Welcome remarks: Dominik Ziller, Federal Ministry of Economic Cooperation and Development (BMZ)

Local Capital Markets Event, 12 April 2018, KfW, Frankfurt

Opening Remarks - 10:30- 11:00

Dear

- Prof. Dr. Joachim Nagel, Member of the Executive Board of KfW
- Yaw Kuffour, Division Manager Trade Finance of the AfDB
- James Polan, Vice President of the Overseas Private Investment Corporation
- Nick Dyer, Director General of the Department for International Development of the UK
- Huib-Jan de Ruijter, Director, Dutch Development Bank FMO
- Jingdong Hua, Vp Treasurer International Finance Corporation
- Jennifer Price, CEO, Calvert Impact Investments
- Distinguished ladies and gentlemen,

- I feel honored that you have invited me as a humble public servant to not only join you in todays deliberations but also to give you some insight into my ministry´s take on where we are standing in our joint agenda on developing local capital markets. It is a phantastic opportunity to engage with a number of important stakeholders on how we can build effective partnerships between governments and financial institutions to harness local capital markets for sustainable growth and development.
- Let me just add, that my very personal feeling is that this conference comes exactly at the right point in time. Why is this so? Well, one of the main findings of the Addis conference in 2015 was that we have to broaden our development scope from the former ODA-focus and to rather mobilise considerably larger levels of financing for development from all available sources. And we were specifically tasked to address the challenge how to develop national and local capital markets in developing countries. This happened almost three years ago. And while we have already made some progress we will all have to admit that we

have not yet found any silver bullets nor succeeded in making the big steps forward, we would need in order to ensure that our means of implementation are fit to deliver on the promises the world made to itself in the first 16 SDGs. Or, in other words, there is a certain risk to lose the dynamics created in Addis. Therefore, yes, this meeting here today comes at a point in time where additional dynamics should be created, new ideas should be fostered and an open debate on the achievements as well as on the shortcomings of the first three years of implementation of Addis is most welcome.

- We need to jointly define policies and strategies to mobilize local savings, and we need to learn from each other about the measures and instruments that achieve the best results. Therefore, I am looking forward to this exchange of views and experiences with you today.

Financing for Development and the role of local capital markets

- Why are the national, the local capital markets so important? The first answer is rather trivial. The national level is the hub where all financing flows mentioned in the Addis Agenda – public and private, national and international - come together and need to be coherently directed toward sustainable development.
- But there is more: Domestic capital markets have the potential to become a vital source of stable, sustainable finance and underpin a thriving private sector. By giving companies the ability to borrow domestically in local currencies, domestic capital markets can also reduce currency mismatches for borrowers, thus reducing risks. At the same time, government bond markets create tools to manage macroeconomic and fiscal risk and provide important pricing benchmarks. While capital markets can be a vehicle for intermediation, let us not forget that the main provision of finance to SMEs in Africa stems from a local and diversified banking sector extending loans. We support efforts, particularly of the AfDB, in extending lines of credit to local banks in this context. In doing so we must ensure that certain criteria (e.g. additionality and development impact) are applied to favour those institutions that actually deliver on our target of inclusive growth.

- Thus, the German government is emphasizing and strengthening the role of local currency and capital markets and functional financial systems as an important priority in the G20 Compact with Africa and the Marshall Plan with Africa.

Areas for intervention for German Development Cooperation

- In many developing countries, we are still facing large unmet financing needs in infrastructure, housing markets, and for local enterprises. Available financing is often short-term, risk-averse and expensive, thus creating significant bottlenecks for development. Strengthening local financial sectors in a comprehensive manner is therefore highly important to achieving the SDGs. How can we overcome the maturity mismatch between short term deposits and long term financing needs? I remember our first efforts in the Nineties when we developed deposit insurance funds – with mixed success I have to admit.
- Today in order to promote efficient, inclusive and sustainable financial systems in our partner countries and to accelerate the mobilization of local and international private sector capital, German development cooperation follows a more comprehensive approach. We have a broad set of capacity development and financial cooperation instruments at our disposal:
    - BMZ funds a broad range of activities to promote **access to basic financial services** such as savings, payments, credit and insurance for the poor.
    - We **strengthen capacities of local SMEs** and assist financial institutions to better serve local enterprises.
    - BMZ supports **Green Finance** to redirect financial flows away from assets that deplete natural resources and towards climate and eco-friendly investments.
    - Finally, we support **blended finance mechanisms** such as **structured funds** which reduce the risks of investors and thus help to mobilize the large amounts of capital needed for sustainable development.

Local currency financing

- One area of particular focus is the development of local capital and credit markets and local currency finance. My very personal point of view is that this is the main challenge of todays development finance agenda. If we want to make the famous step from billions to trillions we will inevitably need private funding as ODA will always be very scarce. And while quite a few challenges of the SDGs can probably met with intelligent solutions to mobilize international private investment, wherever local investors need funding, international loans can only be second best. I mentioned our structured funds. Really great instruments and I am proud that I was one of those who supported KfW when the first such funds like EFSE in South East Europe were created almost 15 years ago. Great success stories were written. But in these structured funds we have not yet found a solution how to bear local currency risks without making the loans to expensive for the end customer. If such a fund lends to a partner bank in a developing country this loan can only be denominated in the very same currencies the investors of the fund have provided. Which will mostly be international currencies, Euro or Dollar. The alternative would be a hedge – certainly an option but the hedging cost would have to be added to the interest rate the fund is charging, the loans to the partner bank and to the end customers, the clients of the partner bank would become more, sometimes even much more expensive. Without a hedge the partner bank has two options how to proceed with a loan denominated in Euro, either onlend in local currency – which would mean that the partner bank would have to charge the end customer with interest rates covering potential losses due to depreciation of local currency. Or onlend in Euro – which means that the depreciation risk would then have to be taken by the end customer. In any case we will end up with expensive loans and we will foster a landscape favouring borrowers in the service sector, where turn overs are high enough to cover expensive loans. Service bubbles are created and a sustainable development of the financial sector becomes rather improbable.
- Therefore we need to tap much more into the potential of local capital. And, believe me, there is a lot of local capital available, even in the poorest countries. But mostly this local capital is invested in international funds, be it pension funds, be it venture capital funds. So, our challenge is – how can we create regulatory and other environments conducive to on-shore investments? With our compacts with Africa Germany - making use of its G 20 presidency - has together with the

World Bank, IMF and the African Develoment Bank introduced a tool to improve the legal, regulatory and tax environment in our African partner countries. While the media, not always aware of the local potentials, have mostly commented that this is an undertaking to attract foreign direct investment it is our firm belief that the envisaged improvements shall also promote local on shore investment. Domestic capital is a strongly underestimated financing source for development in Africa.

- The compacts are a **new *form* of cooperation**, to help **reform champions to fulfil their potential.** Essentially they are a **platform** for willing countries to define the most pressing bottlenecks and **unite development and other partners around a shared reform agenda**. The Compacts allows reform-minded countries to **showcase their progress** and send out a **strong signal** to international and domestic investors: **look at the facts, redo your risk analysis and invest!**
- As our bilateral contribution to these investment partnerships, we established three **reform partnerships** with **reform-oriented African countries** (TUN, CIV, GHA). They will **receive substantial and additional support** to boost progress on their path and to address persisting challenges.
- The compacts are aiming to support a **reliable regulatory and legal framework** in order to increase investment opportunities, **push for a more sustainable infrastructure** as well as **create jobs and employment** in African countries.
- These agreements could include tailor-made multilateral and bilateral contributions from **Multilateral Development Banks**, **G20 members**, and **African partner countries**.
- These are important steps forward. But are these steps enough? Probably not. We can always do better, the largest room in the world is the room for improvement. Since so many experts are in the room today I would like to challenge you to provide us (politicians, the ministry) with your ideas on how to use the liquidity in financial markets in Africa and steer it towards sustainable development for our partner countries.
- You are the experts. We need your knowledge, ideas and innovative thinking to guide us in the development of local currency markets. Because we see local currency market development as one main chance to mobilize local resources and enable local players. This will remain a biq topic in the coming years.

<u>Let me just add a few words on the role of digitalization in developing local financial systems</u>

- Mobile technology as means for financial services becomes increasingly important in developing countries. A major benefit associated with digital financial services is increased reach. By now, more households in developing countries have access to a mobile phone than to electricity or improved sanitation. Access to a mobile phone is a major entry point for many digital financial services, which makes it possible to reach people who have been financially excluded until now. With the mobile payment service M-Pesa, Kenya, for example, has championed as a pioneer with regard to mobile payment systems. M-Pesa also allows small savers to buy government bonds in small denominations (from 25 EUR) directly from their mobile phone for one year, thus strengthening their savings behavior and developing local bond markets.
- At the same time, new actors are emerging and business models are evolving, with financial technology companies, or “FinTechs”, making use of big data and algorithms, of innovative delivery and information channels to provide financial services. Digital solutions open up new opportunities for an appropriate design of financial services to ensure that services are accepted and used.
- BMZ supports the digitalization of financial markets through a variety of measures, e.g.
    - through the support of digital financial service providers (e.g. Musoni in Kenya, M-Birr in Ethiopia (DEG)) the support of microfinance networks to expand mobile banking activities
    - Financing and development of interoperability (e.g. in Ghana and Mozambique)
  - Here again we need your input on how to use new digital technologies most efficiently and beneficial in services and processes in and for our partner countries. It is your expertise we need to strengthen these initiatives and expand the knowledge base on how to successfully guide digitalization for the benefit of international cooperation.

Closing

- To conclude, let me reiterate the importance of local capital markets for financing sustainable development. Sound and strong local capital markets are a key driver for jobs and growth and empower economies to become less vulnerable to external shocks.
- But let me also reiterate that developing local capital markets is only one very important pillar in a broader approach. The focus of discussion should be on how to support developing countries to build domestic strategies for managing private investment. This is critical for ensuring high quality investment and for protecting against risks - two overarching goals of the Addis Agenda.
- But this cannot be achieved by governments alone. Many stakeholders are needed to make such a broader approach become reality, including by reinvigorating interest in banking systems and national development banks, but also by adapting global rules on trade, tax, investment and debt in order to allow developing countries the policy space to manage private investment – both domestic and foreign – effectively. These policy actions are also highlighted by our CwA and Marshall plan initiatives.
- I am therefore looking forward to our discussions today and learn more about the successes of the ALCB fund as a great example how to promote local capital market development in Africa.
- Let me once again thank KfW for putting an excellent event together and for bringing a variety of important stakeholders here today.