Opening remarks: Prof. Dr. Joachim Nagel, Member of the Executive Board, KfW

Dear participants of the **Local Capital Markets Conference**,

Dear Mr. Ziller,

Dear Mr. Schuknecht,

Dear colleagues and partners.

I warmly welcome you here in Frankfurt at KfW headquarters. We very much appreciate your presence at this event, which covers a topic that is extremely close to my heart: The support for local capital markets in emerging and developing countries, especially in Africa.

For me personally this is a key topic for my tenure at KfW's Board of Directors. And as I can see from your attendance, I am fortunately not the only one interested in promoting local capital markets!

Given my background as a former Central Banker at the Bundesbank I am deeply convinced that economic development can only work out if we create trust in our financial systems and capital markets by pursuing prudent macro policies and transparent processes. This is by the way how Germany returned to the international capital markets after World War II, and this is how I see Africa should develop.

However I don't want to bore you with a history lesson. We have actually set up this event because later today, the African Development Bank and the Overseas Private Investment Corporation – OPIC – will sign a loan agreement for an instrument you all know very well: The

African Local Currency Bond Fund, called ALCB. I want to explicitly thank these two esteemed institutions for their commitment.

Let me also tell you why I think local capital markets are important. They are of course no golden bullet and no panacea, but they can help us to mobilize private sector investment from both developed and developing countries and thus boost the economies. At the same time – and that is the special benefit – they strengthen the economic immunity systems of our host countries and that way again spur development. And we all need and want development. That is our root cause and mandate.

Ladies and Gentlemen:

Where do we currently stand in terms of global development achievements?

Actually on world average, the relevant indicators have never been better than today. But the distribution of wealth and wellbeing between and within countries and regions remains unjust and unfair. And the progress to a large extend still relies on the exploitation of our

environmental resources which in turn endangers that very progress again. Also, political crises and wars do their part to increase human suffering and migration. So it is in fact a mixed picture. We have progressed but we have not progressed enough.
At the same time, with the Sustainable Development Goals and the Paris Climate Treaty, we have a relatively clear and workable framework for the way forward. The two acknowledge the duality of human development on the one hand and climate and biodiversity protection on the other.

Reaching these goals, however, won´t be for free: Rather, it is very well studied for what it would cost to bring the global house in order. We all know the phrase “From Billions to Trillions”, in which the leading Development Finance Institutions point out the path to increase our joint fire power. Meaning we have to raise much more money.

The truth is: There are huge needs for real and virtual infrastructure investments in order to reach the SDGs and the Paris objectives. Be it in transport, telecoms, energy housing, health, education or biodiversity – many of them are very well identified and described. But – the same as in friendship or marriage – the problems always start with money. “Who shall pay for all of this?” the world’s association of bean counters asks. And rightly so.

As a small calculation of what is at stake I have added up KfW’s, FMO’s, OPIC’s and AfDB’s total assets. I can tell you, our combined balance sheets would not even cover 15 % of one year of the necessary global SDG financing, which, according to the UN, comes up to 6 trillion US Dollars. And that would leave us with empty pockets; we could all take early retirement. If there were still any retirement funds left after the big SDG pay out. I find that a slightly daunting perspective and I do not really see this as a viable course of action. So it is quite clear, we have to do more and we have to find new ways to reach our goals.

But how? How can we do it? In this context my back-of-the-envelope calculation taught me two important lessons:

- **First Lesson:** international cooperation in development financing is not a question of political choice or preference. It is a necessity. As development banks we all have to stick together, otherwise we are pretty meaningless on the global scale. I am very happy that our event today is a small institutional celebration of this DFI-Cooperation, where we join forces for the greater good.

  And I am extremely happy we have our American and British colleagues here. I do sincerely hope that their investment into the ALCB Fund will be followed by many more joint investments, despite slight new orientations of their national political agendas. Because we need that kind of joint action. Fortunately, with the International Development Finance Club – IDFC – we have another international Forum in which we can leverage joint activities.

- **Second lesson:** the traditional development bank financing has to actively be supplemented by other forms of financing. It usually consists of bilateral hard currency loans and is backed up by sovereign guarantees from the host states. I see need for action here for two reasons. First of all, it is unfavourable to use our scarce funding for transactions that do not trigger additional investments from other sources such as the local and international private sector. And we need those investments to reach a meaningful scale. Therefore, we have to use our resources more creatively.

  We also have to ask ourselves if we really have the impact we intend when lending long-term in hard currency: Because traditional foreign currency lending is putting the burden of currency risk on the weakest shoulders, that of the host government or worse, that of the final borrower. For all these reasons: We have to read the signs on the wall and see that local currency financing is valuable and necessary.

Ladies and Gentlemen,

So what can we do to increase the impact and outreach of Development Finance Institutions? What can we do to reach the trillions we need? One way is to harness bond markets for development.

This can be done in various ways: as DFIs we can leverage our own capital by issuing specific thematic bonds. Thereby we create new asset classes for international institutional investors, crowd them in and hopefully one day the capital costs for development projects decrease. The beauty of the beast is that almost everything of high developmental impact can be financed by a bond.

Examples include Social or SDG Bonds, Green Bonds and others. KfW is one of the largest Green Bond issuers. IFC also issued a multitude of Green Bonds and created the largest ever emerging markets Green Bond Fund together with Amundi, the French asset manager. The African Development Bank issued several Green Bonds and recently also the “Light Up and Power Africa Bond”. In my opinion, Green Bonds should become a major part of the “Roadmap to 100 Billion US Dollars”. This is the sum that is to be committed annually by the industrialized countries for climate finance in developing countries by 2020.

Although these bonds help to refinance the SDG and climate sectors most of the time they are issued in foreign currency. So the problem of currency risk is not addressed. We as Development Finance Institutions should therefore issue bonds also in local exotic currencies.

We should thus use the proceeds back to back for financing local projects in developing countries.

IFC is well advanced in this and I would very much like to ask them to share with all of us the “Coca Cola Recipe” on how they do it. I really think we should learn more from each other regarding best practices on local capital markets and direct local currency funding. With the TCX Fund that KfW created together with most entities present here, we have at least a platform that allows to access hedging arrangements for many exotic currencies.

Another, deeper way of using capital markets is supporting local markets in local currency. The G20 initiative on Local Currency Bond Markets as well as the Marshall Plan and the Compact with Africa strongly support this idea of help to self-help. Many developing countries do have a lot of local capital in pension funds and other entities. That, however, does not find its way into the productive economy but is often invested into treasury bonds or real estate speculation.

This need not be so. If the countries turn to prudent macro policies, the interest rate levels of local treasuries will fall and private sector investment will be more attractive for asset managers. But this is often not enough. As the economists Ugo Paniza, Ricardo Hausmann and Barry Eichengreen have found out in their research, called “Original Sin”, there often is a strong element of market failure, where borrowing in local currency is not possible despite of macro prudence. The reason is a general lack of trust in the system.

This is where the Development Finance Institutions should and already do step in. Building of trust through credit enhancement, guarantees, structured finance platforms or anchor investments will achieve a great deal of inclusion of local private sector investment. With estimated total pension sector assets alone of about 400 billion US Dollars in Africa this is no small feat.

And this is exactly where the ALCB Fund fits in. It has a Technical Assistance Facility that is kindly provided for by the Federal Ministry of Economic Cooperation and Development and will hopefully soon also be filled by the courtesy of DFID. With this facility the ALCB Fund helps issuing bonds. And by acting as an anchor investor it triggers on average a 10-fold investment by the local private sector. That is quite an impressive factor.

As of today the ALCB Fund has invested more than 80 million US Dollars in 29 bonds in 14 African countries. It is thereby reducing vulnerability to currency swings for issuers as well as for final borrowers. Just in the beginning of this month it supported the issuance of the first local currency bond of a Nigerian Microfinance institution. This was a landmark deal for the whole microfinance sector in Nigeria with a huge demonstration impact.

But that´s not all: In March the Fund helped bring to market the first ever corporate Green Bond in South Africa, issued by a real estate company. More Green Bonds for financing renewable energy are in the pipeline in Nigeria and South Africa.

Given the size of the problem that I described earlier, these success stories might seem small, like a mere drop in the ocean – and honestly they still are. Nevertheless, with your help and the new investments of OPIC and the African Development Bank we will make this drop bigger and bigger: particularly, because the African Development Bank will equip the ALCB Fund for the first time with local currency. A fact, we are very grateful for.

I am convinced: With investments of this kind the drop grows until it becomes a steady stream that will have a real impact and recognition throughout Africa. Given the mobilisation effect of 10 times, the Fund with almost 200 million US Dollars in total assets will soon mobilise 2 billion

US Dollars in financing for African private sector companies – a figure that is much more remarkable, isn´t it?

Nonetheless, we need to do more. But to do more we need more than simply more money:

First of all, it is hard to find good local currency bonds with development impact in Africa. This is due to a variety of reasons. It starts with poor macro policies and ends with a lack of good governance, regulation, transparency and accountability. We need more capacity development and less red tape for African capital markets. We need reliability and trust in the system to create deep and liquid capital markets.

This is an ongoing quest; here we need to work hand in hand with host governments, central banks, regulators, arrangers and lawyers to improve the local investment environment. Luckily there are many positive developments in African local capital markets. Green Bond frameworks for example have been established in South Africa, Kenya, Nigeria and Morocco.

Secondly, we as development banks need to further look at the way we work in developing countries. Regarding renewable energy for instance we should strive for more Power Purchase Agreements in local currency. This would help decreasing the burden of currency swings for utilities and for final customers. For all of this we as Development Finance Institutions need to work together, exchange views, learn and complement each other. I repeat: DFI-Cooperation is a necessity to move forward!

Thirdly, we should be more creative with our resources and take more risks. Our owner governments could provide us with new tools to allow for further risk taking, such as direct guarantees for currency risks. I am looking at you, Mr. Schuknecht of our Ministry of Finance and you Mr. Ziller of our Ministry of Development Cooperation. We are very pleased for what you have done so far to existing local currency solutions such as the ALCB Fund, TCX, Frontclear and our standard guaranteed loan programs. But we need your continuous and creative support for new local currency and capital market development solutions!

Ladies and Gentlemen, let me summarize my thoughts in four points:

- We as development banks have to do more in local currency and continue to work closely together;
- We have to help bring about change, transparency and accountability in local capital markets through anchor investments and technical assistance;
- Local governments have to continue on the path of prudent macro policies and efficient regulation, cutting red tape;
- Our owner governments should continue to equip us with the right tools to take more local currency risk.

If we make all this happen then I hope my dream will come true: I imagine that one day local savings, pension and insurance assets will be properly recycled and invested into building the infrastructure and the real economy of developing countries. I also imagine that one day even conservative widows and orphans pension funds of the developed world will regard local currency African bonds as staple investments. As assets that provide good returns at acceptable risk levels.

That is still a dream of course. But as Collin Powel, the former US Foreign Secretary once said: “A dream does not become true through magic. It takes sweat, determination and hard work.” So let´s continue the work we have begun for the benefit of the local capital markets. The conference today is one opportunity to do so. I now wish you a fruitful day of creative thinking and a good sense of determination.

Thank you.