

Box 1

The growth of sovereign wealth funds: what impact for Africa?

I | Overview of the global sovereign wealth fund sector

Already posting strong growth before the financial crisis, in the last few years sovereign wealth funds<sup>1</sup> have become unavoidable players in the financing of international economic activity. Although it is difficult to identify global trends due to the wide range of strategies adopted by SWFs, the largest funds in the sector have clearly embarked upon structural diversifications of their asset classes (an extension of portfolios to include so-called “alternative” assets) and of their geographical investment foci (exposure to emerging markets).

• The sovereign wealth fund sector has experienced rapid growth in recent years

Sovereign wealth funds are mainly located in Asia and in the Middle East. In Asia, they are generally “non-commodity” funds whose resources originate from current and financial balance of payments surpluses and/or from fiscal surpluses. In the Middle East and Africa, they are primarily “commodity” funds managing the incomes of oil and mineral exporting countries. However, the world’s largest fund is in fact European – the Norwegian government pension fund<sup>2</sup> – and it is considered one of the most transparent sovereign funds in the world.

In recent years the sovereign wealth sector has seen substantial growth in its assets under management (AuM): In 2012, the sector’s total assets amounted to 5,200 billion dollars compared with approximately 3,000 billion before the crisis. These figures should nevertheless be regarded with a certain degree of caution as different sources advance different totals. The discrepancies in the figures are mainly due to two factors: a) the scope applied to the sector varies – for example certain analysts include public funds that do not exactly correspond to the sovereign wealth fund definition – and b) some of the data used to calculate these totals is based on estimates due to a lack of transparency at certain funds. By way of comparison, the AuM total for the world’s pension funds amounts to USD 33.9 billion and at the world’s mutual funds to USD 26.1 billion.<sup>3</sup>

List of principal SWFs

(in USD billions)

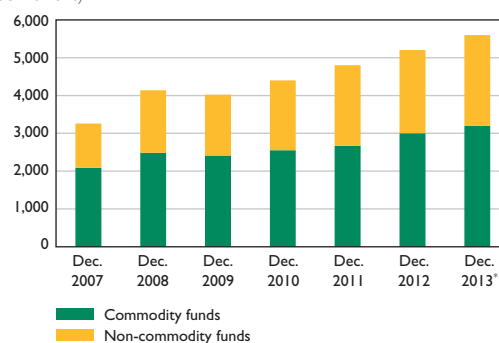
Country	Name	AuM	Origin of resources
Norway	Government Pension Fund (GPF)	737	Oil
UAE	Abu Dhabi Investment Authority (ADIA)	627	Oil
China	China Investment Corporation (CIC)	482	Other
Kuwait	Kuwait Investment Authority (KIA)	342	Oil
Singapore	Government of Singapore Investment Corporation (GIC)	247	Other
Russia	National Wealth Fund (NWF)	175	Oil
Singapore	Temasek Holdings	173	Other
Qatar	Qatar Investment Authority (QIA)	115	Oil
Australia	The Future Fund	89	Other
Libya	Libya Investment Authority (LIA)	65	Oil
South Korea	Korea Investment Corporation (KIC)	57	Other
United States	Alaska Permanent Fund	47	Oil

Sources: SWF Institute, International Forum of Sovereign Wealth Funds (IFSFW).

Note: Only the member funds of the IFSWF have been ranked.

Chart A SWFs assets under management

(in USD billions)



\* The CityUK estimates.

Source: SWF Institute.

1 According to the IMF, (Santiago Principles, 2008), sovereign wealth funds are “special purpose investment funds or arrangements that are owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses, and/or receipts resulting from commodity exports.”

2 However, with limited financial disclosure, the exact value of the assets under management at the Abu Dhabi wealth fund is not known.

3 The CityUK, Sovereign Wealth Funds, March 2013.

The principal factor underpinning the recent growth has been an unprecedented wave of new fund being established. In this context, **Africa** could rapidly become one of the continents with the highest number of sovereign funds. In 2012, Africa's two largest oil exporting nations, Nigeria and Angola, both created sovereign funds and the International Monetary Fund and the African Development Bank have both underscored the benefits of these initiatives.

- **Sovereign wealth funds are currently diversifying their investment targets both in terms of asset class and of geographic focus.**

Usually, sovereign wealth funds begin by investing primarily in low-risk assets (bonds for example), then diversify into equities and, at a later stage, into so-called "alternative" assets such as real estate, alternative asset management, private equity, infrastructures, etc...

This is the path followed by the Norwegian government pension fund for example. Initially invested in bonds, the fund gradually diversified into equities and then real estate: (i) in 2009, the market value of its investments in equities exceeded the value of its fixed-income investments for the first time since the fund's creation; (ii) in 2011, the fund placed its first investments in real estate, and then began a diversification into infrastructures and private equity.

While global trends in the sector are difficult to discern mainly because of the diversity of strategies adopted by sovereign funds, bonds and equities nevertheless remain the dominant targets of their asset allocations, even if an increasingly large portion is being channelled into alternative assets. According to data provided by Research Capital Analytics, the Qatar Investment Authority (QIA) is now the largest sovereign investor in European real estate.

As regards the geographic focus of sovereign funds' investments, the picture also varies substantially from one fund to another. Certain funds have remained highly exposed to developed economies, whereas others have adopted strategies with a greater focus on emerging markets. Moreover, certain funds – including the Norwegian fund – have recently adjusted their asset allocations strategies to confer a larger proportion of their resources to emerging market assets.

## 2| The emergence of African sovereign wealth funds

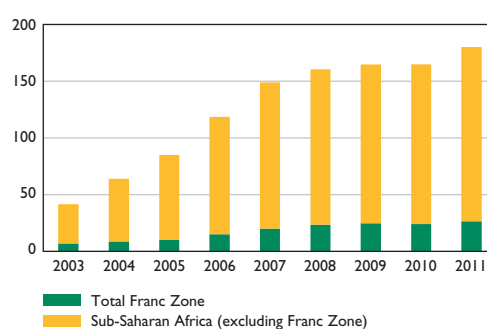
While only 2% of the world's sovereign fund assets were managed by African funds in 2012 (USD 121 billion, 86% of which was managed by the North African countries, Algeria, Libya, Mauritania), Africa is the most dynamic region of the world in terms of sovereign fund creation:<sup>4</sup> since 2011, fifteen new sovereign funds have been, or are being created, on the back of an increase in commodity export revenue (see: first part on the evolution of commodity markets) and a resulting increase in foreign exchange reserves.

In fact, foreign exchange reserves have rapidly accumulated in developing countries since they began the process of trade liberalisation in the 1970s (Rodrick, 2006). In sub-Saharan Africa, foreign exchange reserves rose faster in the 2000s (on average, +16.4% p.a.) than in the 1990s (+8.4% p.a.), with their share in global reserves only increasing marginally over 20 years (from 1.5% in 1990 to 1.6% in 2011).

In sub-Saharan Africa, Botswana's sovereign wealth fund – the only sub-Saharan member of the International Forum of Sovereign Wealth Funds (IFSWF) – represents almost two-thirds of the region's total SWF assets and is funded by income from exports of minerals and diamonds. The recently created Angolan and Nigerian funds represent respectively 23% and 5% of the region's total SWF assets.

Chart B African countries' foreign exchanges reserves

(in USD billions, at year-ends)

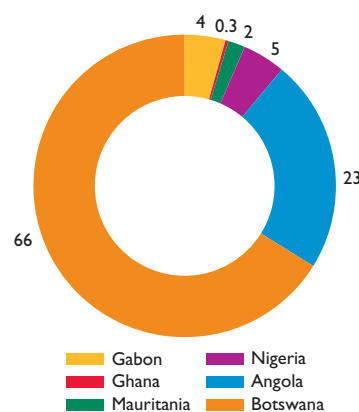


Source: World Bank.

<sup>4</sup> Source: [http://www.african-markets.com/pdf/fr/Guide\\_des\\_Fonds\\_Souverains\\_Africains\\_FR.pdf](http://www.african-markets.com/pdf/fr/Guide_des_Fonds_Souverains_Africains_FR.pdf)

- Although, since its creation in 1994, the **Botswana's** Pula Fund only invests in foreign currency denominated assets of developed countries, several sub-Saharan African sovereign funds have been investing in regional integration. For example, **Angola's** new sovereign fund, with assets of USD 5 billion, aims to support certain sectors that contribute to regional integration such as infrastructure, agriculture, water, energy and transport. Its investment policy steers 50% of its resources towards low risk assets (sovereign or institutional bonds rated investment grade) while the other half of its funds is invested in emerging markets, commodity markets and priority investment sectors in Africa.
- In May 2012, **Nigeria** launched a new sovereign wealth fund, the Nigerian Sovereign Investment Authority (NSIA), in replacement of the previous Nigerian fund (Excess Crude Account – ECA). Initially established with USD 1 billion financed by the difference between the market price of crude oil and the reference price used in the State's fiscal planning, it will have three subfunds: one for future generations, one to absorb economic exogenous shocks and one to finance infrastructure projects. Over the next three years, the fund's assets are expected to grow to as much as USD 5 billion.

Chart C Relative weight of sovereign funds in sub-Saharan Africa (in % of total assets under management)



Source: African Markets.

- In **Gabon**, the Fonds souverain de la République gabonaise (FSRG) – launched in February 2012 to replace the previous Fonds Pour Les Générations Futures – has resources of USD 1 billion and will be funded each year by a quarter of the income generated by its investments (the remainder being absorbed by the State budget) and by any additional oil revenue over and above that forecast by the previous year's Finance Law.
- Since the end of 2012, **Senegal** has also been setting up a new sovereign fund for strategic investment (Fonds souverain d'investissements stratégiques – FONSIS), whose assets under management are expected to reach approximately USD 1 billion in the medium term. The FONSIS will have the distinctive feature of not relying on any mining revenue. The fund's resources will come from an initial endowment of cash and assets transferred to it by the State. These assets should allow the FONSIS to raise funds on financial markets through leverage. The fund is planning to act as a strategic co-investor in the capital of businesses, particularly SMEs, along the lines of a private equity fund. The fund's investment targets will be mainly local companies operating in the energy, infrastructure, industry and agriculture sectors.

### 3| International sovereign funds: greater interest in Africa

A number of factors have made Africa a particularly attractive destination for international investors. These include the rise in commodity prices, the existence of still largely unexploited mineral resources, the continent's rapid urbanisation and its relatively young labour force.

The high GDP growth rate (the McKinsey Global Institute forecasts an average annual growth rate of 7% in African countries over the next 20 years, which is higher than their forecast for China) and the low level of initial capital required because of African industry's early stage of development, are major advantages from an investment perspective. In addition, according to McKinsey, returns on foreign investments in Africa are higher than in any other developing region of the world. Lastly, the emergence of middle classes in Africa represents a high level of future demand: McKinsey estimates that by 2030, the overall purchasing power of the populations of the 18 largest cities in Africa could amount to USD 1.3 trillion.

The sovereign funds that invest in Africa are mainly based in the Gulf region (the Mubadala fund [Abu Dhabi], the Qatar Investment Authority) and North Africa (Libya). For these funds – following the model of Asian funds investing in emerging Asian countries – the decision to invest in Africa is essentially a matter of geographical proximity which has advantages in terms of information, networks and historical knowledge and allows them to optimise positive externalities. The traditional investment sectors such as oil and minerals are no longer the only sectors benefiting from sovereign fund investments; a diversification has been observed in recent years, with sovereign investments being directed into infrastructure, telecommunications, financial services and tourism.

The volume of sovereign fund FDI flowing into Africa has grown rapidly in recent years: Amounting to less than USD 1.5 billion in 2007, it totalled USD 11.4 billion in 2011. In fact, Africa's attractiveness as an investment destination is probably under-estimated since the FDI data does not include all of the different kinds of financial cooperation that can exist between the sovereign funds of different countries.

• **Sovereign funds can, under certain conditions, contribute to the financing of African development**

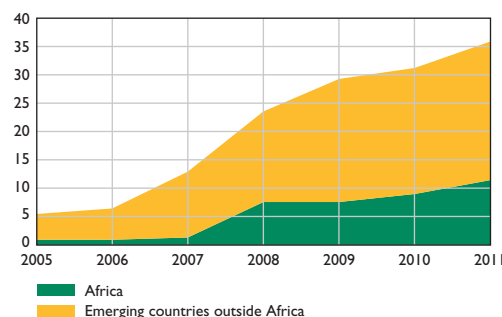
As investment vehicles, sovereign funds are in effect particularly well suited to financing long-term development expenditure because their funding is stable and less subject to short-term profitability requirements. They can also more easily invest in relatively illiquid or longer-term assets that are less attractive to traditional investors. According to the OECD, if sovereign funds invested 1% of their total resources in Africa, the total cumulative investments – including the leverage associated with joint investments with private companies – could amount to USD 420 billion dollars over the decade 2010-2020, a figure that roughly corresponds to the financial resources cited as being the shortfall needed in order to achieve the Millennium Development Goals (MDGs) in terms of infrastructure.

However, to increase its attractiveness, apart from the implementation of a business climate offering a high level of security, particularly legal, for investors (protection of creditors rights, respect of contract law, effective justice systems, genuine possibility for creditors to recover their assets, etc.), the African continent must, via the implementation of suitable economic policies, create a less volatile environment that is less vulnerable to external shocks, whether economic or political, and increase the size and liquidity of its markets. The lack of coordination between SWF investments and government policy, both fiscal and monetary, can also generate difficulties (a sudden increase in liquidity, for example, causing inflationary pressure) and this problem requires prudent management. In the case of countries with fixed or pegged exchange rates, an inflow of liquidity can lead to substantial fluctuations in foreign exchange reserves.

Lastly, in order to ensure the sound management of SWFs, particularly in African countries that have opted to establish sovereign funds that are partly invested in the local economy, their activities must be controlled by **strict governance frameworks** that include rigorous investment target selection and risk monitoring. These frameworks are indispensable if the funds are to effectively contribute to development financing. The adoption of high **transparency** standards is also an essential pre-requisite in fostering the necessary incentives for the sound management of sovereign funds and in sustaining international investors' interest in Africa.

Chart D Cumulative sovereign fund FDI in developing countries and Africa

(in USD billions)



Source: CNUCED, World Investment Report 2012.