INTO AFRICA

A publication from Capital Markets in Africa

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THE YEAR 2018

AFRICA ECONOMY NORMALIZATION

THE AFRICAN YEAR IN 2018: INDICATORS TO LOOK FOR

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Happy New Year! A new year, a new edition and a wealth of new insights – tailor made for you. The Capital Markets in Africa would like to proudly introduce the February 2018 edition of the **INTO AFRICA** - the publication with fresh insight into Africa's emerging markets.

The edition provides insight and foresight into African economies (from Southern Africa to North Africa and East Africa to West Africa as well as Mid Africa regions). Overall, economists and analysts are optimistic about African economic growth and are of the view that the economy is recovering and normalising from the 'new normal' conundrum, hence the edition title: ***The Year 2018: Africa Economy Normalization.***

As the global economy begins to advance on surer footing, Africa's economies face an important test. Some will be buoyed by the creeping rise in commodity prices. But this could be partially offset by rising interest rates in Western economies. The World Bank projected economic growth in Sub-Saharan Africa is estimated to have rebounded to 2.4 percent in 2017, after slowing sharply to 1.3 percent in 2016. The rise reflects a modest recovery in Angola, Nigeria, and South Africa—supported by an improvement in commodity prices, favourable global financing conditions, and slowing inflation that helped to lift household demand. But, growth was slightly weaker than expected, as the region is still experiencing negative per capita income growth, weak investment, and a decline in productivity growth.

For the year 2018, World Bank estimates growth in the region is projected to continue to rise to 3.2 percent in 2018 and to 3.5 in 2019, on the back of firming commodity prices and gradually strengthening domestic demand. However, growth will remain below pre-crisis averages, partly reflecting a struggle in larger economies to boost private investment.

RODDY BARCLAY (Head of Intelligence and Analysis, Africa Practice) opens the edition with a stimulating write-up titled *"The African Year in 2018: Indicators to Look for"*, where he examines African political, economic and business climatic conditions.

Navigating the North pole, **DANIEL RICHARDS** (MENA Economist, Emirates NBD, UAE) and **RAZA AGHA** (Chief Economist, Middle East & Africa, VTB Capital) discuss Algeria and Egypt prospects in *"Algeria: Expansionary Budget to Boost Growth" and "Egypt's Macroeconomic Dynamics in the year 2018"*, respectively. Equally, we provide economic commentaries from the International Monetary Fund (IMF) and the Institute of International Finance (IIF) on Morocco and Tunisia economic prospects.

Exploring the South pole, **TIAGO DIONISIO** (Chief Economist, Eaglestone Advisory) discusses Angola in *"Angola: The Beginning of A New Chapter"* and **MOATLHODI SEBABOLE** (Market Strategist, First National Bank, Botswana) discourses on Botswana in *"Botswana Macroeconomic Fundamentals in the Year 2018"*. In parallel, **SHAILEN SREEKEESSOON** (Head of Strategy and Research, SBM Group Mauritius) and **THABI LEOKA** (Independent Economist) diagnose Mauritius prospect in *"Mauritius Macroeconomic Recovery Gaining Momentum" and South Africa's prospects in "South Africa Macroeconomic Realities, Myths and Prospects in 2018"*, respectively. Likewise, **THEA FOURIE** (Senior Economist, Sub-Saharan Africa, IHS Markit Economics) and **TAPIWANASHE KAZUNGA** (Investment Analyst, Invictus Securities Zimbabwe) distil Zambia in *"Zambia: Improving Prospects, Hinging on IMF Support Program"* and Zimbabwe in *"Zimbabwe Economy: Hindsight, Insight and Foresight"*, respectively.

Steering to the East coast, **STEPHANIE ONCHWATI** (Assistant Investment Analyst, Cytonn Investments, Kenya) deliberates on Kenya in *"Kenya's Economic Prospects in 2018 Amidst Political Unrest"* and **ADAM SENGOOBA** (Associate Director, PricewaterhouseCoopers, Uganda) identifies the key economic signs in *"Uganda Macroeconomic Indicators in the Year 2018"*. Manoeuvring the West end, **COURAGE KINGSLEY MARTEY** (Senior Economic Analyst, Databank Group, Ghana) dissects the Ghanaian economy in *"Ghana's Economy in 2018: Turning stability into Growth"*. In the same spirit, **MICHAEL FAMOROTI** (Chief Economist, Vetiva Capital Management Limited, Nigeria) reviews Nigerian economy in *"Nigerian Economic Prospects in the Penultimate Election Year"*. We also provide a synopsis of Fitch Ratings credit decision on Ethiopia's long-term foreign and local currency.

Looking at the horizon, **STEPHANE COLLIAC** (Senior Economist, Euler Hermes) highlights new Africa's growth drivers in *"African Risks and Opportunities: Emerging New Trends"*. **JOHN ASHBOURNE** (African Economist, Capital Economics, London) provides a synopsis in *"Insight on Sub-Saharan Africa Macroeconomic Prospects in 2018"*. Similarly, **SAMIR GADIO** (Head, Africa Strategy, FICC Research, Standard Chartered Bank) examines the African local fixed income and FX markets in *"African Fixed Income and FX Markets in the Year 2018"*.

On a final note, **LUCY JAMES** (Consultant at specialist global risk consultancy Control Risks) raises concerns over the surge in African debts in *"At Debt's Door: the Clouds a Sovereign Debt Crisis Loom over Africa"*.

Tunde Akodu
Editor

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THE AFRICAN YEAR IN 2018: INDICATORS TO LOOK FOR

By **Roddy Barclay,** Head of Intelligence and Analysis, Africa Practice

As the global economy begins to advance on surer footing, Africa's economies face an important test. Some will be buoyed by the creeping rise in commodity prices. But this could be partially offset by rising interest rates in Western economies. These will both increase the cost of foreign currency debt-servicing for African governments and corporates, and make high-risk investments in Africa less appealing to foreign investors. In the last three-to-four years, the reform narrative in Africa has felt more committed, amid efforts to diversify economies away from commodity-dependence, broaden the tax base and increase capital expenditure. Yet implementation has been patchy, politics has often smothered progress, and there are growing concerns as to the sustainability of spending plans as African debt comes back on the rise..

This write-up explores African political, economic and business climatic conditions for year 2018.

Managing the pace of change

The stability of African governments is increasingly defined by their ability to manage the pace of social and political change. Africa's burgeoning youth populations are flocking to the cities, embracing new forms of communications and media, and vocally demanding greater accountability from their governments. Young and aspirational societies are above all anxious for jobs, but they also expect better public services and more evident social justice. This tide of expectation from the grassroots makes change inevitable. But while governments cannot stop it, they can still shape the pace and direction of change.

Africa today appears an ever more divergent continent in which reform-minded governments with the political will to deliver on their development strategy have the potential to oversee robust growth, while those that are resorting to window-dressing efforts at reform while clinging to power through a reliance on patronage are bumbling along in a dysfunctional status quo – or facing overthrow or electoral defeat. In 2018, we anticipate more bumps in the road for African leaders who fail to respond to the clamouring of their young populations. But we also see the emergence of a new generation of leadership which has grown savvier to these risks, and more responsive as a result.

The new administrations of Cyril Ramaphosa in South Africa, João Lourenço in Angola, and Emmerson Mnangagwa in Zimbabwe, while facing notable political and economic challenges, will all strike a more reformist and accountable tone than their predecessors. These leaders all face monumental political and economic challenges which they will battle with in the year ahead. Notably with Mnangagwa and Lourenço, it remains to be seen whether they represent real change or merely a new pivoting in elite patronage networks. And sometimes actions and policies will undoubtedly fall short of the optimistic rhetoric which is sweeping these countries. But the impact of this political change in setting a new direction for economic and social engagement cannot be under-stated, and each leader will benefit from significant goodwill in the short term at least. Meanwhile, in countries where leaders continue to push back and resist the forces of change, political risks will increase, as was evidenced recently in Zimbabwe.

"In 2018, we anticipate more bumps in the road for African leaders who fail to respond to the clamouring of their young populations."

In perhaps the most prominent example of this dynamic, President Joseph Kabila's dance around the international community in the DRC will continue to fuel a political and security crisis in 2018 that carries risks of escalation. Kabila will continue to play to the gallery on his commitment to elections, but we see this as a means to drag his heels as he remains in power. This dynamic will continue to foment unrest and violence as the country limps along its transitional route. The impact on the mining sector will be limited in relatively stable regions like Katanga, whereas companies operating in the volatile Kivus and Kasai region will see greater risks. But while the political crisis may distract from some of the more aggressive policy initiatives being considered by the Kabila administration, we anticipate substantial license and policy review in the coming years as the government seeks to reap greater rewards from its prized copper, cobalt and coltan reserves.

In Cameroon, President Paul Biya retains a tight grip over his party but not over his country, with the military struggling to contain both Boko Haram infiltration in the Far North, and growing restiveness in the Anglophone regions. With little sign that the President will seek to manage a dos Santos-style succession, an anticipated bid to stand for re-election in October 2018 may inflame geopolitical rivalries in his own party and produce a more volatile political landscape as the ageing President clings on to power without managing a clear plan for his aftermath. Biya still represents a firm favourite to remain in power in 2018, but his lack of succession planning will exacerbate structural risks in the event of his death. The status quo in Cameroon therefore looks increasingly untenable.

Although Yoweri Museveni has recently taken a similar course of action to Biya in amending the constitution to ensure he can stand once again for election in Uganda in 2021, this year is unlikely to mark such a critical juncture for the country. Museveni's calculated move was certainly controversial, and he will face strident criticism from the opposition for his autocratic tendencies. But his grip on the political and military apparatus is such that for now at least, he is reasonably secure in his position.

Lastly, Ethiopia is an interesting example of a country where the forces of grassroots mobilisation are creating upwards pressure on the ruling system. Since the death of Prime Minister Meles Zenawi in 2012, the country has been transitioning from its heavily centralised leadership. Formal mechanisms for grass-roots participation with political leaders are weak and it is notable that social media has become a powerful tool for political debate and mobilisation in the country, signalling a growing trend that political actors across the continent are struggling to respond to. Recent cycles of protest in the ethnic-Oromo and -Amhara regions of the country reflect a deep dissatisfaction amongst the youth of the country who are frustrated by social hardships and the perceived political marginalisation of key constituencies (the Oromo and Amhara make up almost two-thirds of the population but are politically less powerful than the minority Tigray).

"The stability of African governments is increasingly defined by their ability to manage the pace of social and political change."

In response to this tide of pressure, the ruling EPRDF has taken steps to respond, reshuffling the cabinet to replace controversial party stalwarts with younger or more technocratic figures, releasing selected political prisoners, and opening political dialogues to give more political power to regional administrations. Behind these moves, we are witnessing a generational power-struggle within the ruling party, which is seeing younger figures rise to prominence to provide some form of representation for the restive youth. Yet while robust economic growth provides a degree of legitimacy to the government under its state-led development strategy, the pace of political change remains slow, and some would argue that the measures taken are superficial at best. As such, the new status quo in Ethiopia will likely see more bouts of unrest met by a forceful government response as the authorities make fitful progress in responding to the frustrations of its young and aspirational population.

Between populism and pragmatism

Linked to this same demographic pressure for reform and progress, governments are having to make tough decisions on how they run their economies, make policy and fund their development plans. With commodity prices still somewhat subdued, donor streams proving unreliable, and China taking a more cautious approach to the continent, in the last two-to-three years African governments have been forced to place a greater focus on economic diversification, debt-raising, fiscal reform, and efforts to broaden the tax base. Such reforms are much-needed to strengthen the macro-economic sustainability of many countries. But they also carry structural risks, and notable opportunities and risks for business, which need to be carefully evaluated.

With regards to structural risk, IMF chief Christine Lagarde in December 2017 sounded the warning bell over resurgent public debt levels in Africa, with external debt in particular vulnerable to foreign currency appreciation noting the likelihood of further interest hikes in the US and Euro-area this year. After a swathe of debt write-offs in the 2000s with the launch of the Heavily Indebted Poor Countries Initiative (HIPC) in 1996, African debt is again on the rise, with many governments using commercial and concessional borrowing to plug persistent fiscal and budgetary gaps. As a positive note, unlike in previous debt cycles, much of the focus of recent borrowing has been to fund capital spending on infrastructure and developmental projects. However, many governments have also proven either reluctant or unable to trim the public wage bill, cut back on subsidies and reduce wastage in the system by pioneering robust public-sector reform. This has proven evident in the challenging IMF negotiations around concessional reforms to enable extended credit facilities in countries like Ghana, Guinea and Zambia. The IMF is still smarting from its experiences with the concealed debt in Mozambique and we anticipate more stringent requirements around concessional lending, with greater disclosure as a centrepiece.

While 2018 is unlikely to be the year when the tide turns on African debt, we expect this issue to come increasingly into focus with several bond issuances nearing maturity, and the long-term sustainability of debt in countries like Kenya, Zambia and even Ethiopia being called into question. Fortunately, African governments appear more engaged with the IMF and other lenders than they were during the stubborn debt crises of the 1980s. But public-sector reforms will prove a bitter pill to swallow, and with governments under pressure to maintain spending and preserve jobs, the debt mountain is more likely to swell than deflate. This issue could well come back to bite, and donors are unlikely to countenance a second bailout along the lines of HIPC, underlining the long-term structural risks this presents if spending is not contained.

On the other hand, the move towards economic diversification – particularly in resource dependent economies – presents huge opportunities to business. These range from reforms and incentives to open untapped or under-productive sectors like mining and agriculture in Nigeria, to the launch of special economic zones or ring-fenced industrial parks like the export-oriented manufacturing hubs being developed in Ethiopia. Such moves are unlocking significant potential for both companies and government, with an aligned benefit from wealth and jobs creation, and increased fiscal contributions.

Yet in other areas, fiscal reforms and efforts to broaden the tax base come with risks for business. Internal revenue generation in Africa is lamentably low due to a combination of poor checks and systems, high levels of informality in the economy, low tax rates, and corruption. The drive to address this issue forms an important step to build more sustainable economies. Yet while improving tax collection systems and broadening the tax base to capture untaxed areas is likely to be a positive move, we are also likely to see a struggle play out between the need for pragmatic fiscal management and the desire to secure easy populist wins which carry political capital. In particular, where tax authorities target the low-hanging fruit of existing tax payers to drive up tax collection, this is likely to carry risks to business and in some instances, have a detrimental effect on economic activity.

In 2018, we are likely to see hikes in excise taxes on consumer goods that are seen to carry health and environmental impact – notably drinks, plastics and tobacco products – and the telecoms sector will also face similar pressures as a perceived cash-cow for government. While environmental and health issues will be used as the rationale, often the real driver of fiscal change will be short-term revenue-raising requirements. And while the foot has been taken off the pedal in terms of resource nationalism in the extractives sector after a wave of fiscal and regulatory reform in the last decade, tax and regulatory enforcement – including stringent sanctions for non-compliance – is likely to remain a feature for this strategic sector, where local content and beneficiation will be the primary government focus.

Businesses will need to be alert to these risks, which can originate domestically or result from contagion stemming from ‘influencer markets’ like South Africa, Nigeria and Kenya, which can carry significant regional influence. While the risk of contagion from the more radical forms of policy that has been pursued in recent years in countries like Zimbabwe or even Tanzania is limited by the realities of the political-economy in other markets, tax and regulatory pressures are likely to become a growing challenge for business, requiring robust and proactive engagement to manage the impact on operations and the bottom line.

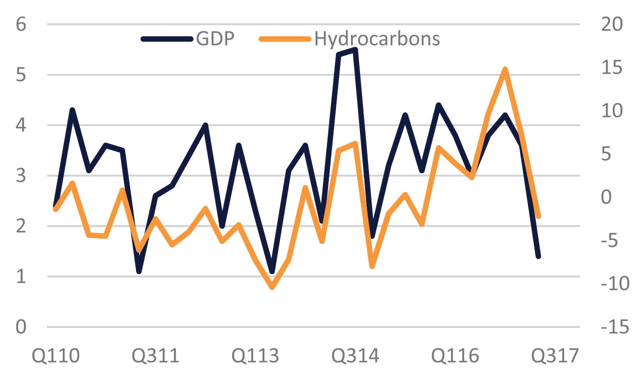
Contributor’s Profile
Roddy Barclay heads up the Intelligence and Analysis team at Africa Practice, a strategy and communications consultancy that specialises in managing external relations. In this role, he oversees a team of political risk analysts and business intelligence consultants spread across Africa, helping clients to mitigate stakeholder and policy risks and manage their reputation. Roddy has worked in the political risk advisory industry for over eight years and formerly specialised on West Africa when he worked as a Senior Consultant at the multinational risk advisory firm, Control Risks. He has travelled extensively across the continent, building strong networks and knowledge in over 20 African countries.

ALGERIA: EXPANSIONARY BUDGET TO BOOST GROWTH

By **Daniel Richards,** MENA Economist, Emirates NBD, UAE

A failure to effectively diversify the economy during the oil boom years, coupled with a deeply entrenched reluctance to open up to international investment, will continue to weigh on Algeria's performance in 2018 and beyond. The economy remains hugely oil dependent, and while there is room for a small production boost in 2018, ongoing OPEC curbs will limit the scope of this, while government efforts to stimulate other areas of the economy will see mixed results owing to a challenging operating environment. Also, although an expansionary budget will encourage growth, this will largely be financed by central bank debt issuance, eroding household's purchasing power. We forecast real GDP growth of 2.5% in 2018, far short of the government's 4.0% growth target. This compares to an estimated 2.3% in 2017 and an average 3.4% from 2012 to 2016.

Real GDP Growth, % y/y

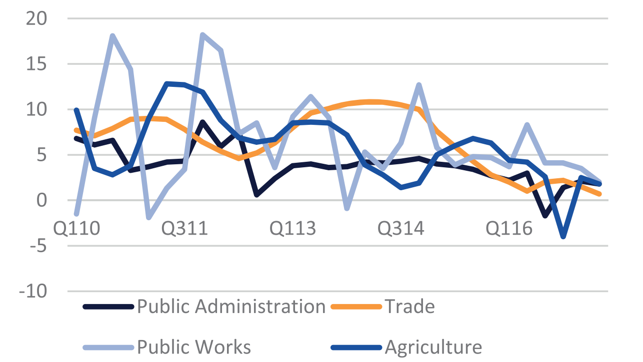


Source: Havers, Emirates NBD Research

Room for oil sector growth despite production curbs

Real GDP growth in 2017 was weighed down by oil production curbs agreed with the rest of OPEC in a bid to draw down global stockpiles and boost global prices. Algeria averaged oil production of 1.04mn barrels per day (b/d) in 2017, compared to an average 1.10mn b/d in 2016. Given its target was for a cut of 50,000 b/d from October 2016 output of 1.09mn b/d, this implies compliance of 100% over the year. Prior to the H2 2014 oil price slump, 'Petroleum products and natural gas' accounted for a third of the Algerian economy. This has steadily declined in the intervening period as production has fallen, standing at just 17.9% in Q2 2017, during which quarter the sector posted a real y/y contraction of 2.2%. While this is the latest available data, we expect that the sector will have seen a similar performance over the remainder of the year.

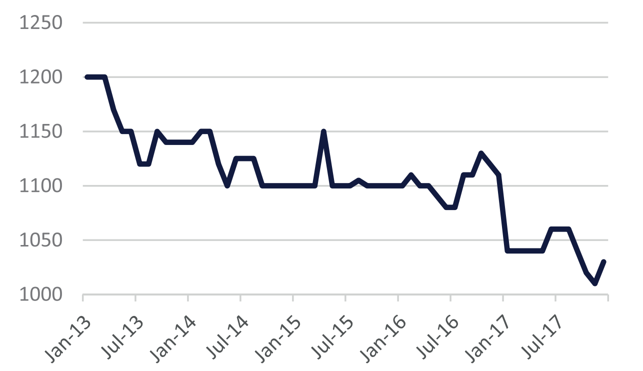
Real GDP Growth by Sector, % y/y



Source: Haver Analytics, Emirates NBD Research

Although extended production curbs will limit oil sector growth this year, there is some scope for a boost to GDP from increased production. This will be limited given that Algeria met compliance in 2017, but higher oil prices will make slippage increasingly attractive from a budgetary perspective. We forecast Brent crude to average USD56.0 per barrel (/bbl) in 2018, compared to USD54.8/bbl last year. Algeria was one of the more vocal voices in calling for an extension to the OPEC strategy, as it looked to cement the price gains already secured. These higher prices will mean greater government revenues, helping to fund a planned increase in spending.

Oil production, b/d ave

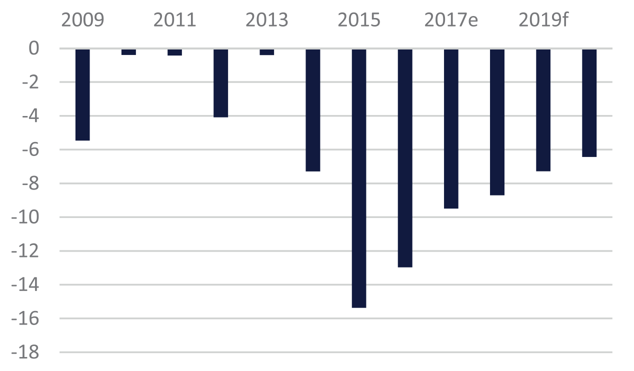


Source: Bloomberg, Emirates NBD Research

Expansionary budget will boost growth…

In 2018, Algeria has announced an expansionary budget for the first time since 2015, projecting a 25% increase in expenditure, all of which will be directed into capital spending. The authorities have recognised the need to urgently develop other areas of the economy than the oil sector, and plan to invest in education, construction and increasing self-sufficiency in staple foodstuffs like cereals – particularly important given the introduction of an import ban on 900 different items introduced in January, as the government seeks to stem the rapid depletion of its FX reserves.

Fiscal balance, % GDP



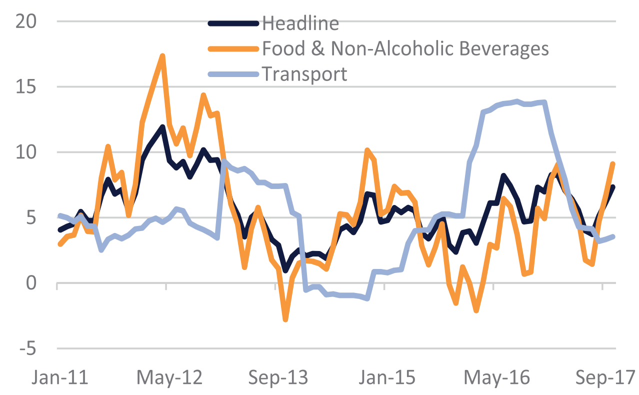
Source: Haver Analytics, Emirates NBD Research

The expansionary fiscal policy is a positive signal for growth following the past several years of belt tightening in Algeria. The slump in global oil prices hit the fiscal balance hard, leading to massive declines in revenues and necessitating spending cuts and tax hikes. In Q316, the Public administration component of GDP – second only to the oil sector in size – contracted, and has posted only anaemic growth since. We expect that the planned investment will offer some stimulus to economic growth this year; the settling of overdue payments to construction firms in particular will likely help boost activity, and infrastructure investment could help support growth over the longer-term also. The positive government investment story is bolstered by the results from an Oxford Business Group survey from November in which over two thirds of respondents were either likely or very likely to make a significant capital investment in the next 12 months.

…but means of financing is inflationary

However, the means by which the government intends to fund this increase in spending is a cause for concern, and will likely offer a drag on growth alongside the boost. Algeria will benefit from rising

Inflation, % y/y

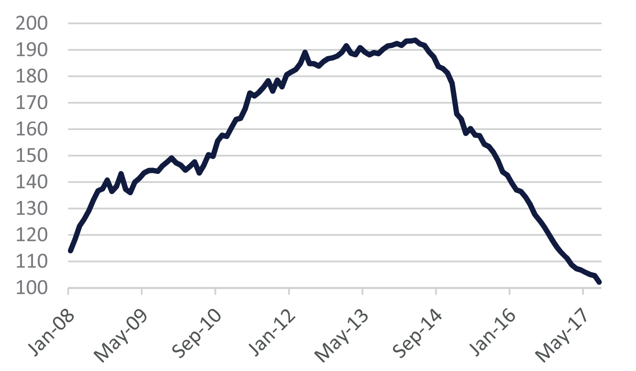


Source: Haver Analytics, Emirates NBD Research

hydrocarbons revenues this year as global oil prices tick higher, but this will still be far from sufficient to fund this spending. The substantial oil stabilisation fund Algeria had built up in earlier decades helped cushion some of the impact of lower oil prices on finances in recent years, but the Fonds de Régulation des Recettes is all but depleted now. Indeed, the fund dropped from DZD4.4bn at the close of 2014, to just DZD840mn in December 2016, having reached its statutory floor.

In order to plug the gap, the government has announced an unorthodox plan to borrow directly from the central bank, a move which we believe will have adverse effects on the economy. Despite comparatively low debt levels, the Algerian state is highly reluctant to borrow from international investors – despite ongoing encouragement from the IMF to do so. While the government has assured sceptics that borrowing from the central bank will not lead to higher inflation, we are dubious, and would expect price pressures to build. We forecast average inflation of 7.0% y/y next year, compared to an estimated 6.3% in 2017 and 5.8% in 2016. This will erode purchasing power and have a negative effect on consumption levels, already

Official reserves, USDbn



Source: Haver Analytics, Emirates NBD Research under pressure as the government remains committed to its austerity programme.

Consumer will remain under pressure

This will put the Algerian consumer, already reeling from the past several years of austerity, under further pressure. The planned increase in spending this year will not immediately benefit Algerian households, which will continue to grapple with squeezed incomes. VAT was raised from 17% to 19% last year, in addition to other new taxes introduced on alcohol and tobacco, car sales and real estate. This has been mitigated somewhat by a 2.5% boost to pensions and a rollback on electricity price hikes in the southern desert in 2017, but new Prime Minister Ahmed Ouyahia is expected to be firmer on cutting recurrent expenditure cuts, having overseen similar strategies in previous decades. In addition, a continued depreciation of the dinar, and higher costs for black market items owing to the import ban, will add further pressures. There could be some positive effect on GDP from a diminished demand for imports, but we expect the overall consequence for growth to be negative.

Foreign investment will lag

The government's planned capital spending boom is an indication that the need for economic diversification has been recognised. However, the state's preference for self-sufficiency, reluctance to take on international debt, and a challenging business environment for foreign investors, could impede progress in this. In addition, domestic rather than international borrowing will also impact upon liquidity, crowd out private sector borrowers and impede the development of small and medium-sized enterprises.

Further, outside of the oil and gas sector, which itself presents significant challenges, the country is fairly unappetising to foreign investment, despite a new reported interest among regional governors in attracting it. Algeria ranked 166th globally in the 2018 Ease of Doing Business report, having dropped 10 places that year despite the introduction of a new investment law in late 2016. Out of the MENA region, only conflict-ridden states such as Syria and Yemen ranked lower. By contrast, next-door neighbor Morocco ranked 69th globally and has been enacting reforms which have seen it move up through the rankings every year. Governmental pressure has compelled European automakers to invest in manufacturing plants to gain access to the market, but this will not work with every industry. Aims to develop tourism will continue to be stymied by a long-winded procedure in obtaining visas.

MOROCCO'S GROWTH TO ACCELERATE AND TUNISIA'S ECONOMY FACES THREATS

MOROCCO: Growth to accelerate with reforms, to widen dirham's floating bands

The International Monetary Fund indicated that Morocco's economic resilience improved following the implementation of sound macroeconomic policies and reforms. It noted that real GDP growth recovered in 2017 and expected it to accelerate over the medium term in case external conditions improve and additional reforms are implemented. The Fund called on authorities to continue implementing fiscal consolidation, which would reduce the public debt level and create fiscal space for priority investment and social spending in the medium term. In addition, the IMF considered that Bank al-Maghrib's (BAM) recent decision to widen the dirham's floating band from +/-0.3% to +/-2.5% would further improve Morocco's external position, strengthen the economy's capacity to absorb shocks and maintain its competitiveness. In parallel, Fitch Ratings considered that the widening of the floating band would pose limited risks to macroeconomic stability. It anticipated supportive economic fundamentals, such as a comfortable level of net international reserves of $26bn in early January 2018, a low inflation rate, a narrower current account deficit and a moderate foreign-currency exposure, to limit the pressure on the exchange rate. In addition, Fitch projected the current account deficit to narrow from 4.4% of GDP in 2016 to 3.8% of GDP by 2019, and the inflation rate to remain close to 2% over the coming two years.

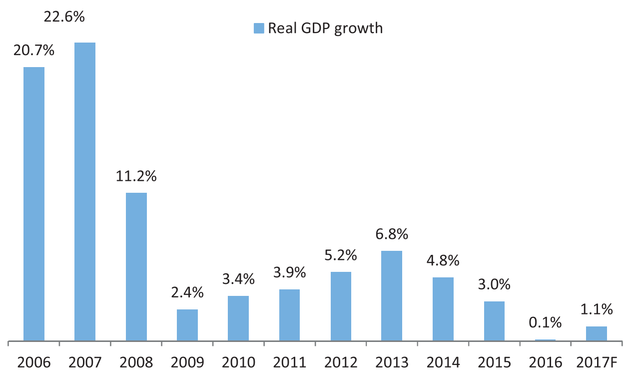
TUNISIA: Economy continues to face significant challenges

The Institute of International Finance (IIF) indicated that Tunisia's economic conditions have deteriorated since 2011, with subdued economic activity, persistently high unemployment rates, especially among the youth, and worsening external and fiscal imbalances. It estimated real GDP growth at 2% in 2017, supported by a modest recovery in tourism activity and a strong rebound in phosphate production, and expected it to remain subdued at 2.3% in 2018. It pointed out that the inflation rate accelerated from 4.2% at the end of 2016 to 6.3% at end-2017, partly driven by the depreciation of the dinar, which prompted the Central Bank of Tunisia to increase its policy rates. It projected the inflation rate to slightly regress to 5.2% at the end of 2018. In parallel, the IIF indicated that the fiscal deficit widened from 5.4% of GDP in 2016 to 6% of GDP in 2017, mainly due to higher spending on wages, pensions, transfers and subsidies. In addition, IFF projected the deficit to narrow to 5.5% of GDP in 2018 in case authorities implement the fiscal measures included in the 2018 budget, such as increasing the value-added tax rate on several goods & services and cutting fuel subsidies. It added that fiscal consolidation measures, along with deteriorating economic conditions and the rising cost of living, have triggered protests that called for revising the fiscal measures. Further, it forecast the public debt level to reach 71% of GDP by the end of 2018. In parallel, the IIF projected the current account deficit to remain at 10% of GDP this year, while it forecast foreign currency reserves at $5.4bn, or 2.5 months of import cover at end-2018

ANGOLA: THE BEGINNING OF A NEW CHAPTER

By **Tiago Dionisio,** Chief Economist, Eaglestone Advisory

Economic activity in Angola has decelerated markedly since the second half of 2014 mainly as a result of the significant decline in oil prices during this period. The freefall in oil prices (from a peak above US$ 110 in early-2014 to as low as US$ 28 in 1Q2016) had major implications in the country's fiscal and external accounts, foreign exchange market and the real economy. Real GDP growth stood at only 4.8% in 2014, 3% in 2015 and stagnated to 0.1% in 2016. This is well below the 6.8% in 2013 and the double-digit growth average recorded in the previous decade.



Source: Angolan authorities and IMF

Specifically, the oil price shock had a major impact on: (1) oil related exports and fiscal receipts, with the latter falling almost 30% since 2014; (2) inflation, which in 2016 surged to levels unseen since 2004 and has reduced the purchasing power of a large part of the local population; (3) foreign exchange market, as a lower availability of foreign currency led to a devaluation of the kwanza and a widening of the gap between the exchange rates in the official and parallel markets; (4) net international reserves, which have kept a downward trend since 2014; and (5) liquidity, leading to higher interest rates that have impacted debt service levels and hurt private investment.

The Angolan authorities have implemented several measures in recent years, both on the fiscal and monetary fronts, in order to try to attenuate the impact of sharply lower oil prices. On the fiscal front, the government lowered spending levels, namely capital expenditures (down nearly 45% in the period 2014-17), and gradually reduced the level of subsidies, eliminating fuel subsidies almost entirely. It also introduced programs to re-register public sector employees as well as to improve tax collection. On the monetary front, the central bank adjusted the foreign exchange rate, allowing the kwanza to depreciate by nearly 70% during 2014-16. The BNA intervened in the foreign exchange market in order to defend the local currency and help stabilize the kwanza, but not without sacrificing the level of reserves, which have fallen almost 50% since 2014 (to US$ 14 billion at end-2017). The central bank also raised the BNA rate nine times (a combined 900bps) since end-2014, lifting its benchmark rate to a multi-year high of 18%. Moreover, the BNA raised restrictions on hard foreign currency supplied to commercial banks, which led to a widening of the gap between the official exchange rate and the parallel market rate. The unofficial rate reached a level above 600 kwanzas to the dollar in 2016 and a spread of over 180% to the official rate (the kwanza currently trades at around 450 to the dollar on the streets).

On the political front, José Eduardo dos Santos' last term in office ended at the end of September 2017 after he was president of Angola for nearly four decades. Mr. dos Santos remains the head of the ruling MPLA party for now. The new president, João Lourenço, hopes to change Angola's fortunes and quickly address its more acute challenges, including (1) reaching economic stability, (2) relaunching vigorous economic growth to create more jobs and (3) mitigating the more pressing social problems. Since taking office, Mr. Lourenço replaced the heads of the central bank, Sonangol, Endiama (the government-backed diamond company), the boards of all three state-run media companies and, more recently, the head of the country's sovereign wealth fund. The new president's greater than anticipated appetite for reform could face some headwinds this year, but for now it has been generally well received at home and abroad.

The new government believes that economic activity will improve significantly in 2018 from the performance in recent years. Its real GDP growth forecast of 4.9% incorporated in the budget proposal recently presented to the country's parliament is broken down by projections of 6.1% for the oil sector and 4.4% for the non-oil sector. This compares with estimates of -0.5% and 1.9%, respectively, for 2017 and overall real GDP growth of 1.1% last year. The 4.4% growth forecast for the non-oil sector incorporates a 5.9% expansion in agriculture, 4.3% in commerce, 3.1% in construction, 1.8% in manufacturing, 4.4% in extractive industry and 60.6% in energy.

We believe the growth forecasts for 2018 are likely to be somewhat optimistic bearing in mind Angola's current macroeconomic situation and immediate challenges. The growth outlook in the longer-term will depend on the commitment to implement major structural reforms in the country. These will be fundamental to a rebalancing of the local economy away from its dependence on the oil sector and also improve the business environment in order to attract higher foreign investment in the country.

Besides the acute challenges aforementioned, the local authorities will be faced this year with (1) the need to implement additional fiscal consolidation measures, (2) a persistently tight monetary policy stance and (3) the likely impact of further adjustments to the newly announced exchange rate regime. On the latter, we note that this new mechanism states that the kwanza will fluctuate within a range against the euro determined at central bank currency auctions, with the other rates resulting from how the euro trades against those currencies. At the first auction in early-2018, the kwanza depreciated roughly 10% against the dollar, but a stronger euro expected this year would put further pressure on the dollar/kwanza rate.

Meanwhile, consumer price inflation is expected to remain elevated in 2018 after peaking at 42% in late 2016 and gradually declining to an estimated 23% last year. This assumption comes despite significantly tighter monetary and fiscal policies as well as the implementation of several measures aimed at combating inflation, including the introduction of price controls and the replacement of the supply of some essential goods. A new customs tariff regime due to come into effect is also expected to lower import duties on a number of food and other items. That said, the government's 28.7% inflation forecast likely incorporates the impact from the adjustment(s) to the kwanza exchange rate in 2018, which will push up the prices of imported goods.

MACRO FORECASTS	2013	2014	2015	2016	2017 (1)	2017 (2)	2018 (1)
Inflation	7.7%	7.5%	14.3%	42.0%	15.8%	22.9%	28.7%
Annual oil production (mn barrels)	626.3	610.2	648.5	611.2	664.7	610.6	620.2
Daily oil production (million bpd)	1.716	1.672	1.777	1.675	1.821	1.673	1.699
Average oil price (US$ per barrel)	107.7	96.9	53.7	41.8	46.0	48.4	50.0
Gross domestic product:							
Nominal value (AKZ billion)	12,056	12,462	12,321	16,662	19,746	18,350	23,872
Oil sector	4,818	4,304	2,884	3,149	3,753	3,573	5,017
% of total	40.0%	34.5%	23.4%	18.9%	19.0%	19.5%	21.0%
Non-oil sector	7,239	8,158	9,436	13,513	15,993	14,778	18,855
% of total	60.0%	65.5%	76.6%	81.1%	81.0%	80.5%	79.0%
Real GDP growth	6.8%	4.8%	3.0%	0.1%	2.1%	1.1%	4.9%
Oil sector	-0.9%	-2.6%	6.3%	-2.3%	1.8%	-0.5%	6.1%
Non-oil sector	10.9%	8.2%	1.5%	1.2%	2.3%	1.9%	4.4%
Exchange rate (US$/AKZ)	96.6	98.3	120.1	164.0	165.9	165.9	-

(1) Budget Proposal; (2) Forecast. Source: Angolan authorities.

On the fiscal front, the government anticipates in this year's budget proposal that a significant improvement in oil-related receipts (40.9% YoY), boosted by slightly higher oil prices and production, will help to reduce the fiscal deficit further in 2018. The current budget proposal foresees average daily oil production increasing 1.5% to 1.699 million barrels per day while the oil price is expected to average US$ 50, slightly higher than the US$ 48.4 in 2017. We believe this oil price assumption is rather conservative, standing at the bottom-end of current consensus estimates for Brent crude oil. Non-oil revenues are also projected to see a (likely optimistic) rise of 39.9% YoY, reflecting the continued efforts by the local authorities to improve tax collection outside of the oil sector. In terms of expenditures, it is worth noting the surge in interest payments (36.2% YoY and double the amount projected in 2017), which come as a result of the large increase in debt levels in recent years. Indeed, public debt represented less than 30% of GDP in 2013, but rapidly surpassed 70% of GDP in 2016. As a result, spending on interest payments is expected to represent 18.9% of total spending and 4.1% of GDP (vs. 2.8% and 1.2%, respectively, in 2014). Overall, the 2018 budget proposal foresees a deficit of 3% of GDP (down from an estimated 5.3% of GDP in 2017). It is also worth noting that the primary fiscal balance (which excludes interest payments) is projected to reach a surplus for the first time since 2013. This is an ambitious target aimed at continuing the fiscal consolidation efforts of the Angolan authorities that will ideally place public debt back on a downward trajectory and below the debt ceiling of 60% of GDP.

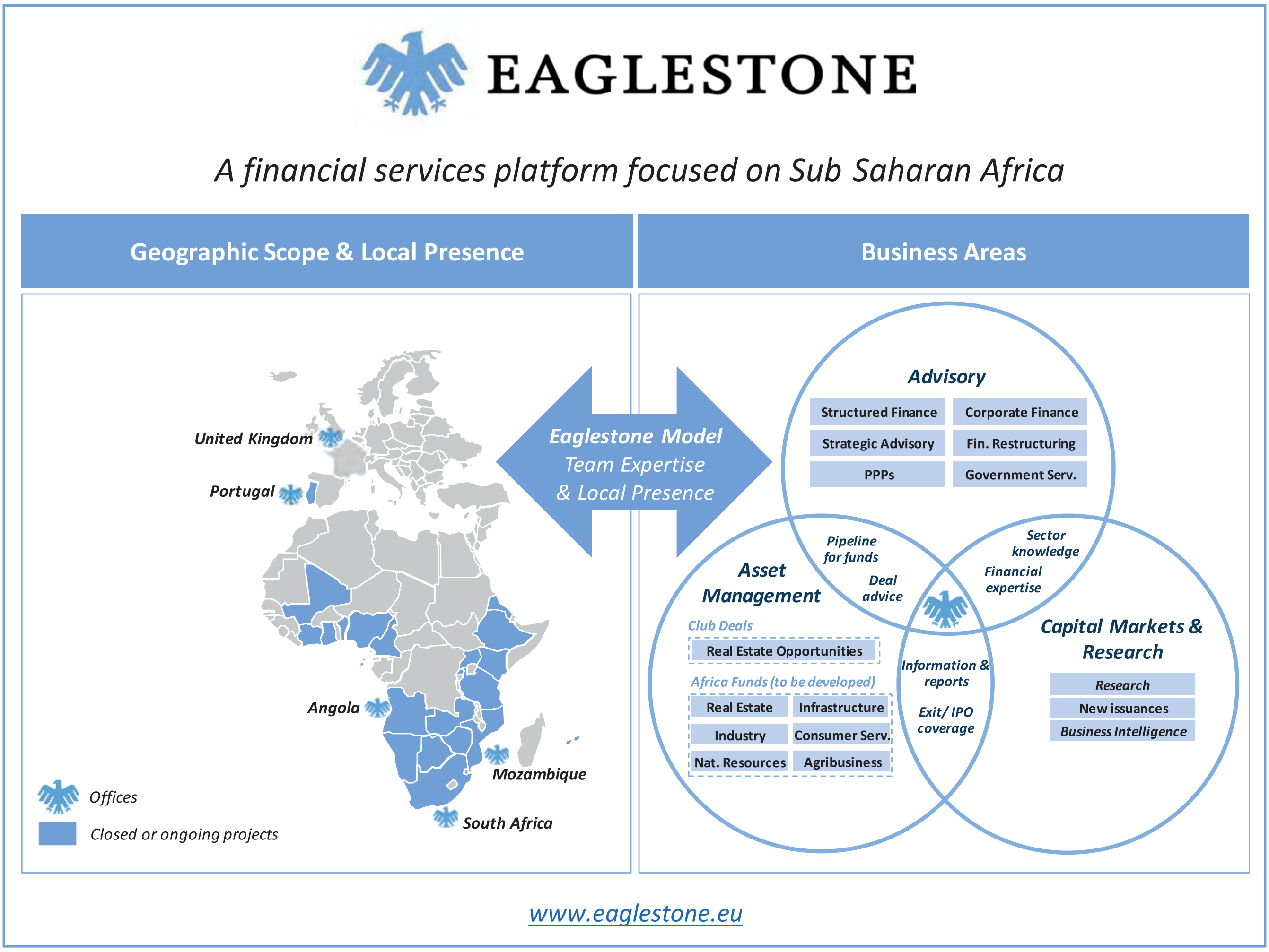
GOVERNMENT ACCOUNTS									Change	
AKZ BILLION	2012	2013	2014	2015	2016	2017 (1)	2017 (2)	2018 (1)	2018 (1) / 2017 (1)	2018 (1) / 2017 (2)
Revenues	**5,054**	**4,849**	**4,403**	**3,367**	**2,900**	**3,668**	**3,254**	**4,404**	**20.1%**	**35.4%**
% of GDP	*46.5%*	*40.2%*	*35.3%*	*27.3%*	*17.4%*	*18.6%*	*17.7%*	*18.4%*		
Tax Revenues	4,826	4,602	4,098	3,042	2,599	3,404	2,947	4,139	21.6%	40.5%
Oil Revenues	4,103	3,630	2,970	1,898	1,373	1,696	1,703	2,399	41.5%	40.9%
% of Total Tax Revenues	*85.0%*	*78.9%*	*72.5%*	*62.4%*	*52.8%*	*49.8%*	*57.8%*	*58.0%*		
Non-oil Revenues	723	972	1,128	1,144	1,227	1,709	1,244	1,740	1.8%	39.9%
Of which: Income Taxes	325	502	545	664	720	862	697	834	-3.3%	19.6%
Non-tax Revenues	228	247	305	325	301	264	307	265	0.5%	-13.7%
Expenditures	**4,329**	**4,816**	**5,221**	**3,774**	**3,648**	**4,808**	**4,222**	**5,129**	**6.7%**	**21.5%**
% of GDP	*39.8%*	*39.9%*	*41.9%*	*30.6%*	*21.9%*	*24.3%*	*23.0%*	*21.5%*		
Current Expenditures	3,184	3,437	3,666	3,038	3,003	3,813	3,373	4,190	9.9%	24.2%
Wages	1,031	1,155	1,319	1,390	1,397	1,614	1,493	1,647	2.1%	10.3%
Goods and Services	1,297	1,228	1,249	787	624	1,035	718	975	-5.8%	35.6%
Interests	105	99	147	249	470	484	711	968	100.0%	36.2%
Transfers	752	955	950	612	512	680	451	600	-11.8%	33.0%
Subsidies	548	710	668	279	161	292	112	225	-22.9%	100.4%
Capital Expenditure	1,145	1,379	1,555	736	645	995	849	939	-5.6%	10.6%
Public Investment	1,145	1,376	1,547	719	634	995	839	939	-5.6%	11.9%
Primary Fiscal Balance	**830**	**131**	**-672**	**-159**	**-278**	**-656**	**-258**	**244**	**n.m.**	**n.m.**
% of GDP	*7.6%*	*1.1%*	*-5.4%*	*-1.3%*	*-1.7%*	*-3.3%*	*-1.4%*	*1.0%*		
Overall Fiscal Balance	**725**	**32**	**-819**	**-407**	**-748**	**-1,140**	**-968**	**-725**	**-36.4%**	**-25.2%**
% of GDP	*6.7%*	*0.3%*	*-6.6%*	*-3.3%*	*-4.5%*	*-5.8%*	*-5.3%*	*-3.0%*		

(1) Budget Proposal; (2) Forecast. Sources: Angolan authorities and Eaglestone Securities.

The government is likely to give high priority to continuing to consolidate relations with key strategic partners (like China and Portuguese-speaking countries) and to diversifying the country's access to international finance. There are increasing talks about a new Eurobond deal reaching as much as US$ 2 billion taking place as early as 1Q2018. Moreover, the government confirmed last October that it was looking at a new IMF program, although it had not yet been decided if it would include financial assistance. The new president also seems to be looking to increase Angola's regional presence and economic links with Africa, as recently demonstrated by the lifting of visa restrictions with South Africa on traveling between both countries.

Contributor's Profile

Tiago Dionisio is Chief Economist at Eaglestone since 2013 where he covers Portuguese- speaking countries in Africa such as Angola and Mozambique both as a macro and banking sector research analyst. He has over 17 years' experience in investment banking, namely at Portugal's Banco Português de Investimento (BPI) and later at Espírito Santo Investment Bank (ESIB). Before joining Eaglestone, Tiago was part of ESIB's Project Finance team for two years. Prior to that, Tiago was a sell-side analyst covering the main listed Iberian banks for eight years both at BPI and ESIB. Before that, he was a macro research analyst at BPI for three years responsible for covering Portugal, Spain and several Latin America countries, including Brazil and Argentina.



BOTSWANA MACROECONOMIC FUNDAMENTALS IN THE YEAR 2018

By **Moatlhodi Sebabole,** Market Strategist, FNB Botswana

The local growth slowed to 1.8% y/y in 3Q17, 0.46ppt lower than at the same time in 2016. This growth has been led by the services sectors of transport, communications and financial services – whereas the trade sector has suffered some sluggish growth due to some downturn in the mainstream cutting and polishing diamond industry. The stability in the supply side of water and electricity has continued to benefit the economic prospects.

In the short term, our anticipation is for growth to reach the 4% levels by 2019 with a medium-term average of 4.1% - this rate, which almost matches exactly the country's long-term historical average, incorporates the expected contribution of the government's "Cut 9" diamond mining project, which aims to provide access to 91 million tonnes of ore containing about 110 million carats of precious stones between 2024 and 2033.

Figure 1: Growth will remain positive over our forecast horizon

Source: Statistics Botswana, FNBB, RMB Global Markets

Notably, the first year of the new National Development Plan "NDP11" commenced in April 2017 and is expected to provide the country's economic development policy framework through to 2023. The NDP11 expects an average growth rate of 4.4% over the forecast period. Policy implementation has, however, been a challenge for Botswana in the past, and the success of the country's public-private-partnerships and economic diversification drive will rely heavily on favourable regulation and effective implementation of development projects – specifically those improving water and electricity supply.

We note that meaningful growth in the non-mining private sectors would be a pre-condition for higher employment, wage increases and household consumption. Although we expect fiscal revenue to be supported by slightly better diamond sales, spending is likely to slightly exceed revenue, as the government continues on Phase 2 of the ESP. Despite the pressure this will put on public finances, we are encouraged by the fact that much of this spending will be dedicated to developmental investments in education, health, water and power sectors.

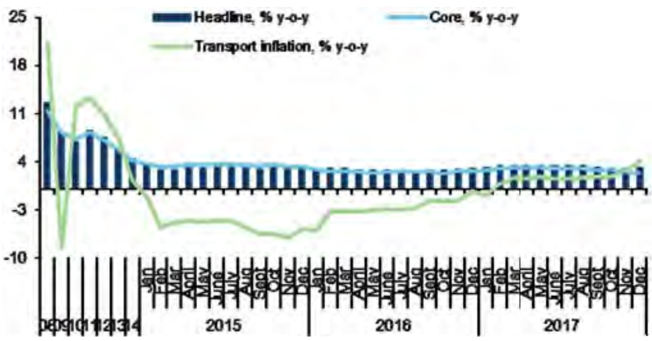
Notwithstanding these potential tail winds, growth will continue to be constrained by high unemployment, limited job creation, low wage increases and consequently, constrained household consumption expenditure.

Price changes remain persistently low

The December inflation rate ticked up by 0.3ppt to 3.2%, due to inflationary pressures from the transport component which increased by 1.6% m/m between November and December as a result of the BWP0.30/litre increase in fuel prices on the 10th of December. These takes the annual inflation average for 2017 to 3.3% (a tick below our forecast of 3.4%) — 0.5ppt higher than 2.8% which printed for 2016.

We note that inflationary pressures for 2017 were

Figure 2: Risks to the downside outweigh the upside despite inflationary transport component



Source: Statistics Botswana, FNBB, RMB Global Markets

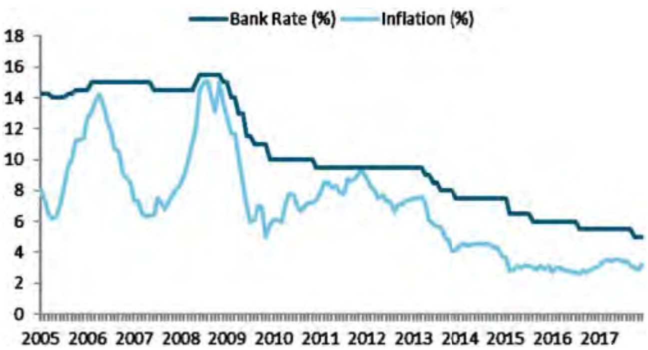
mainly from the supply side as the annual increase in inflation to 3.3% was primarily driven by at least three increases in fuel prices in 2017. These changes in fuel prices mainly resulted in inflation for the transport component printing at 1.6% compared to -2.7% for 2016. Despite the low inflation environment, we note that the price effect still hurts the lower- to middle-income households as transport and food inflation increased on a 12-month average, despite some moderation on housing inflation. The rand weakness for most part of 2017 also meant there was an FX benefit to the retailers who were able to pass on the price benefit to the consumers so as to gain market share.

We reiterate that the lack of creation of sustainable jobs, as well as compressed income levels are limiting demand-pull dynamics and thus forecast a marginal increase in the annual headline rate to 3.8% for 2018.

How low can the interest rates get?

A benign outlook for inflation and a relatively stable real effective exchange rate (REER) have led the Bank of Botswana to cut rates to 5.0% in October 2017. While we expected a rate cut, our magnitude and timing were for 25bp in 1H18. We have subsequently changed our forecast to 5.0% in the bank rate through to 1H18 with some room, albeit small, for the central bank to cut rates by 25bp in 4Q18. This is mainly due to an accommodative real rate differential with trading partners as well the continuous reduction in the core inflation. However, the Bank of Botswana will have to strike a fine balance between focusing on price stability and financial stability, given risks to outflows in a low interest rate environment as well as concerns over interest rate differentials — mostly with South Africa, whose repo rate is at 6.75%.
Although we forecast credit growth to slightly

Figure 3: Rates remain at cyclical lows



Source: Statistics Botswana, FNBB, RMB Global Markets

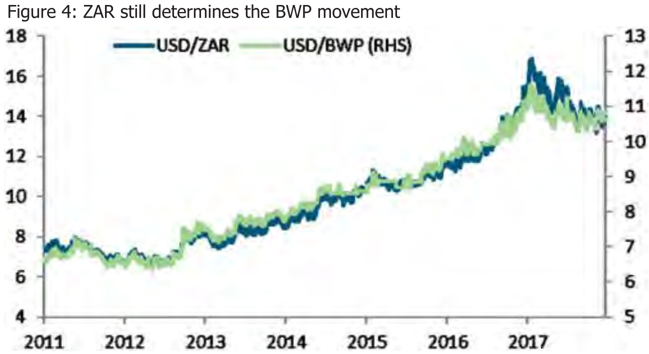
increase as business and household confidence returns, our expectation is that market credit extension will remain below 8% through to 2019.

Pula exchange rate regime

In January 2018, Botswana announced that the pula basket weightings will remain unchanged at 45% ZAR and 55% SDR, but has adjusted the crawl to -0.3% p.a. (depreciation) from +0.26% (appreciation). This makes only a minor difference to the pula outlook: the pula will be only 0.56% weaker at year-end than it would have otherwise been, a difference that can often be seen in a single day's trading. The crawl adjustment, however, pushes up our fair value estimates on yields by 0.56% across the curve and could add marginally to inflation.

The rand weight has been reduced steadily in the past few years, slowly making crosses such as BWP/USD and BWP/EUR less volatile. Since no change in the weightings was made for 2018, it means the pula will trade as it did in 2017.

Figure 4: ZAR still determines the BWP movement



Source: Reuters, FNBB, RMB Global Markets

RISKS TO THE FNBB BASELINE FORECASTS

Table 1: Risks to FNBB baseline forecasts

Table 1: Risks to FNBB baseline forecasts	
GDP growth	- Increased diamond production and sales would support a **recovery in mining GDP**, whereas some mine openings and slight improvement in base metal prices will also support economic activity. - Economic **diversification remains a challenge.**
Inflation	- CPI inflation should rise towards **the mid-point of the target band** as transport inflation gradually picks up. - Increases in inflation will be limited by **modest growth in real income.**
Policy rate	- We expect rates to remain unchanged for the first half of 2018, however risk remains to the downside as other indicators of investment and credit growth remain muted.
Currency	- Given the pula peg, the pula/dollar volatility will continue to be influenced, at least 80% by the movement of the rand against the dollar.
Description of variables GDP growth: Refers to the average year-on-year percentage change in real GDP over the last four quarters. Inflation: Refers to the year-on-year percentage change in the consumer price index at the end of the period. Monetary policy rate: Is a signalling rate, announced by the Bank of Botswana, which is supposed to serve as a reference cap for all other rates in the economy.	

Contributor's Profile

Moatlhodi Sebabole joined First National Bank, Botswana in 2014 from the University of Botswana where he worked as a lecturer in finance. He has previously worked at the University of Essex, UK and at Stanbic Bank in risk management, as well as at the Botswana Stock Exchange in product development.

As FNBB/RMBB Economist, he is responsible for the bank's market intelligence and analysis. He conducts macroeconomic forecasts and analysis, and also provides insight and synergy between the bank's strategy and economic developments. He also actively engages on industry development through participation in forums and reference groups of Botswana Investment Trade Centre, Botswana Stock Exchange, Botswana Qualification Authority, Business Botswana and Ministry of Finance, among others.

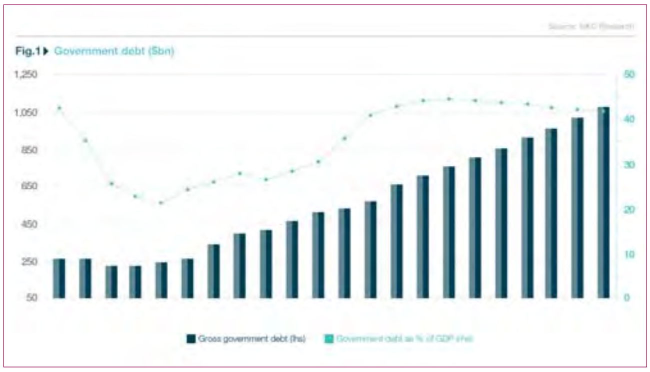
AT DEBT'S DOOR: THE CLOUDS OF A SOVEREIGN DEBT CRISIS LOOM OVER AFRICA

By **Lucy James**, Consultant at specialist global risk consultancy Control Risks
www.controlrisks.com

Chad was the last African country to qualify for debt relief under a programme called the Multilateral Debt Relief Initiative. At a stroke, more than USD 1bn was wiped off the country's balance sheet in 2015. Relief from crippling debt service payments has been credited with improving the economic outlook in Chad and 29 other African countries since the late 1990s.

But now? Debt in Africa is back. With the 2008 financial crisis a fading memory, burgeoning interest in emerging and frontier markets and attractive Eurobond rates have encouraged African governments to borrow more and more. Across the continent, rates of public debt have increased by more than 125% in the past ten years.

Graph 1: Historic Debt



Debt is not always bad. The judicious use of external borrowing to finance major public infrastructure projects, including in power generation and transport, has underpinned strong growth in African countries such as Kenya, whose economies are less resource intensive.

However, steep increases in public debt in recent years have proved problematic in other African markets, particularly those vulnerable to fluctuating commodity prices. In oil-dependent countries such as Nigeria and the members of the Central African Economic and Monetary Community (CEMAC – Gabon, Cameroon, Central African Republic, Chad, Congo (Brazzaville) and Equatorial Guinea), shrinking oil revenues and contracting foreign exchange reserves have seen debt, rather than revenue or tax income, used to plug holes in national budgets. Infrastructure improvements are strong drivers of economic growth, but big projects have big timelines. In the next two years, these sorts of projects are unlikely to generate sufficient revenues to finance debt repayments. As debt once again piles up, governments that borrow will find themselves between a rock and a hard place: continue to borrow and risk default, or rein in spending and risk the political consequences.

Varying vulnerabilities

Debt levels in Africa still tend to be lower than in the rest of the world. But the sharp rise in external debt, combined with proportionally lower tax collection and other revenues, raises concerns over the return of a pan-African sovereign debt crisis not seen since the 1980s and 1990s. The subsequent years of IMF restructuring programmes in multiple African countries shut down economic growth and the development of indigenous industries, and carried heavy social and political costs.

Barring significant shocks, mass sovereign defaults will not materialise in 2018 or immediately after. Economic and political conditions have changed enormously since the debt crisis of the 1980s and 1990s, with debt levels and debt management policies now as varied as the continent's history and politics. The vulnerability of countries to sovereign default varies widely, depending on how borrowed funds are put to use, the strength of domestic institutions and the extent of reliance on primary commodities, among other factors. The challenge is balancing economic imperatives and political interests.

The responses of African governments to rising debt levels run the risk of creating significant political pressures, especially if they take the form of painful domestic reforms. Austerity in countries already struggling with high costs of living, unemployment and limited access to domestic finance has triggered strikes and demonstrations, notably in Chad and Gabon. Meanwhile, political risks are increasing in countries struggling to boost revenue flows by issuing fines and scrutinising business taxes. These include Tanzania and others announcing reviews of tax arrangements, such as Ghana. Although sovereign defaults remain unlikely, managing high debt levels presents a number of other risks to businesses and foreign investors.

Warning signals

In countries with a more diversified economic base, gains in sectors with strong growth, such as manufacturing and agriculture, will keep sovereign risks at bay over the next year. Kenya, a key example of this, will avoid a debt crisis in 2018. Nevertheless, the doubling of government debt over the past five years raises concerns over the sustainability of borrowing in the longer term. The economic impact of the protracted 2017 presidential election, a regional drought and high inflation exacerbates these concerns and has damaged investor confidence.

A pending repayment of the first portion of a Eurobond worth USD 774.8m in 2018 will be a wake-up call for the government to refocus attention on controlling public borrowing and spending before debt becomes unmanageable. But the outlook is not good. Kenya has a strong appetite for external borrowing and has remained politically intransigent about its downsides, even in the face of warnings by the IMF and ratings agencies.

Prudence versus politics

In certain countries, raising of debt without adequate government planning and oversight has already caused serious problems. In Mozambique, revelations of more than USD 1.4bn of undisclosed debt, a missed Eurobond payment and evidence of high-level corruption in the issuing of loans have undermined confidence in the government's ability to manage its borrowing. The lesson? Don't count your revenue flows before they hatch. Mozambique hoped to repay its debts with future cash flows from oil and gas projects that have yet to come online.

Mozambique is not unique. In Ghana, the discovery in 2010 of offshore oil resulted in liberal government spending and borrowing in expectation of quick returns. Ghana then struggled to control spending and to meet its debt obligations, prompting it to turn in 2015 to the IMF. Macroeconomic reforms – and increased investor confidence – followed. And then, in 2017, the revelation of a USD 1.6bn hole in the budget and projections that debt levels will remain around 70% of GDP served as harsh reminders to a new government that only strict management of public finances will undo the damage of excessive borrowing.

Nonetheless, ongoing reforms and government recognition of these issues will drive improvements in 2018. In Ghana in particular, reforms have put the country in a position to clear its maiden 2007 bond. In addition, new revenue streams from liquefied natural gas (LNG) projects and offshore exploration will provide both countries with more room for fiscal manoeuvre.

Graph 2: Sources of Borrowing

Oiling the wheels

Countries dependent on oil revenues are far more vulnerable to ballooning debt in 2018. In Nigeria, plans to borrow heavily to finance long-term infrastructure projects will not generate sufficient revenues in the coming year to finance debt repayments. Compared with more diversified economies such as Namibia, where government revenues are expected to equal 32.3% of GDP in 2017, in Nigeria revenues will be only 5.4% of GDP. Amid rising inflation and muted oil prices, Nigeria's debt servicing payments – which in 2016 doubled to 66% of total revenues – are likely to rise further, placing extreme strain on an already stretched budget.

Meanwhile, pressures in other vulnerable oil economies have already brought the IMF back to Africa. IMF stabilisation programmes in Cameroon, Gabon and Chad, and ongoing discussions with Congo (Brazzaville) and Equatorial Guinea will aim to firm up these economies over the next three years. Still, attempts to alleviate economic pressures via sharp cuts to salaries, subsidies and development programmes carry enormous political risks. Staunch resistance to reform among government elites – whose political legitimacy and support base are threatened by cutbacks – mean that significant improvements in public financial management under new IMF programmes will fail to materialise. For countries due elections in 2018, such as Cameroon, attempts to preserve political legitimacy are even more likely to trump significant reforms aimed at dealing with debt.

EGYPT'S MACROECONOMIC DYNAMICS IN THE YEAR 2018

By **Raza Agha,** Chief Economist, Middle East & Africa, VTB Capital

Since November 2016, significant reforms have been taking place in Egypt under a USD12bn IMF program which has improved the outlook to better than it has been in years. Rating agencies, investors and markets have responded – two of the three major sovereign ratings outlooks have been changed to positive, portfolio inflows are at record levels, local and external borrowing costs have declined as have credit default swaps. However, progress on the Achilles heel of Egypt's macro challenges – public finances – remains anemic.

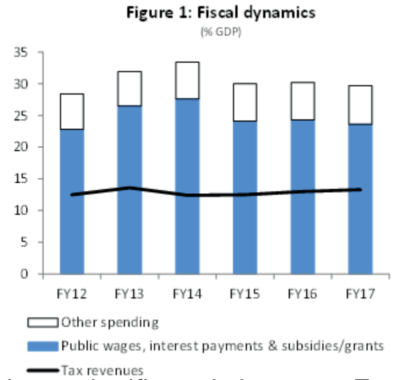
In early November 2016, the Central Bank of Egypt (CBE) devalued the Egyptian pound (EGP) from 8.9/USD to a rate that eventually settled around 17.7/USD. Forced by a sharp decline in foreign exchange reserves and severe hard currency shortages, the move has proven a turning point for Egypt's external sector. Highlighting this annualized net portfolio inflows increased to USD24.3bn in September 2017, 2x their previous peak in September 2010, and compared to outflows of USD700mn+ in the 12 months to September 2016. Exports rose 16% in USD terms over this period driven by both oil (30% of the total) and non-oil exports, after having fallen 30%+ after the Arab Spring. Tourism receipts, down 80% since the Arab Spring, rose 126% to nearly USD6.5bn over the 12 months to September 2017. And home remittances, down 15% from peaks in September 2016, are up 20% to USD20bn.

Aided by stable Suez Canal receipts (annualized USD5.0bn; Sep-17) and sustained strong net FDI inflows (USD7.6bn), the CBE's net international reserves have increased to USD37.0bn in December 2017, their highest ever, nearly double of pre-devaluation levels and equivalent to 6.5 months of imports (G&S). Meanwhile an additional USD11.9bn (as of September 2017) has been built in 'other reserve assets', itself up from just USD32mn in September 2016. Beyond the external sector, other reforms under the IMF program approved in the days after the devaluation have also been taking place - these have included industrial licensing, credit access for small and medium enterprises, a new bankruptcy law and more.

Coupled with risk-on in global markets, the CBE's devaluation of the EGP has proved pivotal in eliminating most external sector pressures. Meanwhile, aided by improved investor sentiment, higher foreign exchange availability, the exchange rate boost to manufacturing and spending on government mega-projects, growth has begun to recover and is seen rising to 5.5% by FY19. Further, as the impact of the November 2016 devaluation peters out, headline price pressures have receded although it still remains high (21.9% YoY; December 2017).

In contrast, fiscal reforms have been nowhere near as decisive as the currency move and some regulatory reforms. The positives have included the introduction of a VAT, hikes in energy prices and restraining the wage bill with some of the savings channeled towards social protection to mitigate reform impact on the most vulnerable. However, measured by their impact on the headline budget deficit, outcomes have been wanting. Highlighting this, realized fiscal outcomes under the IMF program are below initial expectations. According to the Fund, the fiscal deficit (budget sector) fell to 10.9% of GDP in fiscal year 2017 (FY17, ending June 30) from 12.5% of GDP in FY16. That's short of the 2% of GDP adjustment anticipated at the time of the first program review in September last year, just 3 months or so ago. Further, the reduction achieved is due more to revenues being higher than expected (+0.9% of GDP realized vs 0.1% of GDP expected) rather than a fall in spending – the latter was also below expectations (-1.8% of GDP expected vs. -0.5% of GDP realized). Even the revenue outperformance mostly reflects oil excise duties yielding double of what was expected.

Figure 1: Fiscal dynamics



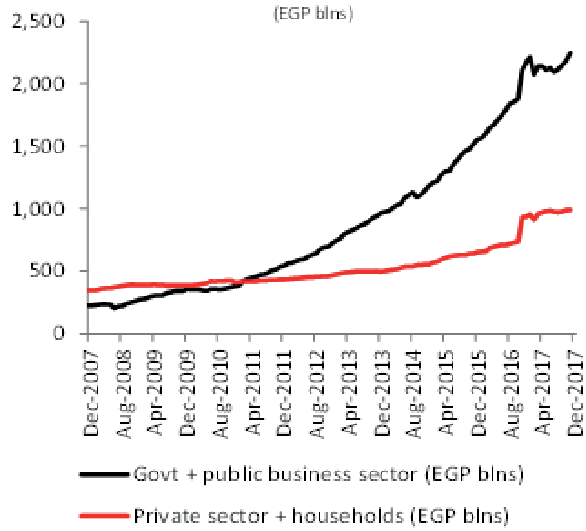
Why the above significant is because Egypt's fiscal challenge is underpinned by an unsustainable spending profile (Figure 1). Interest payments on government debt (9.1% of GDP; FY17) are the single largest spending head equivalent to 68% of tax revenues and 30% of total outlays. Subsidies, grants and other social benefits (8.0% of GDP) equal 60% of tax revenues and 27% of total outlays. With just these two heads, spending exceeds tax collection by nearly 4% of GDP. Add in the public sector wage bill, down 1.4% of GDP in FY17, and that's another 6.5% of GDP (50% of tax revenues/22% of total spending). And then there is the cost of providing public services and capital investment, together worth 4.3% of GDP. It not wonder FY17 was the fifth consecutive year of a double digit fiscal deficit.

Facing this unsustainable level of spending is a low revenue base (tax collection: 13.3% of GDP; FY17) which means funding cannibalizes scarce resources and pressures debt indicators. On the first of these (Figure 2), in January 2011, bank credit to the Egyptian public sector (EGP384.9 billion) was smaller than the stock of credit to the private sector and households (EGP413.1 billion). By September 2017, bank credit to the government (including "public business sector") had ballooned to EGP2.2 trillion, 2.2x the level to the private sector (including households). Needless to state, government inefficiencies – with spending often driven by political considerations particularly in autocratic countries like Egypt –have sustained enormous distortions in resource allocation.

Meanwhile, the large deficits this spending profile has led to means government debt crossed 100% of GDP in FY17 from <70% of GDP prior to the Arab Spring. Within it, external debt more than doubled in FY17 to 18.1% of GDP – reflecting the devaluation and new borrowing – while domestic debt was 85.2% of GDP. But it's not just the level of debt, it's also the composition. Treasury bills, of one year or less maturity, accounts for 38% of domestic debt (CBE; June 2017) – that's 34% of GDP which needs to be rolled over every year. A quarter of this T-bill stock is FX (USD and Euro) denominated while 33% is held by non-residents. The latter equals USD18.9 billion or nearly 40% of total official reserves, inclusive of other assets. What is worrying is that it took just 14 months from January 2011 (when the Arab Spring protests started) for almost the entire stock of non-resident holdings (USD10.3 billion) at that point to exit.

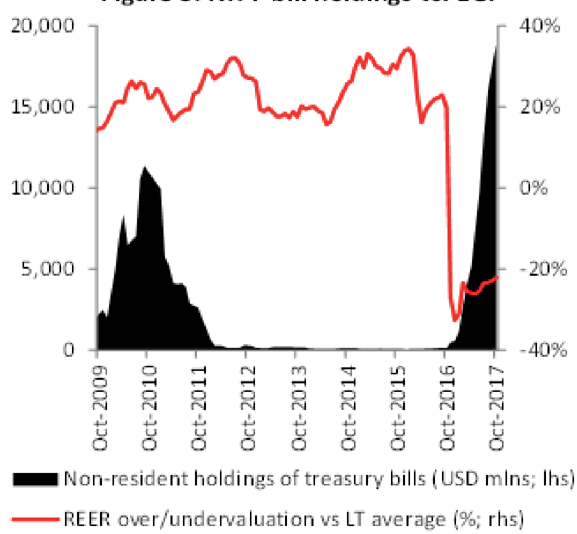
In this backdrop, the key near term risks are maintaining reform momentum (most critically the fiscal targets), controlling inflation and ensuring a more flexible EGP. On the latter, the 50% nominal devaluation of the EGP since November 2016 has kept the currency competitive – REER models suggest the EGP was 20% undervalued versus its long-term (10Y) average in November 2017,

Figure 2: Domestic Credit



although its extent had receded from as high as 32% in December 2016; at the time of the devaluation, the EGP was ~20% overvalued. This undervaluation perhaps explains why the EGP has been kept broadly stable in nominal terms since the middle of March last year. Looking ahead, if the EGP remains flat in spot markets, the extent of undervaluation will continue to moderate as domestic inflation recedes.

Figure 3: NR T-bill holdings vs. EGP



The latter should not have a huge impact on portfolio inflows. The lead-up to the Arab Spring protests in early 2011 showed foreign investors kept piling into Egyptian treasury bills despite an increasing overvaluation of the EGP (Figure 3). Meanwhile, as things stand, Egyptian local currency treasury bills yield over 17%, some 350-400bps higher than in Nigeria and Ghana both similarly rated regional credits with less competitive currencies. Further, what was important for investors back in 2010 were favorable macro dynamics (rising real growth, lower inflation, reductions in the twin deficits and debt levels partially reflecting reforms by the then Nazif administration). Not only are current dynamics similar, investors sentiments are additionally anchored by an IMF program and a cheaper currency. Thus, portfolio inflows - including via Eurobond issuance and equities – should remain significant albeit less so than their unprecedented levels in 2017. Continuing portfolio inflows coupled with IMF projections of a broadly stable trade deficit over FY18 and FY19 (ratings agencies anticipate large increases in gas output will help) imply FX reserve accumulation should continue.

However, the real challenge will be delivering on public finances – the IMF sees the fiscal deficit (budget sector) falling to 9.2% of GDP in FY18 on the back of spending cuts (public wages and subsidies, particularly energy given higher oil prices) totaling 1.7% of GDP with revenues slightly lower. As modest as these cuts are –the targeted reduction in Egypt's fiscal deficits over a two year period is comparable to the near 3% of GDP consolidation that was expected of Ghana in just the first nine months of its program – even achieving this could be difficult given the social and political backdrop. This creates eerie similarities with the lead-up to the start of Arab Spring protests on January 25, 2011: back then, the macro situation had also improved in the run-up to presidential elections that were due later that year. That did not matter – what provoked the protests which brought the government down in a manner of days was the lack of real political choice, political repression, brutality by security agencies, widespread corruption and rising social pressures.

Fast forward to today, social conditions have deteriorated since the Arab Spring – unemployment and poverty rates are higher, have likely increased after the inflation spike post devaluation in November 2016 while perceptions of high widespread corruption remain endemic. Meanwhile, human rights agencies state public criticism and peaceful opposition against the government remains banned and that security agencies regularly use torture. With presidential elections due in March, these parallels with the lead-up to the Arab Spring are probably not lost on the government and perhaps reflect part of the reason behind higher allocations to social safety nets.

In addition to the uncertainty around reform continuation created by these social conditions, the government's commitment to taking difficult decisions is probably testified to in the fact that the IMF was not its first port of call. After President Sisi took office in June 2014, he chose to rely on FX deposits/other support from GCC countries - notably Saudi Arabia and the UAE – to prop up the EGP and FX reserves. But by mid-2016 as the benevolence of richer GCC countries waned perhaps due to the lack of Egyptian enthusiasm for participating in Saudi Arabia's Yemeni adventure and/or the impact of lower oil prices, Egypt requested financial support from the IMF.

In this context, questions around the outlook for reforms are justified as the needed measures (cuts in subsidies and the public wage bill) will stoke inflation (and potentially unemployment) - elevated now for more than a year and seen persisting in double digits till FY20 – even more. Further, with stellar revenue performance on the back of a 60%+ reported increase in tax collection over 1H-FY18 (July-December 2017), the incentive to cut outlays is lower. Hence, even if this means fiscal targets (primary or overall deficit) are met, spending rigidities will remain and perhaps be compounded - while higher allocations for social safety nets are understandable given the difficult reforms undertaken and Egypt's social backdrop, they will be difficult to wean people off of if the government waivers on other reforms to spur job creation by the private sector. If so, this will only mean more expenditure rigidity.

In conclusion, the upcoming elections and higher oil prices pose a significant risk to continued fiscal consolidation which has already been progressing at an anemic pace. This reflects how deeply entrenched these challenges are and perhaps also fear amongst policymakers of potential social unrest from adjusting too quickly/deeply. Yet, that is exactly what is required - given how large the fiscal problem is, small steps will imply a longer period of social pain and austerity which likely increases the probability of social unrest. Egypt therefore needs decisive fiscal policy consolidation, couched in enhanced and better targeted social protection measures. Whether that happens or not is unclear – what is probably clearer is that the IMF may be willing to tolerate adjustments to targets and/or underperformance as long as the broader trajectory is right. More than anything else, this reflects Egypt's geopolitical significance. Meanwhile, with higher oil prices raising the possibility of renewed stronger support from the GCC, Egyptian policy makers may take an even slower approach to reforming public finances. That though would only make Egypt's medium to long term outlook that much more uncertain.

GHANA'S ECONOMY IN 2018: TURNING STABILITY INTO GROWTH

By **Courage Kingsley Martey,** Senior Economic Analyst, Databank Group, Ghana

A Brief on 2017 Economic Performance

Ghana's policy choices in 2017 were geared toward consolidating macroeconomic stability by restoring fiscal sustainability which suffered a setback in 2016, partly due to election-related budget overruns. The fiscal policy framework for 2017 was anchored on the commitment to restore fiscal credibility, transparency and policy clarity in order to revive investor confidence in Ghana's economy.

Budget deficit narrows on the back of expenditure rationalization as revenue underperforms:

Ghana's fiscal performance in 2017 was rocked by broad-based shortfalls in both tax and non-tax revenue, partly reflecting the subdued level of economic activity and the tax reliefs implemented through the 2017 budget. Available fiscal data as at September 2017 revealed a 9.3% shortfall in total revenue (Inc. grants) as domestic revenue of GH¢27.48 billion ($6.25 billion) was 8.7% below target. Donor support for Ghana's budget during the period under review declined by 2.8% Y-o-Y to GH¢948.1 million, representing a 24.2% shortfall compared to the target of GH¢1.25 billion. Against this backdrop, the Ghanaian authorities were consigned to strict expenditure rationalization in order to sustain fiscal credibility and investor confidence. The government's quest was aided by the enforcement of the Public Financial Management Act, 2016 (Act 921) together with the Ghana Integrated Financial Management Information System (GIFMIS) which significantly reduced human intervention in the budget implementation process. Consequently, total expenditure (Inc. arrears payment) was 8.1% below the ceiling of GH¢41.04 billion ($9.33 billion) for January to September 2017.

The effective control of public expenditure in the face of revenue shortfalls triggered a narrowing of the overall budget deficit from 9.3% of GDP in 2016 to 4.6% as at September 2017, firmly on track to achieve the end 2017 target of 6.3%. More significantly, the primary balance recorded a surplus equivalent to 0.2% of GDP, reducing the public sector borrowing requirement and slowing down the rate of public debt accumulation from 22% in 2016 to 13.6% in 2017.

While the downside risks to government revenue remains a critical concern that must be addressed in 2018, the authorities' commitment to expenditure control raises some level of optimism about fiscal sustainability and macroeconomic stability.

Ghana Cedi recovers from a topsy-turvy start to 2017 to close the year on a stable note:

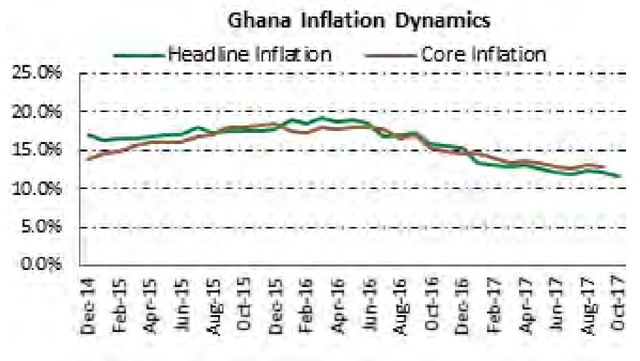
Enduring the knock-off effect of the 2016 election uncertainty and a seasonal spike in the first quarter demand for forex by importers and multinationals, the Ghana Cedi commenced 2017 in a free fall, hitting 8.3% depreciation against the USD by mid-March 2017. The pace of the Cedi's depreciation in early 2017 however appeared exaggerated by the speculative reaction of market agents without much recourse to the prevailing economic fundamentals as the trade and current accounts were in a rare surplus position.

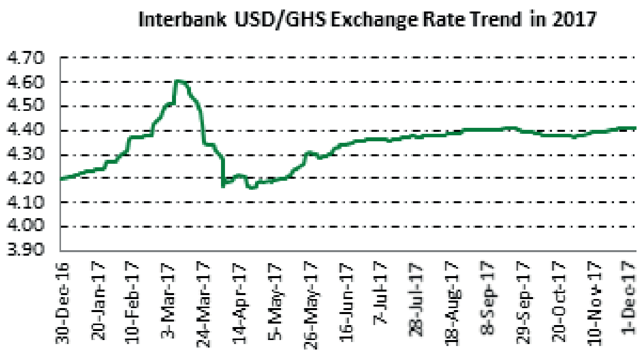
The government's decisive move to issue two new Treasury bonds (7-yr and 15-yr tenors) together with a tap-issue of an existing 10-yr security in April 2017 resulted in ~GH¢9 billion uptake with more than 90% due to foreign investor participation. The substantial forex inflows from the Treasury bond sales significantly boosted the supply of foreign currency on the forex market and provided a short term anchor for the Cedi's recovery from its woes in Q1-2017. The authorities' commitment to fiscal consolidation coupled with the steady improvements in Ghana's macroeconomic fundamentals in 2017 added further support as the Cedi trimmed its losses to 4.88% by end-2017.

Inflation heads south as tax reliefs ease cost-side pressures while Cedi stability restrains demand pressures:

Ghana's return to single digit inflation was boosted by an appropriate mix of fiscal and monetary policy measures which firmly subdued inflation expectations. The disinflation process which commenced in late-2016 was quickened in 2017 on the back of the conscious blend of fiscal and monetary policy consistent with the Central Bank's mandate of delivering price stability. Supported by easing cost-side pressures, a sharp decline in the heavily-weighted non-food inflation propelled headline inflation downwards from 15.4% in

December 2016 to 11.8% in December 2017. In like manner, core inflation (a measure of underlying inflationary pressures) also assumed a downward trend in 2017, albeit remaining above headline inflation and necessitating the Bank of Ghana's cautious approach to monetary easing during the year.





Ghana's Prospects in 2018: Turning Macroeconomic Stability into Growth

With all the key macroeconomic indicators pointing in the right direction amidst a credible policy environment, Ghana is poised for a recovery in economic activity in 2018.

Fiscal Outlook in 2018: Budget deficit to drop within the government's medium-term target range.

The Government of Ghana expects a sustained decline in the overall budget deficit from 6.3% of GDP in 2017 to 4.5% in 2018 (Databank forecast: 4.7%), consistent with the medium term fiscal target range of 3% – 5%. The anticipated narrowing of the budget deficit is predicated on the revenue enhancing measures in place; which include the ports-digitization system to minimize revenue leakages at Ghana's ports and the continued expenditure controls. Total revenue (Inc. grants) is projected to increase by 23.7% Y-o-Y to GH¢51.04 billion ($11.6 billion) in 2018 while expenditure growth is estimated at 14.5% Y-o-Y to GH¢62.01 billion.

Although the revenue targets remain vulnerable to downside risks, the anticipated recovery in the non-oil sector of Ghana's economy in 2018 should boost business profitability with a greater prospect of tax revenue mobilization for the government. The tax reliefs implemented in the 2017 budget are also expected to reflect positively on business operations in 2018 as the operating environment eases.

Ghana's 2018 budget also proposed a 13% reduction in electricity tariffs for consideration by the Public Utilities and Regulatory Commission (PURC). An approval of this proposal would further reduce the cost pressures confronted by businesses in 2018, positively impacting bottom-line and business growth.

Monetary Policy Outlook: Monetary easing to be sustained in 2018 as CPI inflation remains on course to hit single digit.

We expect the disinflation recorded in 2017 to continue in 2018 as our market-based measures of inflation compensation indicates low inflation expectations by the market. Barring unanticipated upside shocks to petroleum prices, the Bank of Ghana remains confident of attaining its medium term inflation target range of 8% ± 2% in 2018. The projections by Databank Research also points to single digit inflation by mid-2018, barring unforeseen increases in petroleum prices and transport fares in the first quarter of 2018. In view of the favorable inflation outlook, we expect further cuts in the monetary policy rate in 2018 in order to stimulate private sector investment and non-oil real GDP growth. We believe the Monetary Policy Rate (MPR) could drop cumulatively by 400bps to 16% by the end of 2018 as inflation risks continue to recede.

Non-oil GDP growth expected to pick up in 2018 on the back of fiscal and monetary stimulus.

Overall, Ghana's growth momentum quickened from 3.7% in 2016 to 7.8% in the first half of 2017 and is projected at 7.9% for end-2017, supported by strong recovery in oil and gas production. The impressive performance of the hydrocarbon-led growth blurs the weak momentum of 4.0% recorded for non-oil growth in 2017. The positive impact of the 550bps cut in the monetary policy rate and the tax incentives in the 2017 budget was restricted by the cautious lending stance of commercial banks as well as government's expenditure controls.

In the face of weakening asset quality (reflected in high Non-Performing Loans ratio of 21%), commercial banks adopted a conservative approach to lending as the risk of further erosion to capital remained elevated. We however expect this risk profile to be minimized in 2018 as the issuance of GH¢4.7 billion energy bond in November 2017 should aid the part repayment of the energy sector's indebtedness to the banking sector. With the authorities' commitment to repaying the remaining energy sector debt in 2018, we expect a marked reduction in the NPLs (from the current level of ~GH¢8.3 billion) to spur private sector credit.

We also expect buoyant activity on the Ghana Stock Exchange in 2018 as the Central Bank's directive to commercial banks to recapitalize to GH¢400 million stimulates trading activity in listed financial stocks. Overall, Ghana's investment climate appears brighter in 2018, supported by an anticipated increase in direct and portfolio investment flows.

Contributor's Profile

Courage Martey obtained his MPHIL and B.A. degrees in Economics in 2011 and 2008 respectively from the University of Ghana Legon.

He has over 5 years of industry experience in the financial services sector with the first 2 years as a Credit Risk Analyst at Procredit Savings & Loans Company Ltd (Now, Fidelity Bank Ghana).

Courage moved to Databank Brokerage Limited in Mid-2014 as the Senior Economic Analyst for the Databank Group, providing economic insights to aid the company's corporate advisory services, securities trading strategies and Fund Managers' investment decisions.

KENYA'S ECONOMIC PROSPECTS IN 2018 AMIDST POLITICAL UNREST

By **Stephanie Onchwati,** Assistant Investment Analyst, Cytonn Investments

At the beginning of the year 2017, an election year, we expected politics to take center stage and be among the key determinants of spending and government policy. We noted that the political stand-off between the government and the opposition would not be good for business and would result in an increase in Kenya's political risk, which would negatively affect investments into the country and lead to slower economic growth compared to previous years. The election period turned out to be like no other experienced in Kenya before, with the August 8th election outcome being annulled by the Supreme Court who ordered a fresh presidential election to be conducted within 60 days as enshrined in the constitution.

The period leading up to the August 8th election was characterized by a relatively stable shilling, depreciating only by 1.5% as speculators held on to the dollar in the period of political uncertainty. However, the equities and fixed income markets defied all odds, with NASI and the NSE FTSE Bond Index gaining 28.4% and 16.5%, respectively on a YTD basis. Despite this, the market was not immune to shocks and this was witnessed on the last week of August, with NASI loosing 5.5%.

In this article, we discuss our outlook on the macroeconomic environment in Kenya in 2018, taking into perspective the political unrest that engulfed the market in 2017.

Kenyan GDP Growth to Recover in 2018

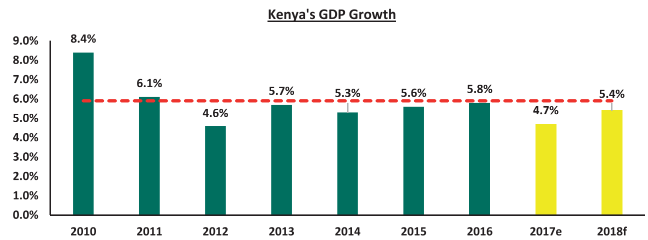
Kenya has remained one of the most vibrant economies in East Africa and in the larger Sub-Saharan Africa, despite the World Bank and IMF revising their 2017 GDP growth projections downwards to 4.9% and 5.0% from 6.0% and 5.7%, respectively, at the beginning of the year. The reasons cited for the downward revisions included:

i. Slower growth of the agriculture sector, at 3.1% in Q3'2017 compared to 3.8% in Q3'2016 following the prolonged 2016/17 drought,
ii. The interest rate cap which led to a reduction in corporate earnings for commercial banks with EPS growth for Q3'2017 at (8.2%), compared to 15.1% in Q3'2016,
iii. Political uncertainty during the year, and
iv. A slowdown in private sector credit growth, which came in at 2.0% in October 2017 compared to a 5-year average of 14.4%.

The year 2018 is set to be a year of recovery for the Kenyan economy, with the IMF projecting GDP growth of 5.5%. We expect this growth to be supported by:

i. Improvement in the agriculture sector as a result of improved weather conditions,
ii. Continued investment in infrastructure by the government, which will support growth in the construction and real estate sectors,
iii. Continued recovery of the tourism sector,
iv. Expected growth in the manufacturing sector supported by the government's efforts to boost growth and revival of select industries.

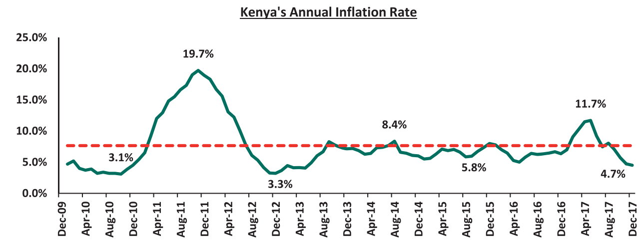
The chart below indicates Kenya's GDP growth since 2010, having achieved an average of 5.9% over the last seven years.



Source: Cytonn Investments

Surge in Inflation rate amid oil price rise

Inflation in 2017 was characterized by high inflation rates in H1'2017 mainly driven by a rise in the food basket component of the Consumer Price Index brought on by the drought, causing inflation to hit a high of 11.7% in May before slowing down to close the year at 4.5%, with the average annual inflation coming in at 8.0%, above the government annual target of between 2.5% - 7.5%. In 2018, we expect pressure on inflation to stem from (i) increasing electricity prices as we begin to feel the effects of the drought on Hydroelectric Power (HEP) in 2017, which led to increased electricity imports from Uganda and use of diesel generators, and (ii) rising transport costs brought about by expected increase in fuel prices as global oil prices continue to recover gradually. This, however, is expected to be countered by a base effect especially in H1'2018, due to the high rates witnessed in a similar period in 2017. Food prices should remain stable, as increased maize flour prices brought on by the end of the maize subsidy on December 31st 2017, should be cushioned by declining prices of other food basket items as a result of improved weather conditions. We therefore expect 2018 inflation to average 6.6%, within the government target range of 2.5% - 7.5%. The chart below indicates the country's inflation rate having achieved an average of 7.7% over the last seven years.



Source: Cytonn Investments

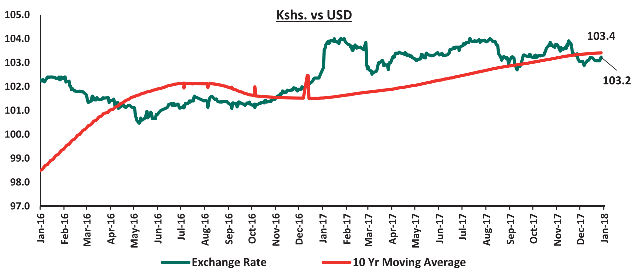
The interest rate environment in 2018

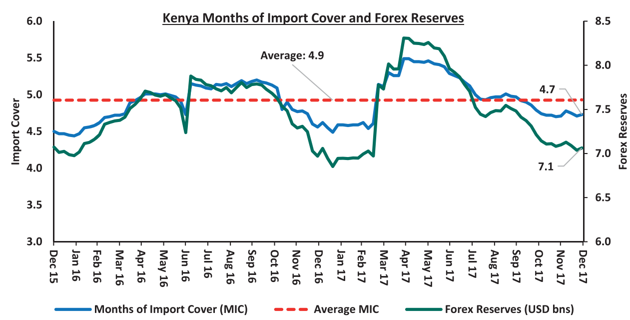
The interest rate environment in 2017 was relatively stable with the Banking (Amendment) Act, 2015 capping lending rates at 4.0% above the prevailing Central Bank Rate, which was at 10.0% throughout 2017, effectively capping the lending rate at 14.0%. The government remained disciplined in the auction market by rejecting expensive bids in order to ensure stability in the interest rate environment. Commercial Banks, who constitute about 50.0% of government primary auction participation, preferred to lend to the less risky government than to the risky private sector. This was evident by the slowdown in private sector credit growth, which stood at 2.0% in October compared to a 5-year average of 14.4%.

For year 2018, the interest rate environment is a bit uncertain, as (i) the government is behind its domestic borrowing target for the current fiscal year, having borrowed Kshs 83.6 bn, against a target of Kshs 213.0 bn (assuming a pro-rated borrowing target throughout the financial year of Kshs 410.2 bn budgeted for the full financial year as per the Cabinet-approved 2017 Budget Review and Outlook Paper ("BROP"), (ii) as per the Q1'2017/18 fiscal year budget review, the government has only borrowed 2.7% of its total foreign borrowing target, having borrowed Kshs 7.5 bn compared to a target of Kshs 277.3 bn, and (iii) the KRA is expected to face challenges in meeting its collection target due to expected subdued corporate earnings in the first half of the fiscal year 2017/18. All these factors could result in upward pressure on interest rates.

Likely depreciation of Kenya Shilling in 2018

The Kenya Shilling remained resilient in 2017 against the US Dollar, only depreciating by 0.7% to close at Kshs 103.2 from Kshs 102.5 at the beginning of the year. This was supported by (i) weakening of the USD in the global markets as indicated by the US Dollar Index, which shed 9.9% in 2017, and (ii) the CBK's intervention activities, as they had sufficient forex reserves, which closed the year at USD 7.1 bn (equivalent to 4.7 months of import cover). For 2018, the shilling is likely to come under pressure from an expected increase in value of oil imports should global oil prices continue to rise; but remain supported by declined food imports, improved agricultural exports as production improves due to improved weather conditions, and continued CBK intervention. We project that the shilling will range between Kshs 103.0 and Kshs 107.0 to the USD in 2018. The charts below shows the Shilling vs the USD movements and movement of the CBK's forex reserves and months of import cover.





Source: Cytonn Investments

"Kenya has proved to be resilient amidst the political unrest and effects of the drought that affected economic performance in 2017."

Ease of doing business in Kenya

According to the World Bank 2018 Ease of Doing Business Report, Kenya improved on the Ease of Doing Business Ranking, rising 12 places to position 80 from position 92 in 2017, out of 190 countries, indicating a positive impact of reforms in business regulations put in place over the last one year. Kenya ranked third in Africa, behind Mauritius and Morocco, which came in at positions 25 and 69, respectively. Despite this improvement, a lot needs to be done to reclaim our 2008 position. Four areas standing out that require improvement include: starting a business, construction permitting, cross boarder trading and property registration. Improvement in these areas will require a clear plan, especially around real estate, which seems to be significantly bureaucratic and inefficient. Therefore, we expect the government to make improvements in property registration in 2018, with the Ministry of Lands having all land-related transactions and payments for the capital, Nairobi, done online through the eCitizen portal as of December 4th 2017 and this is expected to improve Kenya's ranking in the index. A summary of the ease of doing business indicators and Kenya's ranking is as shown below:

Ease of Doing Business in Kenya

Indicators	2008 Rank	2017 Rank	2018 Rank	Outlook
Starting a Business	112	116	117	Neutral
Dealing with Construction Permits	9	152	124	Positive
Getting Electricity	-	106	71	Positive
Registering Property	114	121	125	Neutral
Getting Credit	13	32	29	Neutral
Protecting Minority Investors	83	87	62	Positive
Paying Taxes	154	125	92	Positive
Trading Across Borders	148	105	106	Neutral
Enforcing Contracts	107	87	90	Neutral
Resolving Insolvency	76	92	95	Neutral
Overall	**72**	**92**	**80**	

Banking and Capital Market Sectors Insights

In 2017, Kenyan listed banks recorded an average decline in core earnings per share (EPS) of 8.2% in Q3'2017, compared to an average growth of 15.1% in Q3'2016, owing to the tough operating environment as a result of the interest rate cap and prolonged period of political uncertainty. The listed insurance companies recorded an average decline of 5.6% in core EPS in H1'2017, from an average gain of 69.4% in H1'2016. Safaricom Limited released H1'2018 results, recording a core earnings per share (EPS) growth of 9.0% to Kshs 0.65 from Kshs 0.6 in H1'2017. 6 listed companies and 1 non-listed bank gave profit warnings to investors compared to 11 companies in 2016. Companies are required to issue profit warnings if they project a more than 25% decline in profits year over year. 2018 is set to be a better year and we expect corporate earnings growth of 12.0% in 2018 due to an expected favorable business operating environment given the conclusion of general elections.

In conclusion, Kenya has proved to be resilient amidst the political unrest and effects of the drought that affected economic performance in 2017. Given that we expect relative stability in the operating environment in 2018, we expect stronger economic growth compared to 2017.

Contributor's Profile

Stephanie Onchwati serves as an Investment Analyst at Cytonn Investments Management PLC, having graduated from the Cytonn Young Leaders Program (CYLP). She has 2 years' experience, focusing largely on macroeconomic analysis, fixed income and equities markets in Kenya. Stephanie holds a BSc. in Economics and Finance from the Kenyatta University and is a Certified Financial Analyst (CFA) I candidate. She has participated in the publication of several public markets reports including; Quarterly Kenya Banking Sector Reports, Half-Yearly Kenya Insurance Sector Reports, Kenya Corporate Governance Index Report and Sub Saharan Africa Financial Services Report, among other more frequent weekly reports.

MAURITIUS MACROECONOMIC RECOVERY GAINING MOMENTUM

By **Shailen Sreekeessoon,** Head of Strategy and Research, SBM Group Mauritius

Economic activity to strengthen in 2018

In line with the consolidating recovery of the global economy and growing investor confidence, economic activity in Mauritius is expected to accelerate in 2018, with our projection for real growth standing at 4.1% (compared to the official forecast of 3.9%), up from some 3.8% estimated in 2017. The key driver of the upturn would be the construction sector, which would benefit from improved momentum in the hotel and real estate segments, as well as an array of public infrastructure projects being lined up. These include the "metro express" light railway project, major upgrades to the road network, the construction of a new Supreme Court and two hospitals, the setting up of a sports complex in the buildup to the Indian Ocean Island Games, and an ambitious housing program for the low and middle income earners.

As in previous years, the services sectors are also expected to support the upswing. The trade sector should benefit from initiatives to improve purchasing power for lower income households, such as the introduction of a minimum wage structure and the payment of an across-the-board salary increase. The hotel sector should strengthen in 2018 as outbound tourism in key source markets is expected to remain buoyant, while room capacity should further increase. Besides, business and professional activities, as well as financial services, should maintain solid growth rates on the back of product and market diversification, coupled with increased sophistication of services. On the other hand, the manufacturing sector, particularly textiles, would continue to struggle amidst competitiveness concerns.

Recovery should support job creation

Alongside the economic recovery, the employment situation has improved, with the joblessness rate dropping from a peak of 7.9% in 2015 to an estimated 7.1% in 2017. The labor market should continue to improve – with a projection of 7.0% in 2018 – on account of the positive outlook in the hotel, construction, real estate and business and financial segments in particular. The major dark spot for the job market remains the downtrend in the manufacturing sector, which remains one of the key employers in the country. Increased real wages could also be a source of stress.

Inflation to remain within control despite adverse shocks

The inflation rate increased from 1.0% in 2016 to 3.7% last year, mainly on account of higher vegetable prices on average, linked to atypical weather patterns, as well as increases in the prices of administered products such as cigarettes, alcohol and transport fuel. These factors could continue to generate inflationary pressures in 2018. Vegetable prices are already significantly up compared to last year on account of recent heavy rains prior to and accompanying tropical storm Berguitta. Higher commodity prices on international markets, on an annual average basis, could also feed onto the price structure, particularly in respect of gasoline and diesel oil. Besides, measures to boost the purchasing power of lower income households – including the implementation of a minimum wage system and uniform salary compensation – are also likely to exert upward pressure on prices. Against this background, the inflation rate for 2018 is not expected to return to very low levels, but would nonetheless remain within a manageable range.

External balances to be under pressure

Services exports are expected to remain buoyant in line with strong tourist arrivals, alongside increased foreign earnings in business and financial services, reflecting continued product development and market diversification therein. However, the impact on total exports of goods and services would be mitigated by tepid merchandise exports, amidst lingering competitiveness challenges in the agriculture and manufacturing sectors. Moreover, the import bill is expected to materially increase as a result of higher projected consumption and, particularly, investment. Within this context, the current account deficit is expected to remain high at close to 6% of GDP. Nonetheless, the balance of payments should remain in positive territory, on the basis of strong net financial inflows.

Currency and interest rates to remain fairly stable

Against the background of a balance of payments surplus, the effective exchange rate of the Mauritian rupee should remain relatively stable, and would limit the impact of imported inflation. Interest rates are also expected to hover at current levels as the impact of a projected increase in credit demand, fueled by rising investment, is counterbalanced by a still high liquidity situation. The policy rate of interest – that is the Bank of Mauritius Key Repo Rate – is also likely to remain low as the authorities endeavor to support the recovery while inflation remains under control, barring unanticipated shocks. However, should the upturn be stronger than expected and/or inflationary pressures build up in a more significant manner, an increase in the policy interest rate may be warranted in the latter half of the year.

Budget deficit and public sector debt to remain manageable

On the fiscal front, expenditures are expected to rise in line with an acceleration in the public sector investment program. Nonetheless, the impact on the budget deficit would be tempered by a significant increase in external grants, particularly from the Government of India, linked to the financing of specific projects. Whilst the budget deficit and public sector debt are expected to lean on the high side, at around 3½% of GDP and 65% of GDP respectively, they remain within manageable levels, and should be viewed within the context of an overall improvement program in public infrastructure that would be conducive to future growth.

Risks to the outlook are fairly balanced

Being a small open economy, Mauritius is highly sensitive to changes in major world markets, particularly in respect of export demand, commodity prices and exchange rates. Moreover, disruptions on the local scene – for instance linked to climatic conditions or changes in the global fiscal environment – can have disproportionate effects on the economy. At the same time, the economy has a track record of nimbleness and effectiveness in responding to challenges.

We reckon that both the global and domestic economies are at a turning point, and that upside and downside risks are fairly balanced at this stage. Whilst not comprehensive, some of the most relevant hazard factors in terms of impact and probability are discussed below.

Global economic environment

Recent global indicators are pointing towards a strengthening recovery in key markets such as the US and the euro area. Even the UK economy has recently surprised on the upside, despite the lingering Brexit cloud. Should the global momentum be stronger than expected, the fallout for the Mauritian economy is likely to be positive, particularly for export-oriented sectors. On the other hand, if the recovery is derailed, business confidence is likely to falter, potentially resulting in lower growth for Mauritius.

Commodities could also be a source of stress given the high import dependence of the Mauritian economy. An escalation of geopolitical tensions, for instance, could lead to an abrupt increase in commodity prices. This would put pressure on the external balances and reduce purchasing power of households and competitiveness of industries, potentially impeding growth. Commodities could, however, also be lower than projected if, for example, OPEC is unable to agree on output cuts and/or shale producers increase supply.

Toughening of the regulatory environment

Recent and ongoing changes in the global fiscal environment represent major threats for the Mauritius economy, particularly as it positions itself as a major International Financial Center (IFC) for the region. 'The impact of the change in the India-Mauritius Double Taxation Avoidance Agreement is yet to be fully gauged, notably after the grandfathering clause regarding the treatment of capital gains tax lapses in April 2019. Regulations being brought in the wake of the BEPS discussions may also be unfavorable to the development of some niche sectors, such as wealth management. On the flipside, these challenges could trigger deeper structural changes in the sector, such as market diversification – with Africa being a prime candidate – and increased sophistication. The early sprouts of the strategic shift towards greater substance in the IFC are already visible, and could influence growth going forward in a more positive way than earlier anticipated

Implementation lags and climatic disruptions

To the extent that the forecast recovery of the Mauritian economy hinges largely on the rollout of public infrastructure projects as well as increased capital outlays in the business sector, lags in implementation would weaken the momentum. Again, an upside scenario is also possible given that the baseline growth scenario does factor in some delays in execution, based on historical experience.

Climatic conditions are also a source of risk, although the impact thereof has become less significant given the much reduced dependence of the economy on agricultural output.

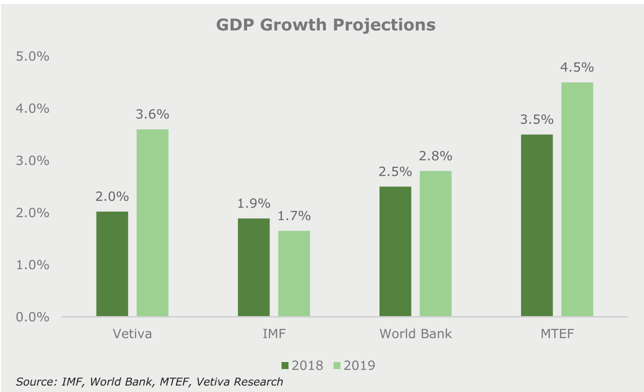
NIGERIAN ECONOMIC PROSPECTS IN THE PENULTIMATE ELECTION YEAR

By **Michael Famoroti,** Chief Economist, Vetiva Capital Management Limited, Nigeria

The year 2018 is not an election year. Still, looming elections are likely to bear an influence, particularly in the latter part of the year. The timing of the 2019 elections is slightly unfortunate given Nigeria's economic position. After an oil-induced recession and currency crisis in 2016, the country inched above choppy waters last year as a recovery in oil production and foreign exchange market reforms bolstered investor confidence. Sticky double-digit inflation, rising unemployment and simmering political dissatisfaction indicate that the economy is yet to recover fully and the hope is that 2018 would see growth hit another gear.

Absent the shadow cast by impending elections, the outlook would have been very positive. Receding inflation and a healthy currency market give leeway for a much-changed Monetary Policy Committee to lower interest rates and stimulate credit growth in the economy while stronger government revenues should smoothen the implementation of another record federal budget. Instead, we have to contend with the accompanying risks to the 2019 elections - heightened political uncertainty, resurgent insecurity and policy distractions.

Thus, our outlook for the year is slightly more conservative – Vetiva Real GDP growth forecast of 2.0% y/y is just above International Monetary Fund projection of 1.9% y/y but below World Bank projection of 2.5% y/y.



Source: IMF, World Bank, MTEF, Vetiva Research

Election Fear and Loathing in Nigeria

In theory, elections should incentivise more efficient policy choices as leaders understand that they will be held to account for failings at the polls. On the other hand, elections also introduce the possibility of political business cycles, where policy-makers intentionally inflate the economy to boost short-run growth in the run-up to elections – usually through increased spending or by printing money – to the detriment of the equilibrium growth path of the economy. There is little evidence of political business cycles in Nigeria since the dawn of democracy in 1999, though there is substantial anecdotal backing for the view that governments do indeed expand public spending to support electioneering efforts. The primary concern here would be that public funds will be diverted away from more efficient uses – infrastructure, social welfare, etc. – to channels that boost electoral chances, mainly because Nigeria's Electoral Act which sets a limit on electoral spending has been poorly enforced.

The 2019 elections also introduce two key elements into the economic mix for this year – uncertainty and insecurity. Similar to the challenge faced by the United Kingdom in its state of limbo through Brexit negotiations, individuals and firms are likely to stall critical decisions until the outcome of elections is much clearer. Furthermore, foreign investors, still a useful source of foreign exchange to the economy, would surely adopt a "wait and see" approach as they tend to be easily spooked by electoral instability in young democracies. The security concerns are even greater as noises from interest groups in the Niger Delta, South East, etc. are likely to grow louder as election fever hits, with legitimate claims freely mixing with opportunistic funding grabs. Though the different security risks have varying degrees of economic influence, any return to arms in the Niger Delta would be a big blow given the importance of stable oil production in supporting economic activities in 2018.

2018 Economic Scenarios

Amid this, it is useful to scope out potential effects of the 2019 elections. Below, I highlight three possible economic scenarios in 2018, each driven by the evolution of political activities and showing the resulting path the economy may chart.

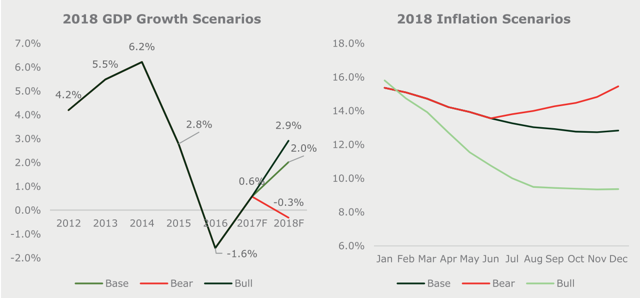
Base Scenario: There is little controversy over the Presidential ticket-holders of the main political parties. Meanwhile, low confidence in the strength and viability of opposition to the incumbent reduces uncertainty over the outcome of the polls. The impending elections influence government spending in H2'18, but discretionary spending is minimised and does not induce higher inflation. As a result, our expectations remain mostly intact – budget implementation is stronger as a result of higher revenues and earlier budget passage whilst the Central Bank of Nigeria eases monetary policy at a moderate pace, accounting for the threat posed to inflation and the currency. In this scenario, we would expect economic activities to cool slightly and some investors to sit out the ride, but the economy should reach the turn of the year largely unscathed.

Bear Scenario: Fractures within the ruling party stoke uncertainty over backing for the incumbent and encourage a more consolidated opposition base. At the same time, growing electoral uncertainty and weakness of the incumbent allow a rise in insurgency and insecurity across the country, with Niger Delta militants, Fulani Herdsmen and Biafran secessionists throwing their weight around. These actors impair Nigeria's oil production and drive up inflation in the country while also causing capital flight. In response, fiscal and monetary tools are used for electioneering purposes, potentially worsening Nigeria's debt situation or instigating even higher inflation. The culmination of these events would likely push Nigeria back into recession and induce a foreign exchange or public debt crisis. Whilst we highlight this scenario as extreme as less likely, we would expect to see negative economic growth of 0.3% y/y, accompanied by average inflation as high as 14.5% y/y.

Bull Scenario: In this scenario, 2018 is like just another year. The expectation of peaceful elections insulates market and economy from political shocks while government's hand is strengthened by outperforming oil revenues and timely budget passage. With uncertainty and insecurity at relative lows, economic and market activities would continue unperturbed, allowing Nigeria to post a better-than-expected GDP growth figure of 2.9% y/y.

All Hands Needed on Deck

There are good reasons to approach this election cycle with less trepidation than usual. Firstly, Nigeria's democracy is maturing, and a first peaceful removal of an incumbent President in 2015 has renewed belief in the machinery of democracy and reduced concerns over violence during the period.



Source: Vetiva Research

Furthermore, barring an adverse oil shock, Nigeria's cyclical recovery should continue on the back of stronger oil production and receding inflation. Finally, the Monetary Policy Committee – which is set to welcome five new members this year – has shown its independence in recent years, an essential check against political business cycles. Of course, with four notable independent committee members being replaced at the end of their tenure, market watchers would be alert to any change in MPC dynamics.

Whilst calling where Nigeria will be at the end of 2018 is a fool's game, what is at stake is much clearer. Despite exiting recession in 2017, Nigeria's non-oil sector actually contracted by 0.8% y/y in Q3'17 – the most recently available data. Meanwhile, even with our bullish real GDP growth rate of 2.9% y/y for 2018, per capita incomes would still decline given Nigeria's population growth rate of about 3%. Combine this with surging unemployment – to 18.8% from 13.9% a year earlier – and it is clear that Nigeria is some way off its goal of inclusive economic growth. Also, structural issues with the economy are still little-changed; despite ongoing efforts in these areas, government revenues and foreign exchange liquidity remain almost entirely dependent on the health of the oil sector.

Clearly, government policy is required to address these issues, elections notwithstanding. Likewise, legacy issues such as the passage of the Petroleum Industry Bill and deregulation of the downstream petroleum sector, inefficiency in the power sector, and fiscal imbalances at the state level will still be here in 2019, even after elections are done and dusted.

The political machinery can be expected to go up the gears pretty quickly as the year progresses, Nigeria's challenge in 2018 is that the economy follows suit, else we risk stalling our nascent recovery.

AFRICAN RISKS AND OPPORTUNITIES: EMERGING NEW TRENDS

By **Stephane Colliac,** Senior Economist, Euler Hermes

Growth should accelerate in 2018 in Africa. Considering Africa as a whole (North Africa and Sub-Saharan Africa), the trough of the cycle was in 2016 with a muted growth of +2%. Overall, 2017 showed a recovery (+3.2%) as Nigeria and South Africa went out of recession (+0.8% both). In 2018, Africa's growth should be enhanced further to +3.5%, driven by these two cornerstone economies (expected at +2.5% and +1.4% respectively). Improving export prices and dovish international credit conditions will help to cope with fragilities in domestic situations. However, this is still below pre-crisis rates (+5% in 2012) and it shows that something has changed in Africa's growth drivers. In our view, two important drivers from the past are still relevant while four new trends may explain the volatility and bottlenecks witnessed in various countries.

Pillar #1: Industrial revolution

In recent years, high investment rates have had positive spillovers on some African economies, which consequently boosted agricultural productivity and manufacturing production. This rise in agricultural productivity was pivotal to strengthen growth in many places in North, West or East Africa, with examples like Morocco, Côte d'Ivoire or Kenya.

Substantial R&D efforts were made across all regions. But, the countries with the most positive results were those where the business climate improved the most. Despite low food prices (e.g. for cocoa or coffee), higher agricultural productivity allows for a better output, which was growth supportive. Of course, this industrial revolution also had positive effect on manufacturing production, as a result of the change nurtured by higher growth. It allowed an increase in the income level that largely helped financing the needs related to urbanization (e.g. car plants). Furthermore, these developments fostered a virtuous circle, facilitating manufacturing exports (with e.g. the development of textile in Ethiopia), under the eve of foreign direct investors like China or Turkey.

Pillar #2: Infrastructure

While they are still suffering from a substantial infrastructure gap, African economies have started addressing the issue. Poor roads or railway connections are still hindering on regional trade integration. The presence of China as a foreign investor in East Africa is decisive in order to develop these trade routes, as well as the willingness of the countries in the zone to build a regional integration area (the East African Community). This trade route is not fully operational yet, but there are already some deliveries or projects in countries from Djibouti to Tanzania, contributing to high and stable growth rates in the region.

Economic development also needs more power generation, including in South Africa where blackouts are regularly reported as a result of years of too poor investment. Water use is an issue related to that, and is also linked to the need to smooth agricultural production by minimizing the impact of drought periods. There are many projects, e.g. in Zambia, Ethiopia or Côte d'Ivoire designed to build dams and/or make the most of water resources in order to provide the agricultural sector with the water needed. These projects will continue to drive infrastructure investment and growth, but financing remains an issue, particularly in order to limit debt ratios and reach the appropriate long-term financing.

> *"In recent years, high investment rates have had positive spillovers on some African economies, which consequently boosted agricultural productivity and manufacturing production."*

New trend #1: Financing needs widened

Current account reversals from surpluses to deficits were a major consequence of the commodity price slump. From USD 56bn surplus in 2006 (adding all countries balances) to -141bn deficit in 2015, countries savings were deeply cut by the price shock. This new imbalance implied new financing dilemmas. Overcoming these hurdles with fresh financing was hard to achieve and many countries had to go to the IMF as a result of liquidity shortages, with recent examples like Gabon.

While the financing gap has recently been shrinking, African economies will still have to find USD 90bn in 2018. It's true that FDI net inflows increased but not by that magnitude. They came from USD 46bn in 2013 to USD 54bn in 2017. This raises a short term issue, as deficit financing will remain difficult for countries with too low or decreasing foreign exchange liquidity (e.g. Congo Republic or Angola). The long-term goal should be to improve attractiveness in order to drive FDI flows higher.

New trend #2: Exchange rates

Many countries were ruled by fixed exchange rate regimes in the past. As export receipts were deeply cut by lower commodity prices, foreign reserves did the same, and many countries had to accept FX depreciation.

The reluctance to let the exchange rate depreciate fueled speculative pressures, increasing divergence between official and black market exchange rates (e.g. in Nigeria, Egypt, or Angola). The indexation to a depreciated black market anchor led to an inflation spike. Many countries were then compelled to accept the switch, whose aftermath was a complete revamping of the exchange rate regime rather than a slight depreciation.

Angola is the last example to date, but other countries will probably have to accept new adjustments, as others weak points cannot be left ignored. Nonetheless, the main fragilities are now located in the two CFA Franc areas, where growth is still suffering from a deflationary shock caused by the depreciation of their competitors' currencies. It also weakens the politics since this deflationary shock hardly hit the ability of public finance to smooth the shock.

New trend #3: Political risk resurgence

Lower export receipts pressured the politics. Inflation and deflation took their toll on countries, as the former reduced the purchasing power of income, and the latter reduced incomes per se. Credit constraints amplified the negative shock. As a result, the governments had an increasingly difficult job to cope with the needs of a young population suffering from high unemploym
ent.

In countries where growth was never an issue, subdued political tensions were triggered by different factors. Irregular rains and the volatility of the agricultural output were key aspects to explain revived tensions in Ethiopia or in Kenya.

The risks associated with friction points are bad political reaction and higher probabilities of a lost reform momentum. All of the above are detrimental for growth and have the potential to trigger unsustainable debt dynamics.

New trend #4: Debt strikes back

Public and external debts increased during the last years. In Africa as a whole, external debt reached 38% of GDP in 2017 (from 20% in 2008) and public debt ascended to 45% of GDP (from 25% in 2008), but these levels are lower than past peaks (55% of GDP each in 2002). This surge in debt levels was not general. But current account reversals, exchange rate depreciation and policy conundrums jointly pressured some economies.

Public debt became a solvency issue for some countries. Congo Republic (117% of GDP in 2017) and Mozambique (100% of GDP in 2017) were the two key examples, with different consequences. In many cases, sticking with a fixed exchange rate regime weakened the position of the country in terms of liquidity, like in Gabon, but the IMF provided a solution. In Angola, the decision to let the Kwanza depreciate was taken in order to halt the dangerous decrease of foreign exchange reserves. In the future, African economies will have to take into consideration that current debt levels are not benign, limiting in some cases their policy space.

"In 2018, Africa's growth should be enhanced further to +3.5%, driven by the two cornerstone economies (Nigeria and South Africa, expected at +2.5% and +1.4% respectively)."

Contributor's Profile

Stéphane Colliac, Senior Economist for France and Africa. Stéphane joined Euler Hermes in 2016 as the France and Africa Economist. Stéphane holds a PhD from the University of Bordeaux. For most of this professional career as an economist, he has focused on emerging markets and country risk. Stéphane worked within different sectors in the past (French Treasury, Groupama Asset Management, Thierry Apoteker Consultant) and has a keen interest in international macroeconomics and finance.

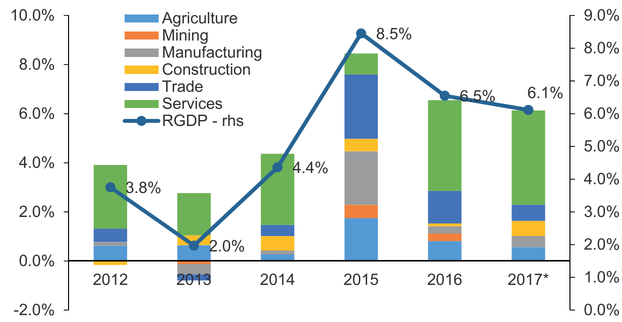
SENEGAL: MAINTAINING MOMENTUM IN 2018

By **Wale Okunrinboye,** Sub-Saharan African Fixed Income and Currency Research, Ecobank Group

Despite a legacy of political stability in the West African region, Senegal has historically struggled to attain meaningful economic growth with real GDP growth rate averaging 3-4% in the decade prior to 2015. However, following the rollout of a new ambitious economic blueprint, *Plan Sénégal Emergent (PSE)*[1], economic growth rates have risen with average of 7.6% in the last two years. The PSE, which seeks to transform Senegal to an emerging market economy by 2035, focuses on three pillars: structural economic transformation via increased investment in public infrastructure supporting sectors with significant export potential, higher expenditure on social sectors (health and education) and improvement in the rule of law and property rights. Beyond the steady growth momentum and aspirational reform agenda, Senegal's macroeconomic gloss looks set to shine with the conclusion of the GDP rebasing exercise which showed that the economy was 30% larger than prior estimates. In line with similar pattern across SSA, the exercise will drive an inorganic improvement in macroeconomic metrics placing Senegal on even stronger footing from an investor perspective.

Though real GDP growth slowed over 2017, with an average print of 6.1% y/y over the first three quarters (relative to 7.6% y/y over the same period), Senegal remains on track to report above trend headline growth for the third consecutive year (2017e: 6.3%). Following completion of the new Aéroport International Blaise Diagne (AIBD) in December 2017, growth outlook remains strong, driven by faster expansion in the Services sector. The AIBD airport has a capacity to handle 3million passengers annually, an improvement on the 1.8million passenger capacity of the old Leopold Senghor airport. Similar upbeat sentiments exist around agriculture (12% of GDP) given an increased focus on irrigation infrastructure under the *Programme de Relance et d'Accélération de la Cadence de l'Agriculture Sénégalaise (PRACAS)* which seeks to ensure food independence. The signing into law of a new mining code in March 2017 is likely to catalyse increased private sector investment into mining even as production from new phosphate, gold and zircon mines comes online. In all, growth is likely to accelerate to 6.7% in 2018.

Figure 1: Senegal: Real GDP growth and its components

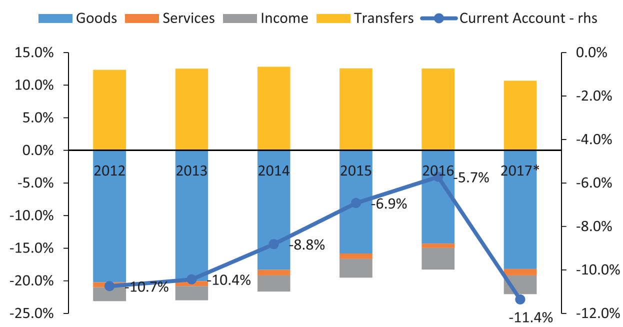


Source: ANSD, Ecobank Research *9M 2017

Enlarged fiscal space post GDP rebasing allows scope for continued expansion of the fiscus

Given the strong growth headroom of recent years, Senegal has remained on the path of fiscal expansion in 2018, relative to a retrenchment pattern across the WAEMU region. In The 2018 budget, the Macky Sall administration proposes a 10.4% y/y rise in fiscal spending to XOF3.7trillion with capital spending up 9.4% y/y to XOF1.3trn. On the revenue side, the central government aims to reform the tax code to reduce tax exemptions and credits, introduce a tax on cement revenues and modernize tax payment and customs collection systems. Further reforms include plans is to reduce subsidies to 0.5% of GDP, implementation of a treasury single account and curbs on public sector hiring. In all the projected revenue improvements

Figure 2: Senegal – Current account trends



Source: BCEAO, Ecobank Research *9M 2017

1 PSE execution is via the adoption of five-year priority action plans which filter into annual budgets

drive scope for further declines in the fiscal deficit in 2018 to 3.6% of GDP (2017e: 3.7%).

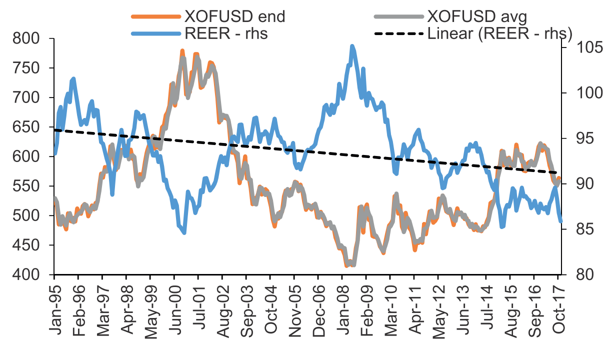
Despite deteriorating external imbalances, XOF to remain disconnected due to EUR peg

Despite the strong growth thrust in recent years, Senegal has recorded persistent external account imbalances on account of high food imports (21% of total imports) and a large fuel import bill (27% of imports). This trend continued in 2017 with deficit of 11.7% of GDP in the first three quarters vs. 5.8% of GDP in 2016, and largely reflects higher crude prices with imports up 17% y/y over the first three quarters of 2017 to XOF2.9trn. Though fresh impetus towards reducing reliance on food imports and initiatives aimed at boosting service exports via tourism and logistics point to continued growth in exports, the current account deficit is likely to remain elevated over 2018 in the light of rising crude oil prices. Admittedly, following rebasing, there exists scope for cosmetic reductions in the current account metrics over 2018.

Notwithstanding the weak outlook for the external account, Senegal's use of the XOF, with a fixed peg to the EUR, anchors exchange rate trajectory to developments across the Eurozone. In 2018, a combination of positive sentiment following US corporate tax reform, continued US monetary tightening and likely political jitters ahead of the Italian general elections hold bearish connotations for the EUR. Accordingly, we expect the EUR to give up some of its 2017 gains over the USD by softening to 1.16 at the end of June. However, ahead of the US mid-term elections in November, we see scope for resumption of bearish sentiment around USD even as the ECB embarks on monetary policy normalization with further measured cuts to its bond-buying program. Set against this backdrop we expect the exchange rate to close the 2018 at XOF560.16:USD1 down from XOF576:USD1 at the end of 2017.

Following protests in Senegal and Cote d'Ivoire, there has been increased rhetoric regarding a likely CFA Franc devaluation/de-peg. However, statements across the political leadership in the WAEMU and CEMAC regional blocks continue to reiterate a commitment to the status quo. While terms of trade shocks to CEMAC countries, where oil accounts for over 80% of exports suggests an over-valued exchange rate, given the largely net import status of WAEMU countries, empirical literature continues to suggest a fairly valued exchange rate. Specific to Senegal, looking at REER data calibrated for its inflation rate, evidence implies that continued use of the XOF has not eroded its competitiveness as the current exchange rate currently tracks below the level implied by its trend level REER (See figure 3 below). Bar a five year period of REER overvaluation between 2005 and 2010, the XOF has traded below trend levels calibrated to Senegal's inflation. Thus, from a fundamental and political perspective there is limited impetus for Senegal to support a CFA franc devaluation in the WAEMU region.

Figure 3: Bilateral USD Exchange rate and Real Effective Exchange Rate*[2]

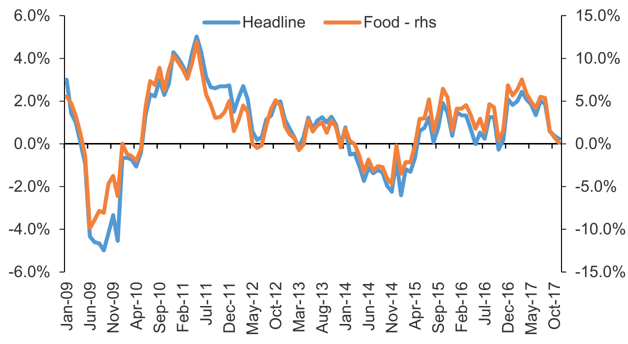


Source: IMF, Bruegel, Ecobank Research *Calibrated for Senegal's CPI

Stable currency backdrop tempers inflationary pass-through from rising oil prices

In all, our view on the currency implies that overall inflation in Senegal remains well anchored within the WAEMU region 3% convergence criterion. In terms of specific drivers, in the absence of potentially large exchange rate shocks over 2018, the major inflationary threats stem from rising crude oil prices alongside plans to trim subsidies to the state-owned refinery. However, energy pressures only account for 8.5% of the CPI index which implies that oil price pressures are likely to be muted. Accordingly, while average inflation is likely to trend higher over 2018 to 1.5% (2017e: 1.3%), the trajectory of headline inflation is likely to remain tethered to patterns in the food index (33% of CPI) where increased food production points to benign patterns, absent weather shocks.

Figure 4: Trends in Headline and Food Inflation (y/y)



Source: ANSD, Ecobank Research

2 REER data was obtained from Bruegel

External financing and political risks remain low for now ensuring policy continuity

Though prospects of further monetary tightening by US Federal Reserve has raised concerns over external debt, Senegal's next principal Eurobond payment is not due 2021 and there are no plans to tap global debt markets for fresh Eurobonds in 2018. Political risks also remain largely muted following a sweeping victory in the legislative elections in July 2017 where the ruling BBY coalition won 125 of seats in the 160-seat legislature. This has boosted prospects for President Macky Sall and his BBY coalition to win re-election in the March 2019 elections and limits scope for departure from the PSE and broad policy areas over the medium term.

The stable political backdrop and limited financing risks is evident in favourable ratings actions on Senegal with Moody's upgrade to its rating on Senegal one notch higher to Ba3 from B1 (in contrast to a downgrades across SSA). The improvements also underline tightening credit spreads on Senegal's Eurobonds. In all, a robust economic growth outlook and increasing reformist policy stance has ensured that Senegal's macro-economic picture which should continue to attract favourable investor assessment and increased capital flows over 2018.

Contributor's Profile

Wale Okunrinboye provides research coverage on fixed income & currency developments across Sub-Saharan Africa at Ecobank. Prior to Ecobank, Wale was a Senior Analyst in the research department of ARM Investment Managers where he wrote macroeconomic research reports on Nigeria and provided sell-side equities research coverage on Nigerian banks among other sectors. Wale holds degrees in Economics from the University College London (MSc) and Covenant University, Ota (BSc.) and is a CFA Charterholder.

POSITIVE PROSPECTS FOR CRUDE OIL AND PRECIOUS METALS IN 2018

Oil prices to reach $60 per barrel in 2018

Crude oil prices reached a three-year high in late January 2018, mainly due to a weaker US dollar, a decline in U.S. crude oil inventories for the 10th consecutive week and sustained production cuts by OPEC and non-OPEC members. ICE Brent crude oil front-month prices reached $70.5 per barrel (p/b) on January 24, 2018, constituting an increase of 28.7% from an average of $54.8 p/b in 2017, while WTI oil prices grew by 29% from an average of $50.8 p/b in 2017 to close at $65.7 p/b on the same day. Similarly, OPEC's compliance with the output cuts reached a record high of 129% in December 2017, which improved investor sentiment. Other factors that have supported oil prices so far in 2018 include the unrest in Iran, higher demand for winter heating in the U.S., a decline in oil exports from southern Iraq, a drop in Venezuela's oil output to a three-decade low, and improved global economic prospects. As the same time, S&P Global Ratings increased by $15 its 2018 forecast for average Brent and WTI oil prices to $60 p/b and 55$ p/b, respectively. Furthermore, it anticipated the oil market to balance by mid-2018. However, it highlighted the major downside risks for oil prices this year include an increase in U.S. shale oil production and the non-compliance of countries that are part of the OPEC agreement.

Gold prices to be supported by strong economic growth prospects

Gold prices are forecast to average $1,324 a troy ounce in 2018, which would constitute an increase of 5.2% from an average of $1,258.5 an ounce in 2017. Prices are projected to trade at a low of $1,200 an ounce and a high of $1,450 an ounce this year. The anticipated rise in the metal's price in 2018 is supported by expectations of a weaker US dollar and higher inflation in the U.S., as well as by higher investor demand for the metal. Also, the price outlook takes into account strong economic growth prospects in 2018, especially in China, Europe and the U.S., which would support demand for gold jewellery and gold-containing technology such as smartphones and tablets. In addition, strong economic growth spurs savings and, in turn, leads to an increase in bar and coin demand for gold. Further, gold-backed investment vehicles, as well as increased gold market transparency and efficiency, are making access to gold easier and more affordable. However, downside risks to the price outlook include weaker-than-anticipated physical demand for the metal in 2018, two U.S. interest rate hikes and a slowdown in U.S. retail demand.

Platinum prices to recover in 2018, high demand and low output

Platinum prices averaged $948 a troy ounce in 2017, constituting a decline of 4% from $987 an ounce in 2016, while they traded at a low of $877 an ounce and a high of $1,033 an ounce in 2017. The decrease in the metal's prices mainly reflects lower platinum demand, due to a decline in demand for diesel-powered vehicles, which accounts for 50% of the world's platinum consumption. However, platinum prices are expected to recover in 2018 and to average $980 an ounce in the first quarter of the year and $1,040 an ounce in the second quarter, partly driven by higher investment demand and lower mine output, which would widen the production deficit in the platinum market this year. In fact, the metal's subdued prices in 2017 have led to lower investment in platinum mines, and have weighed on the metal's mine supply. In addition, platinum jewellery demand is forecast to grow by 3% in 2018, due to higher Chinese and Indian jewellery demand, which would underpin the metal's price outlook.

Silver prices to rise on supportive supply and demand dynamics

Silver prices averaged $17.1 per troy ounce in 2017, trading at a low of $15.4 an ounce and a high of $18.5 an ounce last year. In 2018, the metal's price is forecast to increase to an average of $18.3 an ounce and to trade at a low of $15.5 an ounce and a high of $20.5 an ounce. The rise in silver prices reflects supportive supply and demand dynamics. On the demand side, the global automotive sector will boost silver's industrial demand in 2018. Also, jewellery consumption is forecast to rise by 4% this year following an increase of 1% in 2017, mainly driven by jewellery demand in China. In addition, silver usage for photovoltaic cells is forecast to reach a record-high in 2018, supported by growing demand for solar panels, as individual households in China are increasingly using solar panels. On the supply side, the metal's production is anticipated to decline by 2% this year, constituting the second consecutive annual decrease, which would support the metal's price outlook. However, downside risks to prices include subdued investor demand and ongoing efforts to substitute silver usage in the photovoltaic and healthcare sectors

SOUTH AFRICA MACROECONOMIC REALITIES, MYTHS & PROSPECTS IN 2018

By **Thabi Leoka,** Independent Economist

South Africa found itself in a recession at the beginning of 2017, but a strong rebound in the agriculture and mining sectors pulled the country out of the recession. Despite the strong rebound in the primary sector, GDP in 2017 was just under one percent. The country is expected to growth by around 1.2 percent this year, supported mainly by the recovery in global growth. Since President Zuma became President in 2009, GDP growth has struggled to expand beyond 3.5%. In fact, during his entire term, South Africa's GDP would have averaged under 1.5%. Zuma did start his presidency straight after the 2008 financial crisis, but lack of policy adoption and growth inducing policies kept growth subdued. In December 2012, the ANC launched the New Development Plan (NDP) which was perceived to be the holy grail of South Africa's economic growth path which aimed to eliminate poverty and reduce inequality by 2030. The NDP planned to create about 11 million jobs by 2030. This would require growth in the economy of about 5.4% on average every year over the same period. Since its launch, economic growth has declined consecutively, and the unemployment rate reached its highest level at 27.7 percent in 2017. Stats SA released a report titled: Poverty Trends Report for 2006 to 2016 which revealed that 30.4 million people (55.5% of the population) is living in poverty, compared with 27.3 million people in 2011. The lack of implementation and commitment to the NDP can be directly linked to the benign economic performance.

After a startling midnight cabinet reshuffle in March which saw the recall of the Finance Minister and Deputy Minister, rating agencies, S&P and Fitch reacted with a ratings downgrade reducing the country's credit rating to sub-investment grade. Both agencies were concerned about the extent to which the unexpected cabinet reshuffle would weaken standards of governance and public finances. They also believed that it would result in the change of economic policy.

The plethora of negative news flow on corruption and rating agency downgrades weighed on business confidence. The RMB/BER Business Confidence Index plunged to levels last witnessed in 2009 after the global financial crisis in the second quarter of 2017 and while the index has improved recently, it remains weak. Fixed capital investment, particularly from the private sector is feeble at time a time when public spending is being reined in. In 2012, the National Treasury set a spending ceiling which limits government spending in order to shrink the budget deficit. The ceiling has been strictly adhered to until the Medium-Term Budget Policy Statement (MTBPS) in October 2017 where there was R3.9 billion breach. The breach was a result of the bailing out of South African Airways to the amount of R10 million and South African Post Office by R3.7 billion. Astonishingly, the revenue shortfall is projected to widen to R50.8 billion from R30.4 billion previously and the budget deficit to 4.3% of GDP from compared with the 3.1% forecast previously. Debt-to-GDP is expected to rise to 61% over the next three years, at a time when the opposite is happening in South Africa's emerging markets peers.

Confronted with a massive shortfall, the National Treasury was put under further pressure to plug the shortfall by Moody's rating agency who placed the country under review for a downgrade. Moody's, whose ratings for South Africa is still investment grade (Baa2), essentially gave the country three months to demonstrate its ability to shrink the shortfall and the budget deficit, bring clarity to outstanding reform objectives such as regulation of the mining sector, remove structures that encourage rent-seeking over achievement of public policy goals and solve the state of SOEs.

On the eve of the ANC Conference, Zuma made an unexpected announcement that has huge implications on the national budget. He announced there should be fee-free education for poor and working-class students despite the Heher Commission into the Feasibility of Fee-Free Higher Education and Training, which he appointed, found that there is currently no capacity for the state to provide free tertiary education to all students in the country. It is estimated that the cost of fee-free education will be around R14 billion initially, but this figure can increase to around R40 billon in the following year.

Even though Treasury plans to enforce spending cuts of about R25 billion and raise revenues by about R15 billion, the announcement of fee-free education throws a spanner in the works. Tax buoyancy is reliant on economic buoyancy, therefore raising R15 billion will be no small feat. South Africa has a relatively small personal income tax base and corporate taxes are fairly high by international standards, which means the National Treasury may have to increase VAT by one percentage point in order to raise about R20 billion. Net VAT accounts for about 26 percent of total revenue and VAT collections have been the second-largest contributor to total tax in the past ten years. Increasing VAT is very unpopular especially amongst trade unions who have been very critical of te idea. They argue that VAT is regressive tax that hurts the poor and stifles demand and economic growth. This may be true, however, the other option of risking a Moody's downgrade could sink the country into a recession and lead to further job losses.

It is still unclear what the implications of a Moody's downgrade will be. What is certain is that investors who are mandated to only invest in investment grade country's will pull their money out. This will weaken the rand, increase inflation, increase the cost of borrowing, make it challenging to raise debt and slow growth. The South African Reserve Bank held rates on hold at their first meeting of 2018 mainly because of the uncertainty associated with the Moody's review.

Despite this cacophony of challenges, South Africans seem to be a lot more optimistic in 2018 than in previous years. At the ANC Conference in December 2017, Cyril Ramaphosa was elected as the new president of the party. There is an expectation that Mr Ramaphosa will bring about the much-needed changes to kick-start the economy. Thus far, Mr Ramaphosa has promised to deal with corruption immediately by putting together an inquiry into State Capture – a term used to describe rent-seeking behaviour. Many hope that Mr Ramaphosa will relieve Zuma of his duties. This will allow Mr Ramaphosa to take on Zuma's role for just over a year before the April 2019 national elections. It will not be easy to remove a seating President. If Zuma doesn't volunteer to leave, parliament may decide his fate. Many within the ANC has been implicated in corruption. Mr Ramaphosa needs to spend 2018 separating the chaff from the wheat within his own party. This will not be an easy task and he may be faced with resistance from within.

Contributor's Profile

Thabi Leoka is an Economist who has worked for various organisations in the financial sector. Her interests are in monetary and fiscal policy in Africa and emerging markets. Thabi started her career as an Economist at Investec Asset Management in South Africa and London. She has also worked as an Emerging Markets Economist at Barclays in London and Head of Economic Research, SA at Standard Bank. Thabi has a PhD in Economics from the University of London, MSc in Economics and Economic History from the London School of Economics and MA from the University of the Witwatersrand. Thabi writes for various publication both in South Africa and internationally.

SUB-SAHARAN AFRICA SOVEREIGN CREDIT QUALITY HAS DETERIORATED

S&P Global Ratings indicated that the overall sovereign creditworthiness in Sub-Saharan Africa (SSA) has deteriorated since July 2017. It noted that it upgraded the ratings of the Republic of Congo, which was more than offset by the sovereign downgrade of Angola due to its rising debt service costs and weak economic growth, of the Democratic Republic of Congo as a result of elevated political and economic risks, and of South Africa due to the weakening of its economic and fiscal framework. In parallel, S&P revised the outlook on Botswana and Zambia to 'stable' from 'negative' and that on Ghana to 'positive' from 'stable'. As such, it indicated that 15 out of the 17 rated SSA countries carry a 'stable' outlook on their sovereign ratings; one has a 'positive' outlook; while Mozambique is in 'Selective Default'. S&P expected economic conditions in SSA economies to modestly improve in 2018 due to the pickup in oil prices and broadly stable prices for key commodity exports, such as copper and diamonds, among others. It said that the average rating of the 17 SSA sovereigns stood at just above 'B' as at December 2017, compared to just below 'BB-' in 2009. It added that the average sovereign rating becomes slightly lower than 'B+' when the ratings are weighted by nominal GDP, largely due to South Africa, which is rated 'BB' and accounts for more than one-fourth of the aggregate GDP of the 17 countries. S&P noted that 16 out of the 17 rated sovereigns have a speculative-grade rating, while Botswana is rated 'A-'.

UGANDA MACROECONOMIC INDICATORS IN THE YEAR 2018

By **Adam Sengooba,** Associate Director, PWC, Uganda

A Decade of robust economic growth till 2010, it slows down thereafter

Since 2010, growth has been more erratic ranging from a high of 6.8% during the financial year 2010/11 to a low of 3.9% in the financial year 2016/17. This sluggish and uneven growth resulted in Government failing to meet its desired 7.2% annual growth rate which was the target for the National Development Plan I (NDP I) over the five year period 2010/11 to 2015/16. This trend of slow growth has continued during the current five year period of NDP II.

The slowdown in growth is due to many factors. These include the after effects of the 2010 – 2012 global financial crisis which resulted in a stagnation in demand of goods in many of our export markets and a global decline in commodity prices. Further, the uncertainty and anxiety surrounding the 2011 presidential and parliamentary elections contributed to a reduction in economic activity and a decline in foreign direct investment (FDI).

Thereafter, we saw the withdrawal of budget support by development partners in the year 2012 as a result of financial mismanagement and governance issues in a number of Government departments. This withdrawal of financial support to the budget by development partners forced the government to start exploring non-traditional financing options such as non-concessional borrowing and using domestic debt to finance the budget. This marked the beginning of the rapid growth in public debt which has risen close to 40% of GDP.

The economic situation was made worse by the onset of the civil war in South Sudan in 2013. Before the war, South Sudan was Uganda's leading export destination with exports both formal and informal estimated to have exceeded $ 1 billion during the financial year 2008/09. Since the civil war started in 2013, Uganda's exports to South Sudan have been declining every year from $414 million in 2013, to $385 million in 2014 then further down to $353 million in 2015.

Then came the 2016 elections that again resulted in a decline in economic activity for the rest of that year. In fact; the lag effect of this economic slowdown continued well into 2017. Subsequently, consumer spending was constrained as a result of the low purchasing power and weak demand in the economy. Many local businesses were greatly affected by this slowdown and eventually sought Government's intervention in the infamous "bail outs" of 2016. The situation further worsened by the adverse weather related factors, mainly due to the very long drought of 2016.

A combination of all these factors plus the usual suspects namely corruption, poor management, planning and execution of public infrastructure projects, delays in implementation of Government programs and projects and low domestic revenue collections are all collectively responsible for the decline in growth of the economy that we are now experiencing.

GDP growth was below expectations in FY 2016/17

Growth in all sectors of the Ugandan economy slowed down during the financial year 2016/17. Agricultural output grew by only 1.3% compared to the growth of 2.8% in 2015/16; industrial sector growth slowed to 3.4% during 2016/17 which was below the 4.7% of the previous year, and growth in the services sector slowed to 5.1%, compared to the 5.9% growth in 2015/16. Overall, the economy grew by 3.9% in financial year 2016/17 compared to growth of 4.7% in 2015/16.

With annual population growth of about 3% per annum, this means that the per capital growth in the economy was only 0.5%. The slowdown in growth is mainly due to a combination of domestic factors.

These include; the long drought of 2016 which affected agricultural output, tight financial conditions that culminated into low private sector credit growth and the slow implementation of government infrastructure projects which in return has delayed the realization of the economic benefits expected from these investments.

Why economic growth does not "reflect poverty reduction and inclusive growth?

Although Government knows our priorities as a country and has put in place policies and designed programs aimed at addressing these national priorities, they have not performed well in implementation and execution of these policies and programs in a manner that is efficient, effective and transformational.

For example, we already know that it is only through education and skills development that we will develop our human capital, and ensure Ugandans have a secure foundation for inclusive growth. But how many of our youngsters who enrol for primary education make it to upper secondary school, or tertiary institutions? What impact is this having on our ability as a country to avail firms with skilled workers? If we could fix this problem, what impact would it have on providing the youth with an escape route from poverty?

With regards to manufacturing and industrialization, the objective must be to develop and implement national strategies aimed at fostering the entry of firms into higher value-added areas of labour-intensive production. Agriculture is the sector with the greatest impact on the socioeconomic bottom line of Uganda, as most people depend on it for their livelihood.

With the ever increasing changes in weather conditions, what kind of interventions from both a policy and public investment perspective are planned to ensure an average year-on-year growth rate of at least 5% in the agriculture sector? If we were to achieve this 5% annual year on year growth rate in the sector, we would not only be guaranteeing the food security for all Ugandans, but we would also be creating internal and external demand as well as multiple revenue streams from the sale of agricultural produce. This is because on one hand, agriculture can create jobs and feed the nation, but on the other, the price of food can be a key determinant of the inflation rates in the country.

The economic outlook for FY 2017/18

Government is optimistic that the economy will grow by at least 5% this financial year. The growth will be driven mainly by strong performances in the industry and services sectors, and also by public infrastructure investment and other investments in priority sectors. Rising private consumption and a recovery in private sector credit growth should result in an increase in domestic consumption, which will spur growth of the economy.

This optimism is also shared by the IMF. According to their most recent report on the performance of the Uganda economy, the IMF says that the economic outlook is broadly favourable. With steadfast policy implementation and assuming improved weather conditions, the IMF is predicting the economy to grow by 5% this financial year. Over the medium term, the IMF expects the ongoing investments in public infrastructure and investments in the oil and gas sector to propel growth of the economy to rates of between 6.0% and 6.5%.

With the planned public infrastructure investments, public debt will increase. However, the IMF is of the view that debt will remain manageable, as long as these public investments lead to higher growth and the government continues to increase its domestic revenue collections.

Fiscal stimulus through public infrastructure investments will stimulate economic growth.

The main risk to economic growth remains the current slow pace of implementation and execution of the budgeted public investments and infrastructure development projects. If this slow pace continues, it will deter growth of the economy, as was the case last financial year. Therefore, in order to achieve the projected 5% economic growth there must be huge improvements in the efficiency and effectiveness in the way public infrastructure and investment projects are executed. The major infrastructure projects currently underway such as the power generating plants, roads, airports, the standard gauge rail system, water treatment and sanitation plants, the oil and gas infrastructure facilities, are supposed to create the foundations of Uganda's modern economy.

When done properly, all these projects should have a huge multiplier effect on the economy. This is because every dollar spent on infrastructure leads to an outcome of greater than two dollars3. With the right execution, all these public investment infrastructure projects can have a powerful effect on the economy. They have the potential to raise output in the short term by boosting demand, creating jobs, and increasing the economy's productive capacity in the long term.

In addition, the boost to GDP that the country will get from increasing public infrastructure investment will help to counter the rise in public debt as a percentage of GDP. This will help to keep in check the public debt-to-GDP ratio, so as to ensure that the debt does not rise disproportionately compared to the size of the economy. In other words, all these planned public infrastructure investment projects should pay for themselves, if done correctly.

However, in order to reap these benefits, Government will have to invest well. That is, invest where there is a clear need for the investment, and invest efficiently. If Uganda can achieve this, these public investment projects will provide a much needed boost to the economy, both in 2018 and in the future.

In conclusion, we are cautiously optimistic that the economy will rebound from the slow growth of last financial year to grow by at least 5% this financial year as projected by Government.

However in order to achieve this growth, all the risks to the growth of the economy will have to be managed very well. In addition to managing these risks, implementation of Government's budget for FY 2017/18 will also be very important.

Government will have to increase its domestic revenue collection by at least 0.5% of GDP as was the case in FY 2016/17. This is very important as it will ensure debt sustainability while at the same time providing the funding necessary to finance the public investment projects. With spending on social services having declined in real terms, Government needs to make great efficiency gains in order to protect the quality and level of social services delivery especially to the poor.
The tight current spending envelope will also require strong expenditure controls and efficiency gains to avoid the need for supplementary budgets or renewed domestic arrears.

Contributor's Profile

Adam Sengooba is an Associate Director within PwC Africa's Risk Assurance Service. He has over 12 years' experience in provision of Enterprise Risk Management, Internal Audit, Information Security, Value for Money Audit, Corporate Governance, Regulatory Compliance, Financial Audit and Technology Assurance and Resilience services to clients across Africa.

He has been involved in helping clients across the Public and Private Sectors, to build risk resilient entities through better identification, measurement, mitigation and the optimal leverage of risks for business benefit.

Adam has led teams in helping clients design, implement, test and optimize their internal control environments, including provision of advice, analysis and improvement plans, in the context of business change, regulation or the challenge of returning investment value. He has experience in design and implementation of IT risk and control solutions that leverage investment in IT for maximum business benefit.

He is a member of the National Information Security Advisory Group (NISAG) which advises the Government of Uganda on Information Security Governance, Risk Remediation Planning and Response with the secretariat at the National Information Technology Authority of Uganda (NITA-U) under the Ministry of ICT. He is a Board member of the Institute of Corporate Goverance Uganda (ICGU).

ETHIOPIA: RATINGS AFFIRMED, OUTLOOK 'STABLE'

Fitch Ratings affirmed at 'B' Ethiopia's long-term foreign and local currency Issuer Default Ratings, with a 'stable' outlook. It indicated that the ratings balance strong economic growth, which it forecast at 9.5% annually over the coming year, against a wide current account deficit, a high level of public debt, low external buffers, as well as low development and governance levels. It forecast the current account deficit to narrow from 7.9% of GDP in the fiscal year that ended on July 7, 2017 to 6.6% of GDP in FY2018/19, driven by an increase in manufacturing and electric- ity exports, and improved competitiveness. It noted that FDI inflows grew from $2.6bn in FY2014/15 to $4.2bn in FY2016/17, which helped reduce external financing needs and, in turn, low-ered net external borrowing to $2bn in FY2016/17 and eased concerns about external debt sustainability. Further, it said that the inflation rate reached 13.6% in November, its highest level in five years, following the authorities' decision to devalue the Ethiopian birr by 13% in October 2017. It added that the spread between the official and parallel exchange rates is 12%, and that the short- age of foreign currency is a major constraint on private sector activity. It forecast the inflation rate to reach 15% in coming months, but to gradually moderate afterwards as the effects of a tighter monetary policy are transmitted to the economy. In parallel, Fitch projected the fiscal deficit at 3.2% of GDP annually between FY2018/19 and FY2019/20. It expected the public debt level, including the debt of state-owned enterprises (SOEs), to stabilize at around 55% of GDP over the coming two years, mainly due to lower SOE debt.

ZAMBIA: IMPROVING PROSPECTS, HINGING ON IMF SUPPORT PROGRAM

By **Thea Fourie,** Senior Economist: Sub-Saharan Africa, IHS Markit Economics

Leading indicators such as the Stanbic Bank Purchasing Managers Index (PMI) for Zambia, compiled by IHS Markit, shows that the Zambian economy is set for a stronger recovery during 2018. Mining production could benefit from international copper price resilience and capacity expansion at Zambia's largest copper mine while consumer spending is expected to pick-up due to low inflation, stronger employment in the private sector and lower interest rates. The country's precarious fiscal backdrop poses a risk to the near term outlook, while higher interest rates in the US, higher oil prices and unexpected deceleration in China also pose near term risk factors.

The Stanbic Bank Purchasing Managers Index (PMI) for Zambia, compiled by IHS Markit, recorded a reading above the 50-neutral level in December 2017; this represents the eighth consecutive month that the PMI points to an improvement in overall private business conditions in the Zambian economy. Employment prospects strengthened and inventories accumulated, while output prices continued to fall as businesses compete to attract new customers in the local market.

Business conditions at the beginning of 2017 and for most of 2015-2016 were less favourable, as the PMI readings showed.

Latest statistics by ZamStats, the Zambia Statistical Service, show that some of Zambia's largest sectors, namely mining and quarrying, wholesale and retail trade and the construction sector, failed to record any significant output gains during the first three quarters of 2017. The 3.1% average GDP growth recorded during January-September 2017 emanates primarily from stronger agricultural output and more local electricity generation. Following two dry El-Niño weather spells, Zambia experienced a heavier and longer 2016-2017 rainy season which has stimulated agricultural production and hydro-electrical power provision. The agricultural sector expanded by 16.1% during the first three quarters of 2017 while output in the electricity and gas sector accelerated by 24.3% over the period.

The improvement in local food supply and a stronger kwacha exchange rate have lowered inflation, which fell to an average of 6.6% in 2017 from 17.9% in 2016. Despite the favourable price trend, wholesale and retail spending remains constrained by high lending rates (close to 26%) and negative private sector credit growth. The Bank of Zambia (BoZ) embarked on an aggressive restrictive monetary policy stance during 2016 in an attempt to shield the economy against the inflationary impact of a 40% depreciation of the kwacha exchange rate during 2015 and 20% in 2016. Monetary policy since 2017 has become more accommodative but has not yet filtered through to lower lending rates for consumers. Private sector employment conditions during the first half of 2017 have also been lacklustre, adding to sluggish wholesale and retail output. Although the heavy rainfall has been good for some sectors, it has hampered copper mining production during Q1. Copper production disruptions due to maintenance at one of Zambia's largest copper smelters have furthermore impeded mining output over the August-September 2017 period.

The Zambia government's strong commitment towards its fiscal expansion program in the wake of lower international copper prices and weaker global trade activity during 2015-2016 came at a price. Sluggish economic growth left government revenue flows under pressure, resulting in delayed payments to many contractors who supply goods and services to the government. The World Bank reports that road contractors, state pension fund contributions and dealers that supply farming inputs procured by the government were particularly hard hit by government arrears accumulation. As a result, overall growth in the construction sector eased back to an average of 4.6% during Q1-Q3 2017 from 10.6% in 2016 and 19.2% in 2015, while Zambia's financial sector was also affected negatively. Non-performing loans (NPLs) had reached 12.2% of outstanding loans by November 2016 as businesses experienced liquidity pressures due to rising interest rates and government non-payment. A sharp draw-back in foreign direct investment into Zambia also contributed to the weaker construction activity in Zambia.

Latest United Nations numbers show that FDI inflows to Zambia eased back to a mere USD469 million in 2016 from USD1.5 billion in 2015.

For 2018, IHS Markit is of the view that Zambia's GDP growth rate could edge up to around 4.0%, as suggested by the favourable PMI reading. Higher mining and quarrying, construction and wholesale and retail trade growth is envisioned during the year. The agricultural sector is also expected to maintain strong output levels during 2018.

The copper mining industry could continue to benefit from favourable international copper prices. A very bullish EV (electric vehicles) narrative has reinvigorated optimism for international lithium, cobalt, nickel and copper prices for 2018. However, IHS Markit warns that the market's optimism could have been priced in a bit prematurely. We see copper prices relatively range bound over 2018, but the next 5 year outlook remains favourable. This combined with ramp-up production at one of Zambia's largest copper miners, First Quantum Minerals, during 2018-2019 and higher electricity output will not only benefit the overall mining and quarrying sector's output but also improve external liquidity availability in the near term.

International copper price resilience furthermore bodes positive for the Zambia kwacha exchange rate, since copper prices are the most important exchange rate driver in the Zambian economy. A stronger U.S. Dollar exchange rate and possible less upbeat international investor sentiment towards emerging markets as developed markets' bond yields edge up could nonetheless limit any strong appreciation bias of the kwacha exchange rate. The relatively stable kwacha exchange rate view for 2018 could open up the opportunity to lower the BoZ's policy rate further during the course of the year as inflation continues to moderate. The BoZ lowered its policy rate by 300 basis points during 2017 and a further 300 basis points cut is assumed during 2018. The favourable monetary policy environment and improvement in employment conditions could lead wholesale and retail trade stronger during 2018. A draw-down in arrears by the government could furthermore support construction activity in the economy and improve overall output in the financial services sector.

Unfortunately, the risks to the near-term outlook for the Zambian economy remains tilted towards the downside. Domestic as well as external factors could derail a strong recovery in the economy during 2018. Zambia's precarious fiscal backdrop poses the biggest risk to IHS Markit's near term economic outlook. In its October 2017 Article IV assessment of the Zambia economy, the International Monetary Fund (IMF) warns that the institution "now put Zambia at high risk of debt distress" after several years of fast-paced fiscal expansion and debt accumulation programs. IHS Markit's sovereign risk assessment shows that Zambia's external debt to GDP ratio has doubled to 43.1% in 2016 from 21% of GDP in 2013, leaving IHS Markit's medium-term sovereign risk rating for Zambia at B- on the generic scale, representing the low end of speculative grade. Public sector domestic debt levels have also been accelerating, leaving overall public and publicly guaranteed debt up from 36% of GDP at end-2014 to 60% at end-2016.

The Zambian government's slack adherence to any fiscal objectives in past years leaves any fiscal consolidation effort proposed by the current Zambian government in the balance. Investors keenly await the finalization of an IMF support program to place fiscal finances on a more solid consolidation path. The finalization of such a program has been delayed on several occasions during 2017 and triggered some kwacha weakness towards the end of 2017. Suggestions of an unwillingness by Zambian authorities to scale back future borrowing plans left the IMF describing the Zambian government as being "ambivalent towards debt sustainability". The delays in approving an IMF support program raises Zambia's overall sovereign risk profile, given that it increases the probability of a delayed fiscal consolidation, weaker debt sustainability and ballooning debt servicing costs. Under such an outcome, the probability of escalating external liquidity pressures remains high while monetary easing becomes less feasible. The ongoing normalization of the U.S. Fed policy rate, higher international oil prices and any unexpected deceleration in the Chinese economy also pose near term risk factors for the Zambian economic outlook.

Contributor's Profile

Thea Fourie is a sub-Saharan Africa senior economist at IHS Markit, south African office. She is responsible for analysing and forecasting economic developments in South Africa, Angola, Zambia, Mozambique, Namibia, Comoros, Madagascar and reunion. She has over 20 years of experience in the financial and consulting industry. Fourie holds a B.econ (hons.) degree from the University of Pretoria and is fluent in both Afrikaans and English.

ZIMBABWE ECONOMY: HINDSIGHT, INSIGHT AND FORESIGHT

By **Tapiwanashe Kazunga,** Investment Analyst, Invictus Securities Zimbabwe

The 2018 National Budget Statement underscored on key areas to resuscitate the Zimbabwean economy as below:

- Revitalization of the economy
- Improving Investor Confidence
- Re-engagement with the international community
- Restoration of democracy
- Curbing of corruption
- Rehabilitation of social services and infra-structure

Our views are that this will pave way for the economy in addressing lack of competitiveness, liquidity crisis, debt overhang and high unemployment rate.

Most importantly, the Statement brought in a positive sentiment in amending the repulsive indigenization policy, with only diamond and platinum considered as extractive sub-sectors, giving room to the rest of the minerals open for investment.

Liquidity constraints remain a menace to Zimbabwean economic growth as a result of lack of production and competitiveness as well as inadequacy of foreign currency in the economy. According to the African Economic Outlook (AEO) 2017, our economy has experienced cash shortages since the inception of bond notes in 2016, a move that was taken by RBZ as foreign currency dwindled.

However, the pledged $1.5 billion by the Afreximbank may come in as a way of invigorating the economy by improving production capacity. We also need to highlight that the 90 day amnesty that was pinpointed by President Mnangagwa on externalized funds may also give a remedy to cash crisis in the economy.

The only question arising is whether the money will come through and if so, how much is coming and who will bring the money. However, my views are that retention of externalized funds may not be successful.

Just as an example, Russia took the same stance by giving an amnesty to funds externalized and that did not yield any results.

According to the National Budget Statement presented by Finance Minister Chinamasa, the projected GDP for the year 2018 is 4.5% which is quite optimistic on the back of a 10.7% growth in agriculture, 6.1% in mining and 2.1% in manufacturing.

Sector Growth (%)	2016	2017e	2018f	2019prj
Real GDP (%)	**0.7**	**3.7**	**4.5**	**5.6**
Agriculture	-3.6	15.9	10.7	**8.1**
Mining	8.2	7.5	6.1	**7.6**
Manufacturing	0.2	1.0	2.1	**3.9**
Financial, Banking & Insurance	4.6	0.2	1.2	**9.2**

Source: Ministry of Finance- National Budget Statement

However, according to the World Bank report recently published in January 2018, growth projections were revised down to 0.9% from 1.8% as projected in June last year, which is below the Sub-Sharan benchmark of 3.2%. The bearish sentiment arises from a significant magnitude of risk in the medium-long term with subdued productivity and growth.

The World Bank report went on further to justify the projections on the basis of rising fiscal deficits. Our views on economic growth are that the projected 4.5% growth rate is too optimistic considering the state of the economy, culminated by fiscal debt overhang. We project a GDP growth rate of around 1.1% in 2018 which will rise towards 1.5% in 2019 after elections, slotted in August when there is certainty and direction in the market. With regards to inflation, the economy witnessed massive inflationary pressures which surged from -0.65% to 2.97% in November 2017 mainly attributed to continued issuance of Treasury bills by the Government to cover the fiscal debt position and lack of foreign currency in the economy.

Ultimately, this created a parallel market, paving way for a multiple pricing system which pushed prices in the positive direction. The 2018 budget statement projected 3.1% inflation rate which we believe is still understated considering the hamstrung fiscal deficit position and liquidity crisis. However, we need to address that we do not need to be too optimistic in our projections as elections will determine the direction of the economy.

Fiscal Performance

The absence of access to external development finance in the 2018 budget borrowing requirements have mainly been funded from the domestic market through issuance of Treasury Bills:

Purpose	Amount ($ million)
Budget Finance	386.45
Government Debt	1,070.82
Capitalization	61.06
RBZ Debt	103.73
ZAMCO	130.04
Total	1,752.08

Source: Ministry of Finance and Economic Development, Reserve Bank

Continued excess issuance of Treasury Bills by the Government has been a risk on the macro-economic instability as a result of interest payment obligations which kept on piling up RTGS balances. This resulted in a mismatch between RTGS balances and actual foreign currency giving rise to inflation.

As of June 2017, the quantum of the stock of Treasury Bills and bonds issued was $2.5 billion towards the banking sector. Let's take a closer look at the banking sector and pick CBZ, which is the largest bank by asset base.

Statement of Financial Position as at 30 June 2017:

	30 June '17	31 Dec'16
Assets	$	$
Total Assets	1,967,002,205	1,912,591,402
Liabilities	1,795,296,205	1,745,961,922
Treasury Bills	814,507,942	751,645,905

Source: CBZ Bank Financial Results HY 30 June 2017

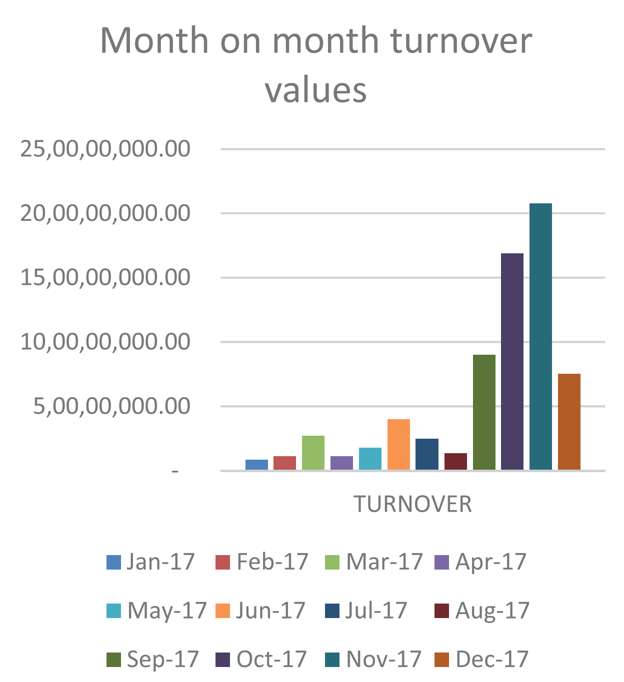
From the statistics above, it is clear that of the total assets held by CBZ Bank, being the largest by deposit base in Zimbabwe, jumped 2% from 39% of Treasury Bills composition in relation to total assets which were being held by the bank, to 41% as at half year 2017.
That is evident to show how bank balances have inflated and crowded the banking sector with Treasury bills, resulting in inflationary pressures in the economy.

However, we need to highlight the fact that the banking sector has done well in recording improved earnings and asset quality and diminishing toxic non-performing loans, thanks to ZAMCO (an SPV created by the Central bank).

The 2018 national budget stipulated that NPL's have dwindled from as high as 20.45% to 7.98% as at half year 2017 which is a favorable position for the economy.

With effect from April last year, the Reserve Bank Governor capped lending interest rates to 12% and since then, the money market platform has not been a hunting ground for most investors which resulted in a massive migration on the Stock market.

Stock market performance



The record bull run which occurred between September and November 2017 was a true replication of the state of the economy amid inflationary pressures, mismatch between RTGS balances and the actual foreign currency reserves as well as no other meaningful investments elsewhere in the market.

Source: ZSE

Because of the bull run, most prices sky rocketed, resulting in overvaluation of the Stock market. A good example is Old Mutual which traded as high as $14.30 in mid-November 2017 with a PE ratio of above 1300 and an arbitrage of $11.70, above its counterparts in JSE and LSE.

Going forward, we expect the Stock market to self-correct, driven by market fundamentals as a result of an expected economic revival in 2018. However we still remain adamant on our views that elections which are expected in August this year should determine direction of where we are heading to in the coming five years. Thus, our views are that fresh foreign investment flows are likely to remain sidelined as a result of market monitoring by investors for political developments.

Year-to-date market capitalization on the local bourse has lost ground by 4.59% from $9.6 billion as at 11 January 2017 and all things constant, we expect the ZSE market capitalization to hover around $6 billion region in 2018 due to market correction driven by fundamentals.

With the 2018 investment outlook that is mainly hinged on agriculture, manufacturing and mining, we picked the following strategic sectors to watch in 2018:

- Agro Industrial
- Construction
- Manufacturing
- Retail
- Mining

Sector: Agro Industrial
Counter: Seedco
Current Price: $2.0000
Market Cap: $481,549,280
PE: 22.81
Year High: $2.0025
Year Low: $2.0000
Target price: $2.4800
Recommendation: Pursuing its proposal to list the group on the regional stock exchange to raise capital for expansion and funding growth opportunities

Sector: Manufacturing
Counter: Proplastics
Current Price: $1.700
Market Cap: $328,134,959
PE: 27.94
Year High: $1.7600
Year Low: $1.7000
Target Price: $2.1000
Recommendation: Manufacturing sector projected to improve from 1% to 2.1% and we anticipate an increased production levels and improved capacity utilization

Sector: Retail
Counter: OK
Current Price: $0.1700
Market Cap: $202,790,745
PE: 21.76
Year High: $0.2000
Year Low: $0.1650
Target Price: $0.3500
Recommendation: Our views are that the retail sector will benefit from price increases which will emanate from inflationary pressures. Our 2018 projected inflation rate is between 5%-8%.

Counter: Simbisa
Current Price: $0.4342
Market Cap: $ 241,755,955
PE: 37.11
Year High: $0.4700
Year Low: $0.4500
Target Price: $ 0.6500
Recommendation: Pipeline proposal of secondary listing on the London AIM to raise capital and negotiating for the acquisition of an international complementary business.
(1399 words)

Contributor's Profile
Tapiwanashe Kazunga is an investment analyst. He currently holds a BCom in Finance from the National University of Science and Technology (NUST- ZIMBABWE).

INSIGHTS ON SUB-SAHARAN AFRICA MACROECONOMIC PROSPECTS IN 2018

By **John Ashbourne,** African Economist, Capital Economics, London

Growth in Sub-Saharan Africa is likely to accelerate in 2018. But this will not be as a result of a widespread increase in growth. Indeed, growth will remain pretty stable across most countries in the region, and will actually slow in a few countries (notably Angola and Ghana). While growth will pick up in over a dozen countries, the improvement in the regional growth is mostly due to pickups in just two economies: Nigeria and South Africa.

South Africa's economy to grow, inflation ease

South Africa's economy is enjoying a rare period of decent growth, which we will expect to continue in 2018. Admittedly, the prices of some key commodity exports – iron ore, coal, and gold – are likely to fall this year. However, commodity prices have a smaller effect on South Africa – a relatively diversified economy than they do elsewhere in the region.

In addition, South Africa's economy has already adjusted to low commodity prices. In particular, South Africa's current account deficit is now smaller than it has been in recent years, and is low by regional standards. This will provide support to the rand, helping to stabilise the currency.

The big shift in South Africa will be domestic. We think that the election of Cyril Ramaphosa as head of the ANC will provide a significant boost to business and consumer confidence. Indeed, the latest surveys suggest that business activity already perked up in December and January. Given that weak investment spending has been a key problem in recent years, an improved political situation should boost growth. Optimism will increase further when President Zuma is eventually removed from office

Mr. Ramaphosa's arrival also coincides with a reduction in inflation, which will help to boost consumers' purchasing power. The South African Reserve Bank will probably keep rates on hold. We expect that stronger consumer spending as well as a pickup in investment expenditure will cause the economy to accelerate in 2018. Our above-consensus forecast is for expansion of about 2.0% year-on-year in 2018.

Nigeria to grow at 3.5%, but still with structural problems

While this would be a very good result for South Africa, growth of about 2.0% is still pretty poor by regional or global standards. But pushing growth to the 5% y/y range that the South African government estimates is necessary to really tackle the country's entrenched poverty and inequality would take significant economic reform. This would take years to enact. And Mr. Ramaphosa is unlikely to push for any disruptive choices in the lead-up to the 2019 election. So while South Africa will pick up this year, it will probably continue to disappoint over the medium term.

While the price of South Africa's exports will probably fall this year, we expect that oil prices will rise. This will provide a boost for many African economies, most notably Nigeria. The country is already experiencing a muted economic recovery following currency reforms and an increase in oil output. Higher oil prices will provide additional momentum and allow for fiscal policy to loosen. Monetary policy will also probably loosen as inflation eases.

The Nigerian economy still faces significant structural problems – as shown by the current fuel shortages. And there are major downside risks; notably another fall in oil prices. But our core view is that growth should pick up to about 3.5% year-on-year in 2018. This would be weak by historical standards, but be a big shift compared to recent year.

Unfavourable Outlook for Angola's economy

Angola, the Africa's second largest oil producer is unlikely to fare so well. Angola is suffering a sharper economic crisis due to its greater dependence on oil and the government's failure to attract investment into other sectors of the economy. The partial devaluation of the kwanza is a positive step, but this will cause a painful jump in inflation and force the central bank to hike rates. We expect that the currency will have to fall by about another 20% in order to make a full adjustment. All in all, we think that the Angolan economy will re-enter recession this year, before bouncing back in 2019.

Table 1: Selected Sub-Saharan Africa

	World Share[1]	GDP (% y/y) 2016	2017e	2018f	2019f	Inflation[2] (%) 2016	2017e	2018f	2019f
Sub-Saharan Africa	**2.4**	**0.7**	**2.7**	**3.8**	**3.5**	**11.9**	**12.0**	**10.5**	**7.8**
Nigeria	0.9	-2.0	1.0	3.5	3.5	15.6	16.5	12.3	9.5
South Africa	0.6	0.3	1.0	2.0	1.5	6.3	5.3	4.8	5.2
Angola	0.2	-4.5	0.0	-1.0	2.5	32.0	32.5	35.0	15.0
Kenya	0.1	6.0	4.5	5.0	5.2	6.3	8.0	5.5	5.0
Ghana	0.1	4.0	8.0	7.5	6.0	17.5	12.4	9.0	9.0

The country's economic problems will raise yet more worries about its foreign debts. We've long highlighted Angola as the country most likely to see a repeat of Mozambique's recent debt crisis. Angola has significant foreign borrowing, operates under opaque accounting conditions, and has a new leader looking to shake up the old regime. This sounds a lot like Mozambique in 2015.

Problems in Angola might draw attention to African debts more generally. While total debt burdens are small, the cost of debt servicing takes up a large share of available revenue, raising the risk of debt traps. This problem is particularly acute in Ghana and Nigeria. Nonetheless, severe crises remain unlikely. And weak linkages between African countries mean that spillovers would be limited.

Indeed, as things stand, we think that the economic outlook for the majority of countries in Africa is brightening. Although currencies are generally likely to weaken, these falls should be relatively modest. Inflation is set to decline and interest rates are likely to be lowered.
In most countries, we expect that GDP growth will strengthen this year. We hold above-consensus views on Nigeria and South Africa, and Angola is the only country where we expect that growth will reach so slow by more than 0.5%pts. For the region as a whole, we expect growth to reach a four-year high. Even so a return to the super-charged growth of last decade remains unlikely.

Contributor's Profile
John Ashbourne is an Africa economist at Capital Economics, an independent macro-economic consultancy firm based in London. John was previously a senior Africa country risk analyst at BMI Research, a division of Fitch Ratings. He holds an MSc from the London School of Economics and a BA from the University of Toronto.

SUB-SAHARAN AFRICA OUTLOOK SUBJECT TO SIGNIFICANT DOWNSIDE RISKS

The World Bank projected economic growth in Sub-Saharan Africa (SSA) to accelerate from 2.4% in 2017 to 3.2% in 2018 and to average 3.6% annually during the 2019-20 period, supported by an increase in commodity prices and stronger domestic demand. Still, it expected the region's growth rate to remain below the pre-global financial crisis level, as Angola, Nigeria and South Africa, the region's largest economies, continue to face challenges. It forecast Nigeria's real GDP to pick up from 1% in 2017 to 2.5% in 2018, driven by higher oil production and improved non- hydrocarbon sector activity. It projected Angola's real GDP to rise from 1.2% last year to 1.6% this year in case the successful political transition improves the investment climate.

Further, the Bank expected economic activity in SSA's oil ex-porters to accelerate from 1.5% in 2017 to 2.8% this year and to average 2.9% annually in the 2019-20 period, due to higher oil exports. It anticipated activity in SSA's metal exporters to accelerate in 2018, supported by rising metals prices, declining inflation rates, easing in monetary policy and increased household demand. Also, it expected power generation in some of the region's metal exporters to increase in case weather conditions improve, which would support private sector activity. Further, it projected growth in non-resource-intensive countries to expand at a solid pace, driven by strong public investment growth. In addition, it anticipated economic activity to remain solid in the economies of the West African Economic & Monetary Union, with Côte d'Ivoire and Senegal expanding at a fast pace. Also, it projected Ethiopia to remain the fastest-growing economy among East African countries, as it implements measures to stabilize its government debt level. It expected Kenya's real GDP to recover due to a lower inflation rate, while it projected Tanzania's growth to accelerate on strengthened investment growth.

In parallel, the Bank indicated that the regional outlook is subject to significant downside risks, which include tighter global financing conditions, slower-than-anticipated increase in commodity prices, heightened policy uncertainty in the U.S., weaker-than-expected growth in China, as well as an intensification of regional political and policy uncertainty and security tensions

AFRICAN FIXED INCOME AND FX MARKETS IN THE YEAR 2018

By **Samir Gadio,** Head, Africa Strategy, FICC Research, Standard Chartered Bank

The outlook for African local fixed income markets is generally constructive in 2018 after strong returns last year. A combination of a weak USD, supportive global market conditions and decent fund inflows should anchor risk-taking in higher-yielding emerging and frontier markets. A number of Sub-Saharan African (SSA) economies have benefited greatly from this constructive backdrop in the recent past. This is evidenced by last year's positive portfolio flows and, in some cases, very large inflows when turnaround stories materialised.

A distinctive feature of 2018 is that fixed income rates are now generally lower in most SSA markets after rallies in 2017. This is true of countries such as Nigeria, Ghana, Uganda and even South Africa, and can be explained by a combination of idiosyncratic and external factors. For example, Nigeria's April 2017 decision to launch the Investors and Exporters' FX window with a more flexible exchange rate has generated significant portfolio inflows on the debt side. This improved backdrop allowed the authorities to push open market operation (OMO) bill yields lower from August 2017 highs, which contributed to a rally in T-bills and bonds late last year. That said, market rates in Nigeria have stabilised more recently amid consistent OMO issuance.

Ghana's bond market experienced a sell-off in early 2017 on news of fiscal slippage. But fiscal consolidation has resumed under an extended IMF programme and external rebalancing has continued, creating conducive market conditions for sustained portfolio inflows, monetary easing and lower bond yields. In South Africa, local bonds sold off following the disappointing Medium-Term Budget Policy Statement on 25 October; this unlocked value and paved the way for a rally (albeit led by onshore investors) as the political landscape shifted around the ANC leadership conference in December.

This lower-yield environment has been facilitated by SSA FX resilience, as a soft USD limited the risk of sharp currency depreciation even amid fundamental imbalances. If the USD weakness persists and the recent back-up in UST yields is capped, we think African currencies should be decently supported in the coming months. Risks to this view could arise from stronger US economic growth, the Trump tax reform package, or an upside surprise in US inflation that forces the market to reassess its benign Fed rate-hike expectations.

For oil exporters such as Nigeria, the recovery in oil prices is clearly positive, as it should smooth external imbalances and perhaps anchor naira stability; the build-up of FX reserves since mid-2017 is likely to alleviate concerns about possible pressure on the current FX regime. In oil-importing economies (for example in East Africa), the oil price recovery could start to weigh on current account positions, which are typically in deficit. The magnitude of infrastructure spending with a capex import component will also influence the current account outlook.

If SSA FX volatility remains limited, then even lower rates could still offer value for portfolio investors seeking to take advantage of a yield pick-up versus developed and mainstream emerging markets. But the focus is likely to be more on carry opportunities than on further bond yield compression given already significant price returns. From this perspective, SSA markets with a strong focus on FX stability and still-decent yields could deliver the best carry optimisation. These include Nigeria, where T-bill yields offer better value given the inverted curve and naira stability. Ghana's local bonds could also generate decent carry returns, although we see less price appreciation from here; this assumes that recent fiscal and external rebalancing caps risks to the exchange rate.

Although Kenya's fixed income yields are nominally lower, the resilience of the shilling may warrant investor exposure to infrastructure bonds. In Zambia, fixed income rates backed up somewhat in Q4-2017 and look more attractive amid signs of FX stabilisation in early 2018; yet the finalisation of delayed IMF programme discussions will likely be needed to unlock significant duration gains. In South Africa, bonds look richer after the rally following the ANC leadership conference, although yields failed to break below their 2017 resistance levels. Further gains will probably require a more credible fiscal path in the upcoming FY19 budget and a more reform-oriented political framework.

Further reforms to deepen liquidity in frontier SSA markets will be needed in the coming years. So far, the SSA fixed income space has largely been a buyers' market where investors seek to position at the peak of the rates cycle for future durations gains, or at least try to maximise value from carry. But it is difficult to take short positions at the bottom of the rates cycle, which amplifies yield volatility during periods of market correction. Addressing this shortcoming will require a more active repo infrastructure that involves all relevant stakeholders. Fixed income market liquidity could also improve on a better-capitalised banking sector, which would allow banks to play a more active role as primary dealers and market makers. On the demand side, steps to develop a more vibrant (ideally private sector-led) pension system should also boost domestic demand for the long end and cap upside risks to yields during bearish cycles.

Most SSA markets have extended their yield curves over the past decade or so, but re-opening bonds and streamlining issuance frequency could help to create larger and more liquid tenors. We also think that taxing bonds is an administrative constraint to more active foreign participation in non-benchmarked debt markets. Inclusion in global bond indices would help to anchor foreign investor holdings in local debt, and perhaps contribute to lower yields in a conducive risk environment. But this is only likely in the medium term for most SSA markets given their still-modest turnover. Nigeria's re-inclusion in the GBI-EM indices is probably not imminent, as the index provider will want to see a longer track record of FX convertibility and price discovery, but should be supported by improved FX liquidity and the decent tradability of local bonds.

Contributor's Profile:
Samir Gadio is the head of the African Strategy team, based in London. Samir holds a PhD and MA in Economics from Fordham University and a BSc in Economics from the Russian Peoples' Friendship University. He speaks English, French and Russian.

EMERGING MARKETS FIXED INCOME TRADING DOWN AND GLOBAL DEBT SIGNIFICANTLY SURGE

Fixed income trading down 6% to $1,299bn in third quarter of 2017
Trading in emerging markets debt instruments reached $1,299bn in the third quarter of 2017, constituting an increase of 14.8% from $1,132bn in the preceding quarter and a decline of 5.8% from $1,379bn in the third quarter of 2016. Turnover in local-currency instruments reached $736bn in the third quarter of 2017, up by 14.8% from $641bn in the previous quarter and down by 16.2% from $878bn in the third quarter of 2016. In parallel, trading in Eurobonds, mainly sovereign and corporate bonds, stood at $553bn in the third quarter of 2017, up by 13.1% from $489bn in the preceding quarter and by 11% from $498bn in the third quarter of 2016. The volume of traded sovereign Eurobonds reached $284bn and accounted for 51.4% of total Eurobonds traded in the covered quarter, while the volume of traded corporate Eurobonds reached $209bn, or 37.8% of the total. In addition, turnover in warrants and options stood at $9bn in the third quarter of 2017, while loan assignments reached $435m in the covered quarter. Overall, the most frequently-traded instruments in the third quarter of 2017 were Brazilian fixed income assets with a turnover of $143bn, or 11% of the total, followed by securities from India with $138bn (10.6%) and instruments from China with $129bn (9.9%). Other frequently-traded instruments consisted of fixed income securities from Mexico at $126bn (9.7%) and from South Africa at $107bn (8.2%).

Global debt at $233 trillion, or 318% of GDP, at end-September 2017
The Institute of International Finance indicated that global debt, which includes the debt of corporates, governments and households, reached a record-high of $232.9 trillion, equivalent to 318% of global GDP, at the end of September 2017, compared to $216.4 trillion at the end of 2016. It noted that global debt continued to rise in the third quarter of 2017 but at a slower pace, and that the debt-to-GDP ratio declined for the fourth consecutive quarter due to growth in the global economy, deleveraging efforts by the Canadian and Chinese governments, as well as rising inflation in China and Turkey. It pointed out that global non-financial corporate debt reached $68.4 trillion, or 92% of GDP, at end-September 2017, followed by government debt with $63.2 trillion (86.7% of GDP), financial sector indebtedness with $57.8 trillion (80.1% of GDP)and household debt with $43.5 trillion (59.1% of GDP). In parallel, the IIF said that emerging market (EM) debt grew from $55.6 trillion at the end of 2016 to $61.1 trillion, or about 211% of EM GDP, at end-September 2017. It indicated that EM non-financial corporate debt totaled $28.1 trillion, or 96% of GDP, at the end of September 2017, followed by EM government borrowing at $13.7 trillion (47.8% of GDP), EM household debt at $10.2 trillion (35.2% of GDP) and financial sector indebtedness at $9.1 trillion (32.1% of GDP). Further, the IIF noted that the debt of mature markets reached $171.8 trillion at the end of September 2017 relative to $160.8 trillion at end-2016.

AFRICAN EQUITY MARKET INDICATORS AS AT 31-JANUARY-2018								
Country Name	Index Name	Index at 31-January	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Botswana	BSE DCI	8,750	-1.24	-1.24	-5.40	8,743	9,379	2.059
BRVM	IC Comp	227	-6.52	-6.52	-18.17	214	290	14.215
Egypt	EGX 30	15,042	0.15	0.15	18.70	11,845	15,472	11.770
Ghana	GSE ALSI	3,077	19.28	19.28	73.21	1,776	3,150	11.298
Kenya	FTSE NSE15	181	5.49	5.49	47.75	120	182	8.584
Malawi	MSE ALSI	22,223	2.90	2.90	69.29	13,109	22,226	3.710
Mauritius	SEMDEX	2,256	2.43	2.43	19.92	1,880	2,270	3.951
Morocco	MORALSI	13,075	5.54	5.54	6.92	11,210	13,282	8.546
Namibia	Local	1,358	4.50	4.50	22.68	12	1,409	18.652
Nigeria	NIG ALSI	44,344	15.95	15.95	70.32	24,547	45,322	19.302
Rwanda	RSEASI	133	-0.17	-0.17	4.71	124	133	0.805
South Africa	JSE ALSI	59,506	0.00	0.00	12.73	50,737	61,777	10.468
Swaziland	SSX ALSI	406	0.00	0.00	6.48	382	407	0.868
Tanzania	DAR ALSI	2,350	-1.94	-1.94	10.43	2,009	2,406	21.667
Tunisia	TUNIS	6,432	2.38	2.38	17.09	5,439	6,458	7.595
Uganda	USE ALSI	2,057	2.78	2.78	54.54	1,342	2,062	32.604
Zambia	LuSE ALSI	5,327	-0.02	-0.02	31.46	4,031	5,348	4.296
Zimbabwe	IDX (USD)	305.35	-5.75	-5.75	117.73	134	534	#N/A N/A

SELECTED AFRICAN CURRENCY EXCHANGE Vs. US DOLLAR AS AT 31-JANUARY-2018								
Country Name	Currency Name	Index at 31-January	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Algeria	Dinar	113.46	1.15	1.15	-3.81	107.60	115.80	2.789
Angola	Kwanza	207.45	-19.02	-19.02	-20.10	164.88	214.97	52.610
Botswana	Pula	0.10	-2.96	-2.96	-9.36	0.09	0.11	6.126
CFA Franc	CFA Franc	539.78	4.52	4.52	13.55	530.98	629.50	16.356
Egypt	Pounds	17.64	0.75	0.75	6.85	15.71	18.95	2.213
Ethiopia	Birr	27.53	0.17	0.17	-17.74	22.40	27.61	2.221
Ghana	Cedi	4.51	0.38	0.38	-3.16	4.13	4.82	16.574
Kenya	Shillings	102.15	1.01	1.01	1.70	101.85	104.18	1.496
Malawi	Kwacha	725.50	0.00	0.00	-0.07	717.03	730.65	2.161
Mauritius	Rupee	32.64	2.86	2.86	9.59	31.74	36.13	10.327
Morocco	Dirham	9.16	1.86	1.86	8.77	9.10	10.22	4.438
Mozambique	Metical	60.00	-2.28	-2.28	17.72	57.57	71.02	11.855
Nigeria	Naira	360.41	-0.12	-0.12	-13.51	304.60	369.50	1.722
Rwanda	Franc	845.50	1.01	1.01	-2.72	425.00	858.25	6.614
South Africa	Rand	11.85	4.48	4.48	13.70	11.80	14.57	11.461
Tanzania	Shilling	2,249.48	-0.86	-0.86	-0.74	2,137.00	2,249.48	4.477
Tunisia	Dinar	2.40	2.83	2.83	-4.51	2.25	2.58	14.164
Uganda	Shilling	3,619.23	0.66	0.66	-0.95	3,549.73	3,666.69	2.338
Zambia	Kwacha	9,771	2.0929	2.09	1.55	8,766	10,388	12.872

SELECTED AFRICAN GOVERNMENT INTERNATIONAL BONDS AS AT 31-JANUARY-2018								
Country Name	Maturity	Index at 31-January	Mid-Yield at 31-January	1-month Yield Chg (%)	YTD Price Change (%)	Price 1-Year Low	Price 1-Year High	Amount Outstanding (US$ M)
Angola	12-Nov-25	117.469	6.590	-0.294	1.451	95.470	118.576	USD
Cameroon	19-Nov-25	118.803	6.397	0.203	-1.116	108.118	122.002	USD
Congo	30-Jun-29	84.459	8.113	0.660	-4.726	65.537	89.100	USD
Cameroon	19-Nov-25	118.803	6.397	0.203	-1.116	108.118	122.002	USD
Egypt	30-Apr-40	102.824	6.629	-0.132	1.221	88.769	103.215	USD
Ethiopia	11-Dec-24	105.952	5.567	-0.162	0.839	90.423	107.070	USD
Gabon	16-Jun-25	103.793	6.297	0.051	-0.233	93.016	106.780	USD
Ghana	14-Oct-30	136.127	6.521	0.155	-1.325	115.553	141.231	USD
Kenya	24-Jun-22	105.729	5.789	0.167	-0.815	96.512	108.350	USD
Ivory Coast	31-Dec-32	99.592	5.814	0.098	-0.456	92.009	101.626	USD
Morocco	11-Dec-42	113.710	4.571	0.004	-0.033	103.736	116.038	USD
Namibia	29-Oct-25	102.678	4.830	-0.071	0.319	98.728	105.604	USD
Nigeria	12-Jul-23	106.640	4.967	-0.068	0.435	97.606	107.418	USD
Rwanda	02-May-23	105.373	5.432	-0.094	0.282	99.294	106.237	USD
Senegal	30-Jul-24	106.993	4.977	0.230	-1.148	98.855	109.777	USD
South Africa	24-Jul-44	100.105	5.367	0.028	-0.408	90.553	103.790	USD
Tanzania	09-Mar-20	105.316	5.275	-0.027	0.137	104.450	106.272	USD
Tunisia	19-Sep-27	111.224	6.651	-0.096	0.591	107.081	111.481	USD
Zambia	30-Jul-27	112.166	7.180	0.055	-0.358	100.218	114.654	USD

Compiled by Capital Markets In Arica