

Caleb M Fundanga: Developments between the Bank of Zambia and the Lusaka Stock Exchange

Opening remarks by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the LUSE/BESA/BOZ workshop for secondary trading of government bonds, Lusaka, 3 March 2008.

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The Chairperson,
Resource Persons,
Workshop Participants,
Distinguished Ladies and Gentlemen,

I am honoured for the invitation extended to me this morning to officially open this important workshop on secondary market trading for Government securities. To begin with, I wish to commend the Lusaka Stock Exchange (LUSE), the organizers, on the timeliness of this workshop. I have little doubt most of you will agree with me that this discussion on the secondary market is long overdue and therefore could not have come at a better time. Dialogue among key stakeholders is invaluable to the success of market development efforts. This is particularly so because this allows each participant to share and learn from their diverse experiences in this area. I must say that this workshop addresses a subject in which I personally take keen interest. This is because I have, over the recent past, participated in a number of meetings with key investors in our securities market. At these meetings, issues surrounding the development of the secondary market have always been at the centre of our deliberations. I am glad that we have now begun to address those very issues. This workshop also demonstrates the stakeholders' commitment to support the market development efforts as outlined in the Financial Sector Development Plan.

Chairperson, over the recent past, the Zambian economy has performed well. This is reflected in a number of the key macroeconomic indicators. To mention but a few; the growth rate in real Gross Domestic Product (GDP) has remained positive and above 5%, we attained single-digit inflation, relative stability in the exchange rate of the Kwacha against major currencies, stable financial sector and improved banking services. These impressive economic trends suggest that the reform programmes that have been implemented are now bearing fruit. The reforms have focused on the restructuring of the economy, to let markets determine key decisions so as to allow the private sector lead, which has provided for increased investment in the economy. It is the contention of many financial analysts that there is no better market to determine prices than the secondary market. In that regard, this workshop is vital.

Ladies and gentlemen, the importance of a secondary market cannot be overemphasized. By facilitating a ready mechanism through which financial claims can be transferred from one holder to another, a secondary market provides wide possibilities for issuers of long term securities to match their cash flows in a stable and cost effective manner. Investors with their diverse liquidity needs are assured that they can convert their investments into cash at any time and at a fair market price. At the same time, issuers are assured that their financing needs, especially the long term ones, will be met in an orderly and timely way. By providing such an assurance, a secondary market ensures that savings are pooled and invested in the economy in a cost efficient manner. In this respect, a vibrant secondary market is therefore an important aspect of the price discovery process.

Chairperson, an active secondary market is important to central banks as it facilitates the efficient conduct of monetary policy. This is because, to effectively implement monetary policy, central banks depend largely on the ability to influence financial markets. Therefore,

with a vibrant secondary market, monetary policy effects are transmitted to the rest of the economy in a more transparent manner, which in itself contributes to price stability.

At this point in time, it is opportune for me to outline briefly the efforts Government has made towards developing our secondary markets. Since the early 1990s, the government has taken steps to develop the securities market. There has been good progress made on the developing the primary market, though further refinements can be made to the structure. As for the secondary market, it has barely evolved beyond the elementary levels.

Let me quickly go over some of the most important changes to the primary market:

- Following the liberalization of interest rates in 1992 the auction system for Treasury bills was introduced to create a more transparent and market-based system of price determination that would encourage broader investor participation.
- Alongside the introduction of the auction system, the maturity structure was extended from the only existing term of 91 days to include 28 and 182 days in order to meet the various liquidity needs of investors.
- In 1995, Government bonds with a maturity term of 12 month and 18 months were added to the list of securities.
- Following the increased depth of the market, the structure of Government securities was streamlined with the termination of the 28 day Treasury bill issuance and the subsequent introduction of the 273 days maturity term.
- In 2005, reforms of the Government securities market continued with the cessation of the 12 months and 18 months Government bonds. In their place, a 364 day Treasury bill was introduced alongside the 3 and 5 years bonds.
- More recently, in August 2007, a portfolio of Government bond maturity terms was further increased to include the 7, 10, and 15 years.

Since that period, the size of the outstanding issues has grown from 7% of GDP in 1994 to 17% by the end of 2007.

With regard to secondary market, policy efforts have been initiated at different stages in the development of our market.

- In 1996, the Bank of Zambia attempted to jumpstart secondary market trading in Government securities by restricting the primary issues of Government securities to commercial banks. It was expected that commercial banks would take up the role of market-making. This did not materialize with most commercial banks preferring to buy and hold the securities until maturity. Consequently, authorities were obliged to re-open the primary market to other non-bank investors.
- Further, since 1998, Government bonds have been listed for trading at the Lusaka Stock Exchange. The benefits have not been realised despite the fact that all banks are registered as brokers in this respect. I am sure the LUSE will provide you with more detail on this as you deliberate.
- More recently, the Government and the Bank of Zambia in 2006, with the support of DIFID and the World Bank undertook a study tour of selected emerging markets in Africa and Asia. The aim of this tour was to learn the actual workings of well functioning government securities markets. Technical information was collected and a report prepared. Once the recommendations in that report have been adopted, I expect that these will complement your own efforts to activate secondary market trading.

I am aware that the successful development of a secondary market needs a reliable and efficient settlement infrastructure. This is important for it addresses the concern that is normally raised on the possibilities of settlement risk. You may wish to know that the Bank of

Zambia and the Lusaka Stock Exchange are already engaged to develop an efficient settlement stream within the RTGS payments system. It is my belief that once this initiative has been fully developed, settlement risk will be reduced and more credibility will be added to securities trading.

Chairperson, I know there are still formidable challenges in building a vibrant secondary market. Hence, in my concluding remarks, let me reiterate what I said earlier; that setting the primary market off the ground has been a challenging task. To set up secondary markets is even a more challenging task. Yet it is not an impossible one. With the participation of every stakeholder, the challenges that seemingly look insurmountable can easily be overcome. We all know that the development of a vibrant secondary market for securities is necessary.

When I look at all of you gathered here this morning, I see a determined optimism that we can get there. Each and every one of us has a role to play, be it Government, corporate institutions, or indeed a small investor. On our part as Bank of Zambia, you can rest assured that we will continue doing our part in facilitating the development of this market.

Thank you very much and I wish you a very successful workshop.