Association des Banques Centrales Africaines

Association of African Central Banks

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ASSOCIATION OF AFRICAN

CENTRAL BANKS (AACB)

31ST ORDINARY MEETING OF

THE ASSEMBLY OF GOVERNORS

DRAFT REPORT OF THE 2006 SYMPOSIUM

ON

" DOMESTIC CAPITAL MARKET AND MOBILIZATION OF RESOURCES FOR GROWTH AND POVERTY REDUCTION "

(Windhoek, Namibia, August 17, 2006)

Tripoli, Libya

August 15, 2007

1. The Association of African Central Banks (AACB) organized a symposium on the theme "*Domestic Capital Market and Mobization of Resources For Growth and Poverty Reduction*" on August 17, 2006 at the Windhoek Country Club and Resort, Namibia. The opening ceremony was marked by the welcoming address by Mr. T. K. Alweendo, Governor of the Bank of Namibia and Vice-Chairperson of the AACB, followed by an opening remark by Dr Paul A. Acquah, Governor of the Bank of Ghana and Chairperson of the Association.

2. In his address, Governor Alweendo, first welcomed all participants and expressed hope that Namibia has met their expectations. He then emphasized the importance of capital market development in Africa, as it serves as alternative source of financing and helps with mobilising savings and employment creation, amongst others.

3. Governor Alweendo indicated that African countries borrow externally at the expense of borrowing from the domestic market. He acknowledged that there are number of African countries with relatively developed capital markets to the extent that they even have benchmarks. For those in which domestic markets are too smaller to have financial deepening, linkage can be established through telecommunications. He also emphasised the importance of sovereign rating, which could lead to development of domestic capital markets. Finally, Governor Alweendo expressed his hope that by the end of the symposium, the participants would have a confidence and better understanding of domestic capital markets in Africa.

4. The Chairman of AACB, Governor Acquah, on behalf of all the participants, thanked Governor Alweendo and the staff of the Bank of Namibia as well as the people of Namibia for their warm hospitality. He pointed out that the symposium is usually one of the major activities of AACB and recalled that the 2006 symposium underlines the need for acceleration of growth and mobilization of finance. After drawing the participants' attention to the financial crises that happened in Mexico, Brazil and Argentina, Governor Acquah indicated that the way forward for Africa is to develop domestic capital markets to the level of that of the developed world. Therefore, he emphasised the need for an effective management of these markets in order to contribute to financial stability.

5. The symposium proceedings were organized into the following three sessions:

   - *Overview of Domestic Capital Market, Mobilization of Resources for Growth and Poverty Reduction;*
   - *Country Experiences with Capital Market Development";*
   - *Capital Market Development and Way Forward".*

<u>1st Session</u>: "Overview of Domestic Capital Market, Mobilization of Resource for Growth and Poverty Reduction".

6. This session was chaired by Mr. Jean-Claude Masangu Mulongo, Governor, Banque Centrale du Congo and a presentation on the theme "Capital Market and Economic Growth" was made by Mr. Jaehoon Yoo, Senior Securities Market Specialist of the World Bank.

7. In his presentation, Mr. Yoo attempted to enumerate what is known on capital markets, economic growth and poverty reduction before reporting on the development of the capital market and reviewing Sub-Saharan capital markets. He also outlined the challenges ahead for the development of financial markets and recent discussions on that issue before focusing on the development of a new capital market as well as the implications on African stock market values

8. Mr. Yoo noted that African countries should maintain macroeconomic stability and avoid "crowding out". In this regard, they must develop a hard and soft market infrastructure i.e. stock exchange, clearance and settlement system, legal accounting, disclosure as well as corporate governance. African countries must also strengthen regulatory capacity and enforce systems, enrich investor base through foreign investment and pension reforms. Mr. Yoo further indicated that the continent must develop a clear and predictable tax system while providing incentives for promoting capital markets. In concluding his presentation, Mr. Yoo underscored the need to ensure a more effective involvement of SMEs in capital markets through lighter regulations and tax incentives for these enterprises.

9. During the general discussions, the Governor of the Bank of Sudan remarked that what was at stake is the efficiency of government in Africa, particularly the problem of bureaucracy. He highlighted that African countries need political stability first as war affects the economy and therefore the functions of the Central Bank. The Governor of the Bank of Botswana remarked that African countries need sound economic management and suggested that sub-Saharan Africa should apply minimum filing disclosure. It emerged from a summary of this plenary session that there is a gap between rules on capital markets and their enforcement in any country and therefore it was crucial that this gap is narrowed. Furthermore, rules and regulations on capital market development should be adapted to country-specific circumstances and be enforceable.

10. In general, the discussions that ensued from the presentation on this issue enabled the Governors to agree on the need for a socio-political and macroeconomic stability as well as a sustainable economic growth to guarantee the development of capital markets.

2nd Session: "Country Experiences with Capital Market Development".

11. The session was chaired by Mr. François KANIMBA, Governor, Banque Nationale du Rwanda. During this session, the experiences of various countries with capital market development were presented.

A- Case of Nigeria

12. The Nigerian experiences have been presented by Mr. Lemo TUNDE, Vice-Governor and Representative of the Governor of the Central Bank of Nigeria. He focused his presentation on the setting up of a regulatory framework, its operating procedures and the development of activities of the Nigerian Stock Exchange established in 1960, and the establishment of the Securities and Trade Commission in charge of registration, regulation, supervision and monitoring of stock market operations.

13. Since 1999, transactions are carried out through an automated system while access to stock market operations was liberalized for foreigners in 1995. These developments were followed by the liberalization of the capital market which in turn contributed to a significant increase in market capitalization over the last few years. Finally, Mr. Tunde mentioned new avenues for developing the Nigerian capital market particularly those linked to the mortgage market, the establishment of a transactions window for raw material and the fight against capital laundering and funding of terrorism.

14. Furthermore, he pointed out that the key challenge confronting capital markets in Africa seems to be the relatively high cost of capital. Thus, it was pointed out in the paper that it was imperative for regulators in African countries to seriously tackle the issue of how to reduce the cost of capital on the continent. There were a number of other challenges that the paper pointed out which entail *inter alia* the following:

    - Realizing the vision of being Africa's leading market regulator and making Nigeria the most preferred market among the emerging markets;
    - Complementing statutory regulation with self-regulation;
    - Ensuring good corporate governance in public companies to inspire investor confidence;
    - Enhancing market discipline through adequate and reliable information disclosure as required in Pillar 3 of the Basle New Capital Accord.

B- Case of South Africa

15. The case of South Africa was presented by Mrs Nicola BRINK, on behalf of the Governor of the South African Reserve Bank (SARB). In her presentation she mentioned that the South African capital market was relatively developed as compared to the majority of emerging countries. According to the rating of the World Stock Market Federation, the Johannesburg Stock Market Exchange established in 1887 is ranked number 16 in the world, based on market capitalization.

16. Before addressing the various development phases of the Johannesburg Stock Market, Mrs. Brink underscored the major role played by Central Banks in general. She identified three main phases in the development of South African capital market during which the SARB played a specific role. The first phase runs from the 70s to the 80s and was an initial phase with a modest informal market during which the SARB saw no clear distinction between monetary policy and budgetary policy.

17. Beginning in 1989 and following several investigations and reports which highlighted the need for a change, the market became more formalised with specific initiatives aimed at improving its effectiveness and liquidity. During this phase, the Government adopted a regular competitive bidding system under the supervision of SARB. Finally, the third phase focused on the formal sophisticated capital market and especially the establishment of the "Bond Market Association" (BMA) with SARB as one of the funding members.

18. Over the past years, the South African capital market has undergone other changes and currently, the SARB's role is less prominent than it was ten years ago. Nevertheless, SARB is still involved in its functions (conducting auctions of Government obligations on behalf of the National Treasury and specific auctions, supervision to ensure that operators adhere to market rules in its capacity as the agent of the National Treasury in close collaboration with the National Treasury on managing debt issues).

19. The presenter concluded that South Africa has smooth-functioning and well-regulated markets which have continued to function efficiently even during times of financial market turmoil. Moreover, the paper further concluded that the South African capital markets are attractive to both domestic and non-resident investors, and will continue to play a central role in the mobilization of resources in the economy and thereby continue to support overall performance of the economy.

C- Case of Kenya

20. Mr. Nicholas B. T. A. Korir, Director of Economics Department of Central Bank of Kenya and Representative of the Governor presented the experience of Kenya. The presentation that outlined Kenya's experience argued that Africa has the least developed capital market *vis-à-vis* other continents. It further argued that Sub-Saharan Africa has the least developed capital markets, with only a few countries such as Kenya, Nigeria, Ghana, Namibia and South Africa having established stock exchanges which nevertheless function poorly for numerous reasons such as high interest rates, high rates of taxation, weak legal and regulatory framework, lack of expertise and poor methods in the stock exchange system coupled with inadequate technological progress.

21. Mr. Korir noted that the monetary system has been in existence since 1896 with the establishment of the first commercial bank. The number of financial institutions increased from 10 in 1950 to the current 45. The capital market began its activities in the early 20s operating informally without regulations until the establishment of the Nairobi Stock Exchange in 1954. Following independence in 1963, the Stock Market activities collapsed due to the uncertainty of independent Kenya before resuming three years later with the restoration of confidence in the market.

22. In the 1970s, the fuel crisis brought about inflationary pressure due to decline in share prices and the introduction of a 35% tax on profits thus creating stock market losses, and following the collapse of the East African Community, neighbouring countries adopted a nationalization policy, value rates and other inter-territorial restrictions which made the Nairobi Stock Exchange lose its regional nature. From the 80s, corporate reforms particularly with a continuous adaptation of a regulatory framework made it possible to progressively strengthen the Stock Exchange activities. In this way, foreigners were able to access stock market trading activities starting from 1995 and since 2002 they can therein hold up to 75% listed shares of a company. In addition, Mr. Korir underscored the important role played by provision of tax incentives and automation of operations in view of expanding the capital market whose market capitalization had improved.

23. The Kenyan capital market has six major categories of market participants, namely: issuers of debt and equity securities, merchant or investment banks which package and market the securities, investors in securities, fund managers who acts as advisors and agents of investors, stock brokers who facilitates trading of a number of securities and regulators who establish and enforce rules and regulations that bind all the other players.

24. A number of challenges facing the development of capital markets in Kenya were outlined including the following:

   - Adherence to comparable and preferable global financial standards. Therefore, the government has to continue to seek the support of development partners in the process of developing and adopting such standards and codes;
   - There is a need to develop measures to strengthen both the primary and secondary markets for government paper and provide meaningful yield curves;
   - Acquisition of modern technological know-how and other benefits of globalization;
   - Establishment of regulatory and policy framework for the operation of microfinance institutions;
   - Liquidity and transparency of the equity market as well as a narrow investor base in the derivative markets.

D- Case of West African Economic and Monetary Union (WAEMU)

25. The experience of the West African Economic and Monetary Union (WAEMU) was presented by Ms Fatimatou Zahra DIOP, Director of Payments System of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO). The presentation highlighted developments of the Regional Financial Market of the WAEMU. It pointed out that the banking crisis in this region which occurred in the 1980s has shed light on the limits of traditional financing of the economy through commercial banks and the common Central Bank. In this regard, in the early 1990s, strategic reflections were implemented towards the emergence of a medium and long-term segment of the capital market that would raise savings and channel its use to meeting investment needs. The mandate of establishing the regional financial market within WAEMU was successfully implemented by the Central Bank of West African States (BCEAO) in 1997. The presenter informed participants that after seven years of operation, the regional financial market within WAEMU has proved its relevance as an instrument for raising savings and financing economic activity offering alternative sources of financing to economic agents in addition to bank credit.

26. Recent initiatives undertaken by the BCEAO have contributed in strengthening the dynamism, transparency and efficiency of the Union's capital market. These were mainly the modernization of payment systems with the introduction of the Real-Time Gross Settlement System (WAEMU-RTGS) and the setting up of a central registry to provide reliable and legal information on WAEMU enterprises.

27. In spite of its relevance, there are key challenges that face the market in its development process which are as follow;

    - Ensuring that the borrowing and financing policies pursued by member countries are market-based to enhance financial market deepening in the region;
    - Combining the current market dynamics with a harmonized and incentive-based tax system for securities and service pricing in order to ensure that the transactions and products offered are competitive;
    - Enhancing the supervision and monitoring of transactions and adapt applicable regulations to transparency and security requirements of investment by further streamlining the missions and activities of the various regulatory organs;
    - Consolidate actor's professionalism and diversify interventions;
    - Revitalizing investments for promoting sustainable economic and social development in order to deepen WAEMU's regional market; stabilizing the macroeconomic framework in WAEMU countries;
    - Putting in place harmonized taxation systems and incentives on securities and service pricing;
    - Adapting a regulatory framework and developing risk monitoring and control tools as well as establishing a mortgage market.

28. At the conclusion of the discussions the Governors agreed on the need for socio-political and macroeconomic stability as well as sustained economic growth for the development of capital markets. In addition, the Governors felt that the choice concerning the establishment of a national or regional stock market for securities should be as a result of cost effectiveness analysis. In this connection, Guinea indicated that they were considering joining the WAEMU Regional Stock Market (BRVM) or the Ghana Stock Market rather than establish a national stock market.

29. In addition, the Governors lamented on the excessive regulations that hinder the development of markets. In this regard, the recommended that enforceable rules be set up.

30. A summary of the session noted that the experiences as outlined above provide valuable lessons of experience with regards to capital markets development in Africa. It was further noted that South Africa's experience is a promising advanced one that provides hope and augur well for the development of capital markets in other African countries.

3rd Session: "Capital Market Development and Way Forward".

31. This session was presided over by Mrs. Linah K. Mohohlo, Governor of the Bank of Botswana. Mr. Tom Lawless, Director of Lawless & Associates and Mr. Konrad Reuss, Director General of Standard & Poor's, made presentations. Both presenters highlighted on private sector perspective on capital market development in Africa.

32. Mr. Konrad presented a paper entitled: "Why Healthy Capital Markets Matter?". He argued that it is crucial for African countries to develop their capital markets given their importance in financing long-term investment needs. The presentation noted that commercial bank financing though important in financing economic growth and development, is more suited for financing working capital needs and trade finance rather than long-term investment.

33. Finally a set of essential conditions for the development of a country's capital market were outlined in the presentation as follows:

- Macroeconomic stability;
- Developed natural buyers of long-dated securities, especially pension funds and insurance companies;
- Strong legal system and predictable bankruptcy procedures;
- Co-ordinated and advanced payment, settlement, repo, and custodian systems; and
- Minimum ancillary expenses so that trading costs are kept low.

34. Mr. Lawless for his part focused his presentation on the development of capital markets in Africa and the way forward. In this regard, he laid particular emphasis on the adoption of appropriate solutions in harmony with the realities of each country, noting that it is not always wise to establish one's own market since one could access to the neighbouring market. The presenter also underscored the need to adopt a legislation and regulation in harmony with international standards as well as tax incentives. He noted the importance of the following factors in developing African capital markets:

- Macro foundations issues;
- Market structure and Regulatory environment;
- Policy Constraints;
- Market infrastructure (systems)

35. Thought provoking conclusions which emanated from this presentation were:

- "One solution does not fit all" in capital markets development;
- African countries must "craft the appropriate policy and strategy solutions for their specific circumstances"
- Countries should not be afraid to ask for help – as they cannot live long enough to make all the same mistakes that others have made.

36. At the end of the discussions it was felt that there is a need to speed up the growth rate of African economies and their capital markets through rationalization of resources and support from international community (concessionary aid, HIPC Initiative...) In this connection, the participants acknowledged the need to ensure macroeconomic stability and adopt regulatory frameworks that are adapted to local realities.

37. A summary of this session noted that an effective and regulatory environment is a very important aspect of capital markets development in Africa. It also noted that a culture of savings at an early age is important for capital markets development in Africa

38. The plenary sessions were concluded with remarks by Dr Acquah who reiterated the importance of the following issues for capital markets development in Africa;

- Macroeconomic and political stability are critical factors in capital markets development in Africa;
- The issue of the link between capital market development and economic growth is not a straightforward one. However, well-developed capital markets enhances economic growth by providing the necessary resources that finance long-term term economic growth and development;
- To develop capital markets for Small and Medium Enterprises (SMEs) financing requires strong players within a country's capital markets;
- Capital markets integration is very crucial for African countries and there is no need for each and every country on the continent to develop its small own Wall Street.

39. Capital markets regulation is crucial for market development. Each country has to craft a regulation that is suitable for its own situation.

40. All in all, the exchanges on various views reaffirmed the importance of capital markets in the process of economic development and the promotion of social progress.