the past six years.

### ✓ **Undercurrent**

EMEs could be seriously adversely impacted by the sudden drying up of foreign flows resulting from an increase in risk aversion, sometimes irrespective of the countries' fundamentals (Calvo and Talvi, 2005)

### ✓ **Mitigant**

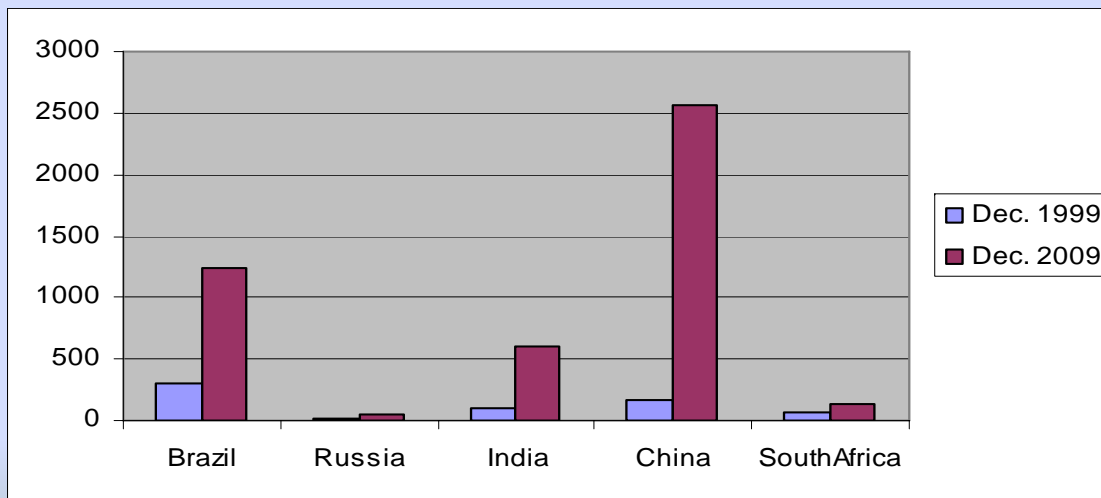
- According to Odonnant and Rahmouni (2006), investors no longer regard EM assets as a homogenous risk exposure in their portfolio choices: there is greater discrimination on a country-by-country basis
- We consider this condition a mitigant



**IV.1.5 BRICS: Domestic Debt Securities by Sector and residence of issuer. Amount Outstanding (In billions of US Dollars)  
(10 – year movement)**

BRICS	Dec. 1999	Dec. 2009	Sept. 2010	10 yr % change(1999-2009)
Brazil	295.89	1237.24	1293.52	318.14
Russia	9.18	48.6	58.17	429.41
India	102.13	603.07	706.79	490.49
China	159.3	2565.42	2969.05	1510.43
SouthAfrica	70.93	140.35	166.91	97.87
<b>Total</b>	<b>637.43</b>	<b>4594.68</b>	<b>5194.44</b>	<b>620.81</b>

Source: BIS Quarterly Review, March 2011

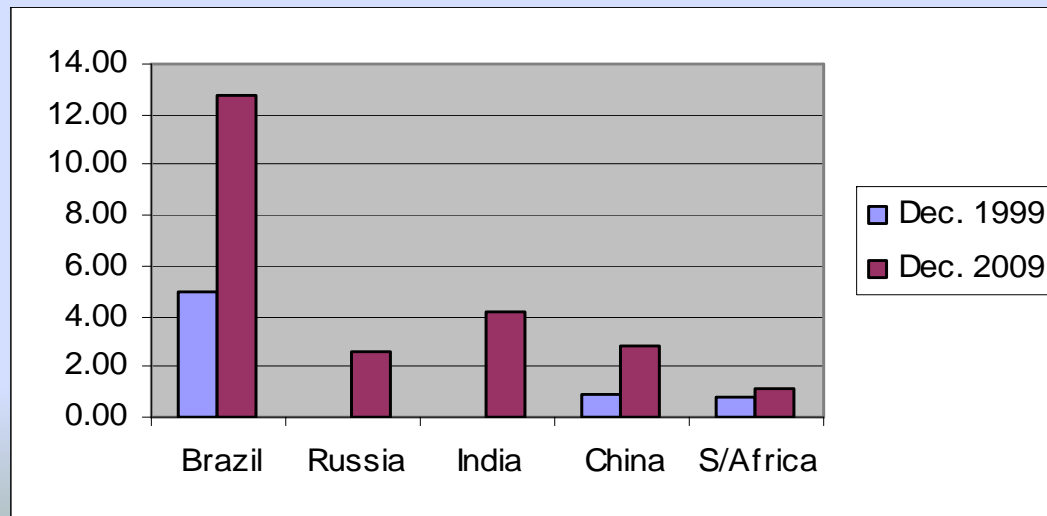


## IV.2

BRICS :International bonds and notes- all issuers By nationality of issuer ( In billions of US Dollars),Amounts Outstanding

BRICS	Dec. 1999	Dec. 2009	Sept. 2010	10 yr % change(1999-2009)
Brazil	4.93	12.81	18.62	159.63
Russia	-	2.60	8.70	-
India	0.03	4.16	1.58	15896.15
China	0.93	2.87	10.31	208.60
S/Africa	0.84	1.16	3.55	38.42
Total	6.73	23.60	42.75	250.83

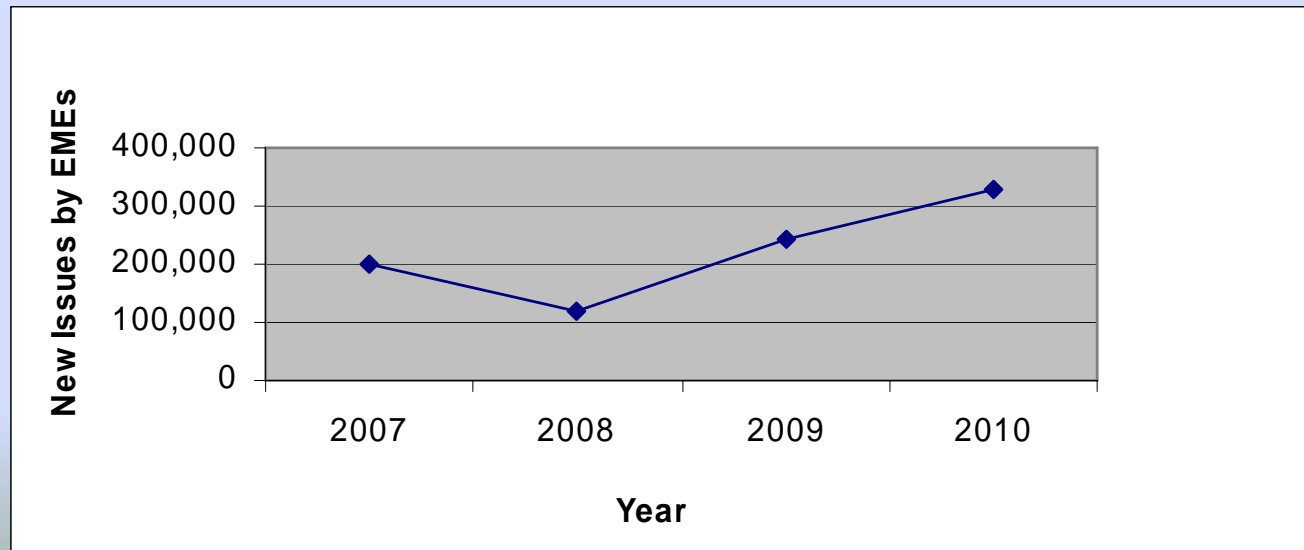
Source: BIS Quarterly Review, March 2011



### IV.3 New Issues from Emerging Economies (US millions)

	2007	2008	2009	2010
<b>Sovereigns</b>	54,608	47,704.81	103,812	105,954
<b>Corporates</b>	44,201	24,560	47,368	83,567
<b>SOEs</b>	47,941	29,224	65,751	91,427
<b>Financial/Insurance Group (FIG)</b>	54,333	16,033	27,364	48,276
<b>Total</b>	201,083	117,521.81	244,295	329,224

*Source: Dealogic, all international issuance, all currencies. SOE's include any state owned corporate or financial institution*

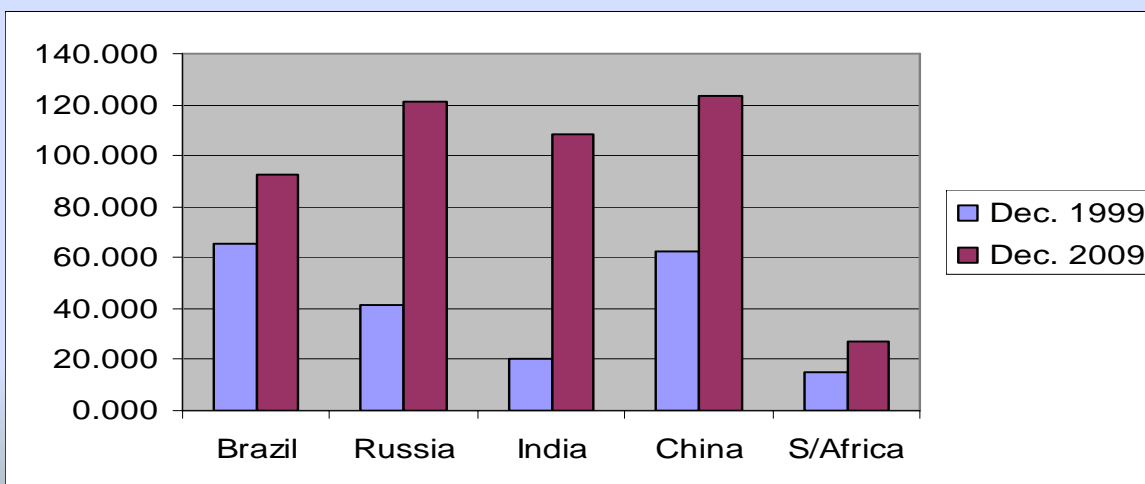


#### IV.4 BRICS :External loans of reporting banks vis-à-vis all sectors in individual Countries

(In Billions of US \$) Amounts outstanding

BRICS	Dec. 1999	Dec. 2009	Sept. 2010	10 yr % change(1999-2009)
Brazil	65.266	92.401	137.386	41.576
Russia	41.146	121.294	119.989	194.789
India	20.429	108.531	140.251	431.259
China	62.144	123.722	213.264	99.089
S/Africa	14.741	27.290	27.190	85.130
Total	203.726	473.238	638.080	132.291

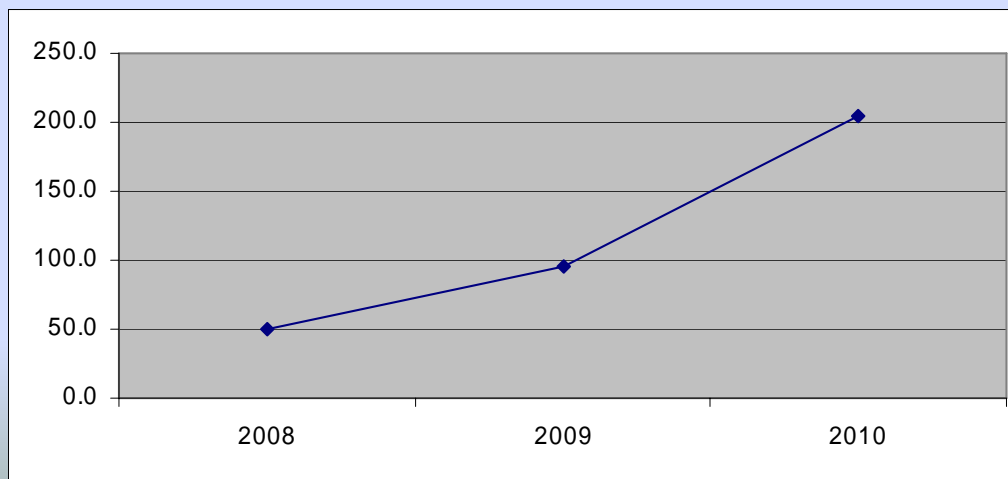
Source: BIS Quarterly Review, March 2011



**IV.5** BRICS: Announced International Equity issues by nationality of issuer  
(In billions of US dollars)

<b>BRICS</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
SouthAfrica	2.6	1.9	3.0
China	16.9	50.6	72.0
India	12.0	17.8	25.8
Russia	3.3	7.2	8.8
Brazil	14.9	17.4	94.3
<b>Total</b>	<b>49.7</b>	<b>94.9</b>	<b>203.9</b>

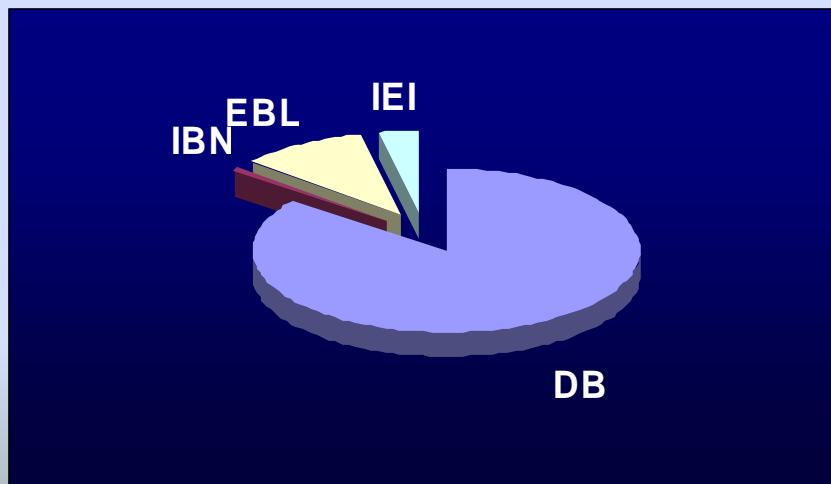
Source: BIS Quarterly Review, March 2011



**IV.6** BRICS: Comparison of Domestic Bonds, International Bonds & Notes, External Bank loans and International Equity (2010) in USD bln

Securities	2010*	% Composition
Domestic Bonds (DB)	5194.44	85.45
International Bonds & Notes (IBN)	42.75	0.70
External Bank loans (EBL)	638.08	10.50
International Equity Issues (IEI)	203.90	3.35
<b>Total</b>	<b>6079.17</b>	<b>100.00</b>

Source: BIS Quarterly Review, March 2011



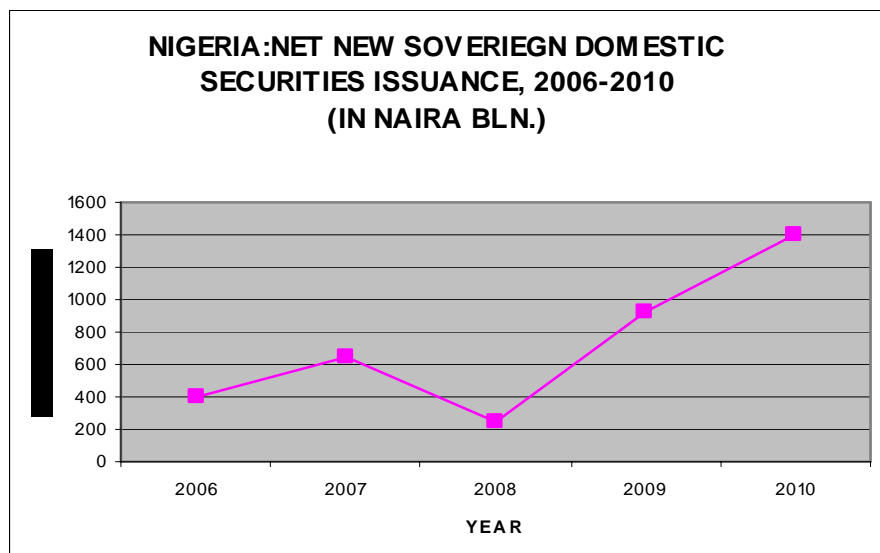
\*As at September, except for IEI which was as at December.

## V. NIGERIA: WHERE IT STANDS

VI. V.1.1 NIGERIA: NET NEW SOVEREIGN DOMESTIC SECURITIES ISSUANCE, 2006 - 2010 ( IN NAIRA BLN.)

YEAR	AMOUNT ALLOTED	AMOUNT REFINANCED	NET ISSUANCE
2006	454.01	55.73	398.28
2007	707.51	67.26	640.25
2008	491.97	238.29	253.68
2009	1,115.05	197.17	917.88
2010	1,724.06	317.77	1,406.29

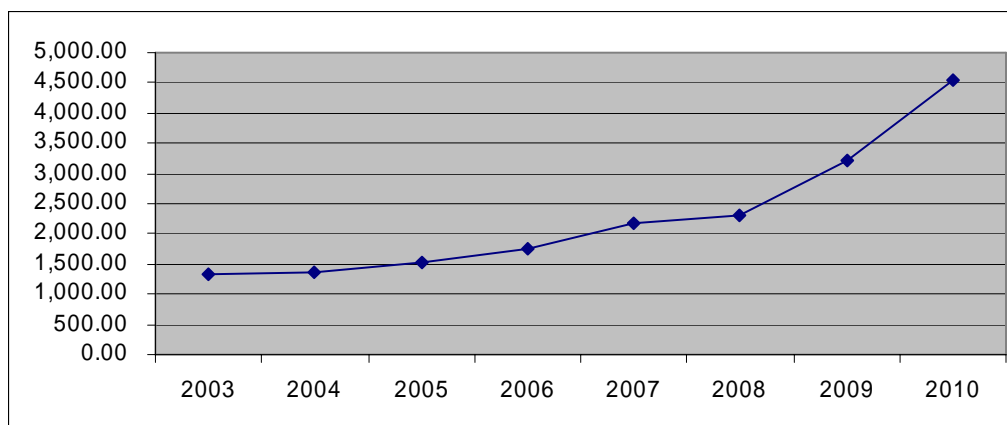
Source: Debt Management Office, Nigeria



### V.1.2 NIGERIA: SOVEREIGN DOMESTIC SECURITIES OUTSTANDING, 2003 - 2010 (IN NAIRA BLN.)

YEAR	DOMESTIC DEBT STOCK
2003	1,329.72
2004	1,370.32
2005	1,525.91
2006	1,753.25
2007	2,169.63
2008	2,320.31
2009	3,228.03
2010	4,551.82

Source: Debt Management Office, Nigeria





V.1.3 NIGERIA: PARTICIPATION BY FOREIGN INVESTORS IN THE FGN BOND PRIMARY MARKET (2007-2010)

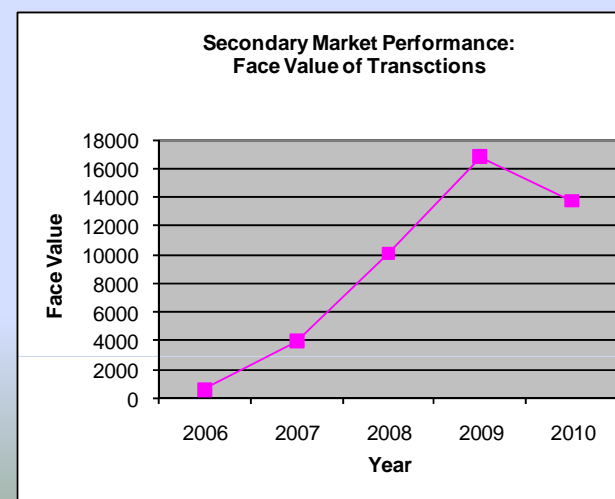
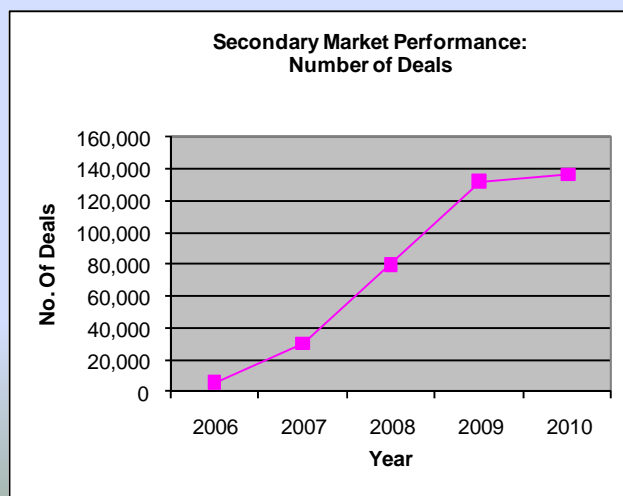
S/N	Year	Total Subscription (=N=Million)	% of Total Subscription	Total Allotment	% of Total Allotment
1	2007	Not Available	Not Available	60,206.14	10.17
2	2008	74,450.00	8.82	26,244.00	5.33
3	2009	120,575.00	10.83	58,378.35	8.04
4	2010	244,944.66	10.83	88,201.97	7.09

Source: Debt Management Office, Nigeria

## V.1.4 Secondary Market Performance: Nigeria Sovereign Domestic Debt Securities

YEAR	NO.OF DEALS	FACE VALUE (In Billions of Naira)
2006	5,482	585.411
2007	30,241	3,947.285
2008	80,135	10,090.236
2009	132,374	16,789.263
2010	136,793	13,755.502

Source: Debt Management Office, Nigeria



## V.2 Nigeria: Corporate Issues In the Local Market

- ✓ For the 9 years (1999-2007) concluded 9 issues worth N33.75 billion (average: N3.75 billion per annum)
- ✓ For the 3-years (2008-2010) concluded 8 issues worth N92.58 billion (average: N30.86 billion per annum)

## V.3 Nigeria's Debut Sovereign Bond in the ICM: Highlights

- **Issuer:** Federal Republic of Nigeria
- **Amount Offered:** USD500million
- **Tenor:** 10 years
- **Type:** 144A/Reg S
- **Security:** Senior Unsecured Debt
- **Rating:** B+ (Standard & Poors) and BB- (Fitch)
- **Total Subscription:** USD1,294.215m
- **Issue Date:** January 28, 2011
- **Maturity Date:** January 28, 2021
- **Coupon (Fixed):** 6.75% p.a.
- **Interest Payment:** Semi-Annually
- **Interest Payment Dates:** July 28 and January 28
- **Listing:** London Stock Exchange
- **Transaction Parties:**
  - **Legal Advisers:** White & Case LLP – London and Banwo & Ighodalo – Nigeria
  - **Financial Advisers:** Barclays Capital – London and FBN Capital – Nigeria
  - **Joint Lead Managers:** Deutsche Bank AG and Citigroup Global Markets Limited

See [www.dmo.gov.ng](http://www.dmo.gov.ng) for more details and the Prospectus

## **V.4 Nigeria's Debut Sovereign Bond in the ICM: Benefits to Nigeria**

- Visibility for Nigeria in the ICM which further supports the attainment of Vision 20: 2020 and FSS 2020.
- To establish a benchmark for future borrowings by the public and private sector.
- To attract foreign direct investors to Nigeria.
- To develop an investor base in the ICM for securities, including equities to be issued out of Nigeria.

## VI. Conclusions

- Emerging Economies have become significant to the world economy and may become even more relevant in future
- Securities issued by emerging economies will continue to offer superior returns due to their higher risk levels. The margins may narrow as some of the countries in this category become stronger and demand for securities from emerging economies increase
- Through the debut USD500m Bond Offer, Nigeria now has a presence in the ICM whose benefits are immense and long term: it has broadened Nigeria's road to joining the EMEs

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