



STRATHMORE BUSINESS SCHOOL

MASTER OF SCIENCE IN DEVELOPMENT FINANCE

END OF SEMESTER EXAMINATION

MDF 8301: AID & SOVEREIGN DEBT MANAGEMENT

Date: Thursday 28th July 2022

Time: 3 Hours

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

Question 1 (Compulsory) (40 Marks)

- a. You have been provided with the following information regarding Kenya's public debt:

Domestic Public Debt

1. Investor base as at Dec 2021- Domestic debt

Banking Institutions	50.2%
Insurance companies	6.8%
Parastatals	5.6%
Pension funds	31.2%
Other investors	<u>6.0%</u>
Total	100.0%

2. The proportion of debt maturing less than one year declined from 26.1% to 25% between the years 2010 and 2020 respectively. The proportion of debt with maturities above 11 years increased from 20.8% in 2010 to 44.7% in 2021. However domestic interest rates have been rising due to inflationary pressures on the economy.
3. In the financial year 2019/2020, public guaranteed debt increased by Kshs. 5,841 million to Kshs. 165,245 million from Kshs. 159,408 million at the end of June 2019. In the same period, the government has had to pay Kshs. 661.2 million as called up guaranteed debt debts owed by public enterprises that were in financial distress.

External debt

4. The structure of the external public debt has changed between June 2010 and June 2021 as follows:

	Year 2010	Year 2021
Multilateral	62%	38%
Bilateral	35%	31%
Commercial	4%	31%

5. The composition of external debt by lender category has changed as follows:

	Year June 2020	Year June 2011
China	67%	13%
Japan	14%	44%
France	7%	16%
Others	11%	28%

6. Global interest rates have also been rising due to inflation pressures world wide

Other information

7. The recurring events around Kenya's economy such as drought are still expected to occur in the near future

Required:

- i. From the information provided above identify and describe the types of risks that Kenya's public debt faces. **[14marks]**
 - ii. Discuss the solutions that the National Treasury and the Central Bank of Kenya can adopt to mitigate the risks identified in part (i) above. **[14marks]**
- b. Resource-backed loans (RBLs) are becoming a major threat to public debt management especially in the African continent where majority of such loans have been issued.
- i. Why are RBL loans a threat to proper public debt management in Africa? **[6marks]**
 - ii. How can the affected governments strengthen public debt management to reduce the threats posed by RBL loans **[6marks]**

Question 2 (20 Marks)

- a. Country Zeta is currently experiencing financial hardships and the national treasury is examining the possibility of restructuring its domestic public debt. The domestic debt comprises 60% of the total public debt. The domestic debt is held as follows: Commercial and investment banks; 55%, Pension schemes and Insurance companies; 35%, Others (Individuals and Private companies); 10%.

Zeta is a non-resource country. The tourism and restaurant sector contributes to 30% of the GDP, agriculture 30%, the financial sector 10% and the rest to the other sectors of the economy. The economy has gone into a recession brought about by a standstill in its key sectors of the economy due to the corona virus pandemic.

Required

- i. Highlight three key considerations that the national treasury must contemplate before restructuring the domestic debt. **[6marks]**
 - ii. Advise the national treasury on the best way(s) to restructure the domestic debt **[4marks]**
- b. List the problems that are inherent in the external sovereign debt market which makes restructuring of such debt difficult **[4marks]**
- c. Discuss two approaches that can be used to address the problems identified in b. above. Comment on the strengths and weaknesses of each approach selected **[6marks]**

Question 3 (20 Marks)

Despite promising signs of a continuing global economic recovery in 2022, the African debt situation remains worrying. More than 20 low-income African countries were in debt distress or were at risk of debt distress by 2021 according to the International Monetary Fund (IMF).

Required:

- Identify at least five different costs of sovereign debt default **[5mark]**
- Describe the factors that have led to the large increase in debt uptake within the African continent **[7marks]**
- How can African countries avoid falling into a debt trap? **[8marks]**

Question 4 (20 Marks)

The following ratios relate to Kenya's debt sustainability analysis

	Threshold	2020	2021	2022	2023	2024
PV of Public Debt-to-GDP ratio	55	62.4	63	64.2	63.4	62.9
PV of Public debt-revenue and grants ratio	300	360	372.6	370.8	348	339.2
PV of PPG External Debt-to-GDP ratio	40	28.7	28.7	28.3	27.3	26.3
PV of PPG External Debt-to-Exports ratio	180	288.3	255.8	239.2	219.8	204.2
PPG debt service-to-exports ratio	15	26.5	19.1	22.7	20.1	29.7
PPG debt service-to-revenue ratio	18	15.5	13	15.8	14	21
Source: IMF – March 2021						

- Based on the ratios given above and general information on Kenya's economy, comment on Kenya's debt sustainability in the next two years, do you expect the situation to improve? **[12marks]**

The legislature plays a critical role in Public Debt Management which includes the enactment of the legal framework, approval and oversight. In Kenya, parliament provides the checks and balances on government borrowing

- Has the Kenyan parliament adequately performed its roles as expected in the last two years? **[8marks]**

Question 5 (20 Marks)

In February of this year Ghana's credit rating was downgraded leading to a crush of its dollar bonds. Several scholars within the continent have accused the Credit Rating Agencies (CRA) of bias against African countries.

Required:

- a. Highlight the short comings of International CRAs especially in rating debt instruments of African Countries. **[10marks]**
- b. Discuss the solutions that African countries can adopt to deal with the shortcomings identified in (a) above **[10marks]**