INTO AFRICA

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GAUGING 2018
AFRICAN OUTLOOK

THE STATE OF SOUTH AFRICAN ECONOMY AND OUTLOOK

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Welcome to the September 2018 edition of INTO AFRICA, a publication with fresh insight into Africa's emerging capital markets. This edition reviews Africa's economies in the first half of 2018 and its title: ***Gauging 2018 African Outlook***.

Africa is set to enjoy a modest growth uptick, and decisive policies are needed to both reduce vulnerabilities and raise medium-term growth prospects, according to the IMF. In parallel, the Brookings Institution projected the average growth in the region is to rise from 2.8 percent in 2017 to 3.4 percent in 2018, with growth accelerating in about two-thirds of the countries in the region, aided by stronger global growth, higher commodity prices, and improved capital market access.

In the second quarter of 2018, South Africa's economy shrank by 0.7% (against 2.6% decrease in the first quarter of 2018), impacted mainly by agriculture, transport, and trade. The contraction in the second quarter indicates that South Africa has entered into a recession. The Nigerian economy grew 1.5 percent year-on-year in the second quarter of 2018, slowing from a 1.9 percent expansion in the prior period. This was the weakest growth rate since the third quarter of 2017, as oil output shrank while the non-oil sector continued to rise.

While Africa remains a region with tremendous growth potential, a prudent fiscal policy is needed to rein in public debt, while monetary policy must be geared toward ensuring low inflation. African countries should also strengthen revenue mobilization and continue to advance structural reforms to reduce market distortions, shaping an environment that fosters private investment.

ANNABEL BISHOP (Chief Economist, Investec, South Africa) reviews the state of South African economic outlook amidst emerging markets uncertainty. At the same time, **MICHAEL FAMOROTI** (Chief Economist, Vetiva Capital Management Limited, Nigeria) examines the health of the Nigerian economy. Likewise, **LINET MURIUNGI** (Head of Research, Dyer & Blair Investment Bank, Kenya) states that the first half of 2018 was characterized by both headwinds and tailwinds across various sectors in Kenya.

In this vein, **TIAGO DIONISIO** (Chief Economist, Eaglestone Advisory, Portugal) moves the discourse forward by offering an insight into the future of Mozambique's subdued economic outlook. In addition, **THEA FOURIE** (Senior Economist, IHS Markit Economics, South Africa) explains Zambia's intensified debt predicament while **CHRISTINE ASIIMWE NAMANYA** (Economist, Macroeconomic Policy Analysis Division, Bank of Uganda) dissects the fiscal and macroeconomics fundamentals of the 2018/19 Ugandan budget.

MAHMOUD HARB (Director, Fitch Ratings' Sovereign Group, London) and **MARINA STEFANI** (Associate Director, Fitch Ratings' Sovereign Group, London) look at the challenging adjustment that CEMAC will need to face when improving the economic prospect. **COURAGE KINGSLEY MARTEY** (Senior Economic Analyst, Databank Group, Ghana) analyses the state of the Ghanaian economic prospects in the first half of 2018.

In the exclusive interview segment, we asked **JOHN ASHBOURNE** (African Economists, Capital Economics, London), **SAMIR GADIO** (Head of Africa Strategy, Standard Chartered Bank, London), **PAUL CLARK** (Fund Manager, Ashburton Investments, South Africa) and **SHARAT DUA** (Fund Manager, Fiera Capital, London) to share their views on what is feeding the current emerging markets bearish sentiments as well as how it may impact African economic outlook and markets (equity, debts and FX).

LINDA KIRAITHE (Research Analyst, Apex Africa Capital Limited, Kenya) features in *"Kenya Equity Market: 2018 Half-Year Review and Year-End Expectations"* and **JERRY NNEBUE** (Equity Research Analyst, CardinalStone, Nigeria) in *"Nigerian Equities Market: Political Scene to Dictate Sentiments through 2018"*. In a similar light, **KAONE KEBONANG** (Equity Research Analyst, Imara Capital Securities, Botswana) in *"Botswana Equity Market: 2018 Half-Year Review and Year-End Expectations"*.

We also bring you special features from **HELEEN GOUSSARD** (Head of Unlisted Investment Services, RisCura, South Africa) titled *"Investing into Private Equity for African Institutions"*. Likewise, **CINDY VALENTINE** (Partner, International Funds, Simmons & Simmons London) and **CHARLES VERMEYLEN** (Managing Associate, International Funds, Simmons & Simmons London) explore African pension funds as a new capital source for private equity. Also, **EDWARD GALANTE** (Executive Director, Mangwana Capital Limited, Zimbabwe) provides a special commentary in *"Zimbabwe: Life After President Robert Mugabe"*.

As usual, we provide you with timely updates on African Capital Markets as well as a summary of what analysts are saying about Africa's economic outlook, credit quality, and monetary policy.

Feranmi Akodu

Associate Editor

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THE STATE OF SOUTH AFRICAN ECONOMY AND OUTLOOK

By **Annabel Bishop,** Chief Economist, Investec South Africa

At the midpoint of 2018, a temperature reading of South Africa's economy shows a contraction in GDP in the first quarter and expectations of weak GDP growth in the second. Additionally, downgrades of its economic growth expectations have occurred, contrary to the rising ebullience in the first six weeks of this year. In contrast, over half of the world's economies are experiencing faster economic growth on the back of an improvement in trade and investment (World Bank data), while unemployment in key developed economies (US, Japan, Europe) is declining. Indeed, the second quarter's release of US GDP annualised growth, at 4.1% q/q for Q2.18, proved to be the fastest growth rate since 2014, lifted by robust consumer spending and non-residential business investment. Q2.18 US GDP was seen as benefitting from stimulus measures, including tax cuts, with Q1.18 revised to 2.2% q/q annualised.

South Africa saw three quarters of growth averaging 2.8% y/y last year, up from 0.6% y/y the year before, on the recovery from severe drought and the rise in global growth, and so in the commodity cycle. South Africa then got off to a weak start in 2018, as GDP growth contracted by -2.2% (quarter on quarter, seasonally adjusted, annualised) in Q1.18, leading to concerns of a recession. A recession is a material risk, as Q2.18 has also got off to a weak start, with industrial production contracting by close to -6% qqsaa for the three months to May. Additionally, in Q2.18 business confidence fell towards 2017's average of 35 (2017 was the worst year since 2009), which is reflective of the impact that the weakening of SA's fundamentals from 2009 to end 2017 has had, and still has. Lower confidence indicates a likely lower GDP growth outcome for 2018.

The damage to business confidence has not yet been repaired, while recent sharply higher petrol prices, rand weakness, broad scale substantial consumer tax increases and the announced, but still not explained, EWC (expropriation without compensation) have contributed to lower confidence levels in Q2.18. Indeed, South Africa has seen its competitiveness and institutional strengths deteriorate substantially in the past few years, as has its credit ratings, to an average of sub-investment grade from the three key credit rating agencies. The governance of the SOEs and state institutions also deteriorated substantially in the past several years, as did the health of government finances, depressing business confidence over the entire period. Real household income growth and the efficacy of corporate boards also deteriorated and corruption proliferated. The IMF warns that economic growth in SA will not lift beyond 2% in the absence of resolving uncertainties surrounding land expropriation without compensation and outstanding structural reforms.

South Africa has a high level of institutional soundness compared to the other sub-Saharan African countries, but not compared to its own rankings of a few years ago. The World Economic Forum's Global Competitiveness Survey rates SA's strength of its auditing and reporting standards, regulation of its securities exchange (JSE) and soundness of banks in the 30s and 40s in the world, although these rankings were in the top ten a couple of years ago. SA's banking sector is currently ranked 37th globally, with deep, liquid sophisticated markets and consistent, sound budgetary policies that allow South Africa to be a key contributor to the global bond market. However, in 2016 SA was ranked in the top ten in the world.

Also a few years ago SA had uniform investment grade ratings from the three key credit rating agencies (Fitch, S&P and Moody's), but currently SA sovereign credit ratings are rated at the last rung of investment grade by Moody's, and sub-investment grade by the other two key agencies. Fiscal deterioration spanning 2009 to early 2017 steadily lowered SA's credit ratings. Newly elected President Ramaphosa is committed to fiscal consolidation, faster, inclusive growth, and the repair of SOE finances (without further drain on government's balance sheet), and so the economic growth outlook has consequently brightened.

This year has also seen global market risk-off escalate as the transition to neutral US interest rates has become more advanced. Emerging markets in general experienced marked portfolio outflows, causing their currencies to weaken, but for the rand this weakness was particularly marked, following substantial portfolio inflows in Q1.18, which were then more than reversed. The rand weakened materially in Q2.18 on the surge in global risk-off (including this year's market recalibration to expected higher US interest rates), as foreigners sold a substantial amount of SA's portfolio assets. The rand is very liquid, and SA's deep, sophisticated financial markets also make the rand an attractive proxy for EM currency sell-offs. The domestic currency will remain vulnerable to global investor sentiment for the rest of the period. A number of EM interest rate hikes have occurred, essentially to increase the attractiveness of interest rate differentials between emerging markets and developed economies.

Foreigners purchased R32.3bn of South African portfolio assets, net of sales, in the period January to April 2018, but then sold close to R80bn on a net basis in May and June, on global market risk-off as the transition to neutral US interest rates was seen to be becoming more advanced. Global risk-on switched to global-risk off and EMs in general were afflicted. Indeed, the Institute of International Finance (IIF) shows EMs in general experienced this trend reversal in net foreign purchases/sales of portfolio assets. US$58.4bn of EM portfolio assets were purchased on a net basis in January to April 2018, and US$14.3bn net sold in May and June.

The rand's reached a weak point in Q2.18 of R14.00/USD, R16.18/EUR and R18.45/GBP. However, the rand would likely have been much weaker, closer to R17.00/USD, R19.00/EUR and R22.00/GBP, without the Ramaphosa effect (where the rand strengthened to a base of R11.51/USD, R14.18/EUR and R16.08/GBP, before its recent weakness). The risk of EM outflows has been heightened under US monetary policy normalisation. Since the global financial crisis to April 2018, US$2.5trillion (IIF) flowed into EMs in a relatively low US interest rate environment. With the US seen as reaching, if not breaching, its neutral interest rate level in 2020, markets fret over a quickened US rate hike trajectory. While EM currencies could see some strength towards the end of this year as market players 'return' in September/October, and US dollar strength wanes, the risk is for heightened market, and so rand volatility in the near term.

SA saw CPI inflation bottom in March 2018 at 3.8% y/y (from 6.7% y/y in December 2016, 7.0% y/y in February 2016), then lift this year on higher petrol prices, rand weakness and broad scale substantial consumer tax increases as a historic VAT increase came through in April, rising from 14% to 15%. Food prices have the highest weighting in the CPI basket, at 15.48%, and the sharp price declines (disinflation), if not outright deflation have largely driven the drop in CPI inflation to March. However, the beneficial effects of drought alleviation in key areas of the country are working their way through the CPI inflation figures, and looking forward CPI inflation will likely rise towards 5.5% y/y this year, if not by next. Many crops are in good shape this year, particularly the maize harvest, which could provide some cap on the escalation in CPI inflation in the last three quarters of 2018. The positive outlook for moderate food price inflation continues to underpin our CPI forecast for this year.

On the international side, US growth is expected to slow from Q2.18's heady pace as stimulus measures wane and the impact of increased protectionism increasingly takes effect. Developed economies' monetary policy is generally accommodatory, and is not expected to be tightened, but return to neutral levels instead as inflation pressures are expected to emerge. The rand is likely to remain volatile, and with further significant portfolio outflows from EM markets likely on elevated levels of global risk-off, SA could also be at risk of higher inflation and so interest rates. We expect SA's interest rates to reach neutral levels after the US does.

However, in South Africa it will take a number of years to unwind the institutional weakness that has pervaded SA, specifically requiring substantial repair in the governance of the SOEs and state institutions, as well as restoring investor confidence, real household income growth and the efficacy of corporate boards, and eliminating corruption. We have lowered our GDP growth forecast for 2018, to 1.4% y/y, from 1.8% y/y. South Africa is unlikely to see any further interest rate cuts this year. Higher business confidence (which instead fell in Q2.18) would kick-start faster economic growth, with both greater foreign direct, and domestic fixed, investment into SA. We expect no credit rating downgrades this year, although if GDP growth continues to disappoint then this will become a risk. Only through permanently reducing unemployment via sustained robust economic growth can we anticipate a sustained lowering of SA's socio-economic inequalities, and the ultimate eradication of poverty.

NIGERIAN ECONOMY: HOPE DEFERRED MAKES A NATION SICK

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

In 1978, Fela Anikulapo Kuti sang Shuffering and Shmiling, an upbeat lament of Nigerians' unflappable optimism even in dire circumstances. That famous resolve was tested through an economic crisis between 2014 and 2016 when the crash in global oil prices and militancy in the Niger Delta hit foreign exchange (FX) and government earnings. Rather than allow a currency devaluation, the central bank imposed capital controls to ration supply, triggering a shortage of FX liquidity in the country. Meanwhile, eventual forced-depreciation and hikes in energy and food prices accelerated inflation and drove unemployment higher.

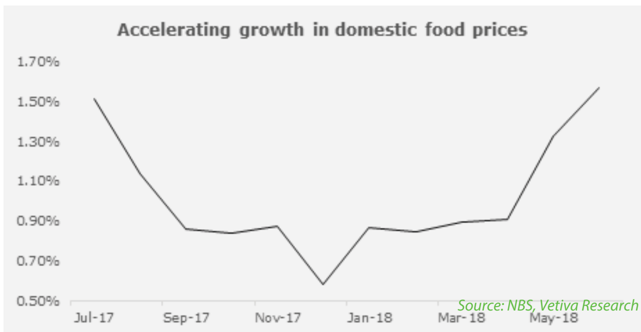
Thankfully, that period was short-lived. 2017 brought some respite as the country reaped rewards of investment in agriculture and a cease - fire in the Nigeria Delta precipitated a recovery in oil production. However, the recovery (0.9% y/y economic growth) was superficial, driven as it were by agriculture and oil, even as wages were stagnant and the cost of living remained high.

Hopes were high for 2018, notwithstanding the spectre of the looming 2019 elections. Basic political business cycle theory—developed by William Nordhaus as early as 1975—indicated a high likelihood of policy being directed towards electioneering at the expense of development. Moreover, tightening monetary policy in the United States had long since been a danger for emerging and frontier markets like Nigeria.

However, hope was premised on the stability of agriculture, anchored on Central Bank of Nigeria (CBN) development finance initiatives, and a healthy oil sector—lifted by high oil prices and recovered volumes—while landmark reforms in the Economic Recovery & Growth Plan would have an extra year to permeate the economy.

The reality so far has been a tad underwhelming. Heightened insecurity in the Middle Belt has completely changed Nigeria's agriculture dynamics, infrastructure integrity issues have hampered oil production, and a more adverse political and external background do not bode well for near-term economic activity.

Nigeria's herdsmen crisis is old. According to data from the Armed Conflict Location & Event Data Project (ACLED), the scourge led to the death of at least 2,000 people in 2015, but had previously been dwarfed by nefarious activities in the North - East and Niger Delta. Now, rapid population growth and climate change have created a scarcity of grazing land, a situation exacerbated by inadequate grazing laws and weak enforcement in the country. Meanwhile, the spread of smuggled arms and pastoralists migrating from Boko Haram - affected areas has led to increasingly violent clashes, with at least three hundred thousand people displaced, millions of livestock destroyed, and thousands of lives lost, per the ACLED. The economic effect has already begun to show; first quarter output growth in the sector dipped to a five-year low, while food price inflation began to increase in recent months. Despite the underlying appeal of Nigerian agriculture and the best efforts of the apex bank, the insecurity issue dwarfs everything else and will continue to drag what was previously the country's leading sector.

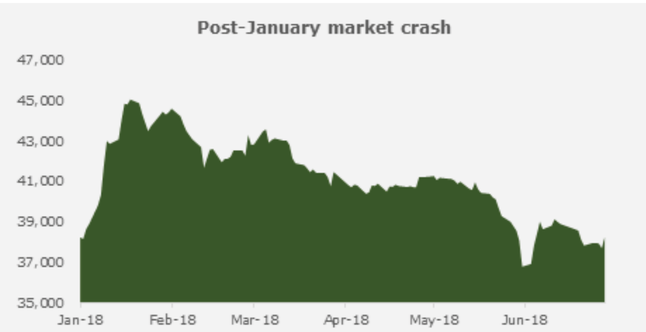


Oil, the other sector of hope coming into the year, has fared better, but still had challenges. Despite murmurings at the end of 2017, the Federal Government's 16-point plan seemed to have appeased militant tensions in the region. However, production was disrupted in the second quarter following a spate of reported leaks, leading to the declaration of Force Majeure on Bonny Light exports and intermittent challenges with both Forcados and Qua Iboe loadings. The aggregate effect was material as estimated production fell by at least one hundred thousand barrels a day in the second quarter. Most loadings are now back on track, but Nigeria bore a significant opportunity cost given high realised oil prices during the period.

High oil prices should have been the pick of global developments related to Nigeria, but two distant threats became realities in mid-2018. Firstly, accelerating inflation and improving labour market conditions compelled the United States Federal Reserve (Fed) to adopt a tighter monetary stance, and this prompted capital flight from emerging markets like Nigeria. Secondly, simmering trade tensions stoked by President Trump boiled over as the U.S. and its major trading partners exchanged blows, kicking off what could be a protracted trade war. Global economic sentiment has weakened after just one round of tariff hikes, and the economic landscape will be less accommodating in the medium-term.

As the agriculture, oil, and external stories grew dimmer, political developments charted a similar path, proving even more disruptive to economic activities. Although the economy has increasingly retreated into the shadow of the 2019 polls, it is hard to estimate the real effect as very little data is available to establish a causal link.

We observed large capital outflows and market sell-offs after January, with the Nigerian equity market losing 14% of its value between the end of January and June, but it is difficult to separate the election effect from the broader global market trend of capital reversals from emerging markets. Meanwhile, although the herdsmen crisis seems to have gotten worse this year—like the Boko Haram insurgency in the previous pre-election period-perception may not reflect reality in this case.



Source: NSE, Vetiva Research

Moreover, it is difficult to gauge how the focus on elections influenced the delays to 2018 Budget passage—or clashes between the Executive and Legislature—and overall sluggish policy activity during the year. Nevertheless, the signs of an adverse election effect are indicative, and we can at least infer that imminent elections induce greater uncertainty so impact investment-related activities. Things will only get worse as electioneering properly kicks off at the end of the third quarter, and we had initially anticipated the most obvious election effects to manifest in the latter part of the year. In addition, the 2019 elections are shaping up in a similar fashion to the 2015 iteration as a string of party defections and coalitions is likely to birth a strong party and candidate challenger to the incumbent. Closely fought election are good for democracy but may hamper near-term socio-economic stability.

Put all of this together, and we see a bleaker picture in the coming months, albeit still an improvement over recent years. Our 2018 growth projections are lower than at the start of the year—1.9% y/y vs. 2.4% y/y—and economic activity is likely to be steered by public spending and electioneering, not all of which would be productive.

Given the size and cost of Nigeria's political campaigns, electioneering would hurt consumer prices. Coupled with resurgent food price pressure, inflation should begin to rise in August. As a result, monetary easing will not occur in 2018, which has repercussions on Nigeria's anaemic economic growth. Furthermore, yields in the fixed income market would be steered by this inflationary outlook, and electoral developments would cloud both equity and fixed income markets.

The post-2018 outlook is little changed since the start of the year, though the sustainability of this view depends on the outcome of the 2019 polls and the journey to reach them. We began the year with a cautious reminder that 2018 was not an election year. Economic and financial developments through the year suggest that word of caution went unheeded.

Contributor's Profile :
Michael Famoroti is a research analyst and economist at Vetiva Capital Management Limited. He holds a Master's Degree from the London School of Economics and Political Science, with a focus on microeconomics and development.

KENYAN ECONOMY : TIME TO TAKE AWAY THE PUNCH BOWL HOPE

By **Linet Muriungi,** Head of Research, Dyer & Blair Investment Bank Kenya

The first half of 2018 was characterized by both headwinds and tailwinds across various sectors. GDP growth in 1Q18 was recorded at 5.7%, relative to 4.8% growth over a similar period in 2017. Improved rainfall in 2018, two relatively peaceful Presidential elections in 2H17 and the Principals' Handshake resulted in improved output particularly evident in Agriculture, Wholesale and Retail Trade, Real Estate and Manufacturing sectors. However, the interest rate cap enacted through the Finance (amendment) Law 2016 resulted in slowdown in Financial Service, Transport and Storage, Construction, Electricity Supply and Mining & Quarry. Inflation has eased to levels of 3.95% in May 2018, relative to 11.70% recorded in May 2017 due to the reversal of a spike in the Food and Non Alcoholic (FNAI) and Fuel baskets attributable to a protracted drought period and high reliance on thermal power sources.

The Kenyan Shilling (KES) has remained relatively stable against the major world currencies, strengthening 2.7% and 0.3% against the US Dollar and Sterling Pound respectively (year to date), while softening 0.1% against the Euro. For one, the expected Fed decisions have had no surprise-related stress factor to the KES so far, and this coupled with the discontinuation of the maize subsidy program, inflows from the USD 2.0 BN Eurobond, diaspora remittances and the extended tax amnesty period supported healthy forex reserves in the first half 2018. The tax amnesty extension relates to Kenyan citizens who repatriate taxable income earned up to 31st December 2017 into the country by 30th June 2019. These funds will be exempted from the provisions of the Crime and Anti-Money Laundering Act or any other Act relating to reporting and investigation of financial transactions, save for proceeds from terrorism, poaching and drug trafficking. Despite Kenya's current account deficit remaining relatively stable, we remain wary of the rising debt stock, currently at circa 52% of GDP.

Key tailwinds in 1H18 have been strong recovery in the agriculture and tourism sectors, further supported by stable diaspora remittances. Aside from growing forex inflows and output, increased food security has maintained inflation rate below the Central Bank of Kenya's (CBK) target of 5.0% with an upper and lower allowance of 250bps, despite rising global fuel prices year to date, enabling the National Government to wean the economy off from the 2017 maize subsidy program. We however expect inflation to rise in the second half of the year courtesy of power and fuel related increments stemming from the revised electricity tariffs approved by the Energy Regulatory Committee (ERC) as well as VAT on fuel to be introduced as from 1st September 2018.

While the government targets to reduce the FY2018/19 fiscal deficit to 5.7%, relative to circa 7.2% in FY107/18, we remain wary of how this will be achieved, despite fiscal tightening policies. This is predicated by the fact that there has been little communication with regards to fiscal consolidation via privatizations or amalgamations. Total expenditure stated in FY2018/19 is 9.7% lower than FY2017/18 budgeted spend (26.3% of GDP), of which the budgeted recurrent expenditure is 2.5x of development expenditure and 4.1x of county transfers. Further, total revenue is expected to rise 17.5% year-on-year to account for 20.0% of GDP due to incremental tax proposals. Tax measures such as the Robin Hood tax which impose a 0.05% charge on transfers above USD 5,000 (which has currently been suspended by the Kenyan High Court), the maturity of the 3 year grace period on VAT on Petroleum products as at 1st September 2018, increased excise duty from 10% to 12% on money transfers, exclusion of certain commodities from zero rated category and increased import duty charges. All these point to the possibility of a GDP rebasing in the short term, to achieve the fiscal deficit targets. We however believe the IMF precautionary agreements extending a USD 1.5 BN cover will be renewed, subject to the repeal of the interest rate cap, possibly in 4Q18.

Looking ahead, the Central Bank of Kenya estimates that Kenya will note 6.2% output growth in 2018. The growth is to be primarily driven by increased government spend, given the constrained private sector credit growth suffered, courtesy of the interest rate collar. The CBK's Monetary Policy Committee (MPC) reduced the Central Bank Rate by 50 basis points to 9.0% in July. We believe that the rate cut may be an attempt to lower the Government's localized debt rate as much as possible, ahead of the repeal. While intention to repeal section 33B of the Banking Act has been communicated, there are still several key issues that need to be addressed by both the public and private sectors in order to ensure healthy and sustainable private sector credit growth is realized. For one, the GoK and related entities must consider taking initiative to clear pending non-performing loans. The accrued non-performing loans attributable to Kenyan Parastatals are estimated to be in excess of 85.0% of the 2018/19 budgeted development expenditure, while an undisclosed amount of NPLs remain outstanding for government service providers yet to receive payment. From the Private banking space, the need to consider consolidation and sector specialization must be considered further and more seriously, in order to realize synergies currently untapped in the sector.

Case in point is the traditional model popularly embraced by the sector, where high deposit rates (cost of funding), plus operating expenses and target profit margins were used as a basis of determining lending rates, prior to the capping of interests. Sector consolidation particularly in the Tier II and III space could augment the capital base of banks, effectively lowering their cost of funds and operating expenses, synergies that can be passed on to the borrower and stimulate aggregate private sector growth. I also believe that banking space specialization is imperative in a developing economy such as Kenya's, given the diversity in our economic base. Operating as a jack of all trades, with significant information gaps in the business of credit extension is an inefficient and expensive model that carries high opportunity costs in a private sector that notes an 80% employment contribution from the Small and Medium Enterprises (SMEs). Therefore, embracing market growth strategies that are led by data analytics in the banking space should be on the private credit growth agenda. This can encourage the development and uptake of credit scores that adopt a risk-based approach to lending, rather than the arguably obsolete cost-based approach currently employed across the board. While the Government continues to yell "affordable cost of credit!", the banking sector continues to yell back "Risk compensation!". Meanwhile the SME space remains parched from trickling financial capital access. The Public and Private sectors must therefore partner in creating viable and sturdy (even bespoke) banking sub-sector solutions that incorporate the unregulated microfinance space, blending incentives (such as lower tax), government guarantees and statutory mandates of extending credit to key SME spaces. Strong upside exists from the informal sector, evidenced by the growth of the Mammoth M-Shwari loan product of Safaricom's MPESA, with a loan book value in excess of USD 833 MN and an NPL ratio that is at least 500 basis points lower than the Tier I Bank NPL average.

In summary, Kenya's economic prospects are contingent on key policy reviews:

- Fiscal consolidation which should include the privatization of State corporations as well as amalgamation of existing Govern ment functions and addressing existing loopholes that create systemic weaknesses and opportunity for leakages through bloated recurrent expenditure and graft
- Embracing capital discipline through devel opment project stratification: While infra structure investment appraisals are inher ently a "private sector" practice, Kenya must take up the same and aligning development expenditures with aggregate income generation propensity, in order to tame the rising debt stock.
- Public Private Partnerships and Policies incentivizing Private sector investment will go a long way in Kenya's economic devel opment, including the ambitious Big Four agenda, of which USD 4.6 BN has been allocated for in the 2018/19 budget. Further, plans to set up the Nairobi International Finance Centre in 2H18 are underway and while we are yet to get clarity on the National Treasury's approach to boosting Kenya's FDI, portfolio flows and national savings through the corporation, there is a dire need for the National Treasury to appreciate the need for transparency, and favourable fiscal policies as an incentive tool, especially with regards to development policies, impact investing and Public Private Partnerships in both traditional infrastructure spheres and in green financing.

CEMAC ZONE: IMPROVING ECONOMIC OUTLOOK BUT CHALLENGING ADJUSTMENT


By **Mahmoud Harb,** Director, Fitch Ratings' Sovereign Group
Marina Stefani, Associate Director, Fitch Ratings' Sovereign Group

The progress of the Central African Economic and Monetary Community (CEMAC) in addressing fiscal and external imbalances supports our base case that there will be no break-up of the currency zone or devaluation of the CFA franc against the euro. Member countries have agreed policies with the IMF to restore fiscal and external sustainability, including IMF-supported programs for four of the six member states. The cyclical pick-up in the region's growth mostly due to the rebound in oil prices and policies implemented by the regional central bank, Banque des États de l'Afrique Centrale (BEAC), should further support the adjustment.

However, we take the view that domestic policies and structural shortcomings will constrain the capacity of national governments to enforce fiscal consolidation and implement reforms. Fiscal deficits are gradually narrowing among the three Fitch-rated CEMAC members – Cameroon, Gabon, and the Republic of Congo, but regional adjustment remains incomplete amid persistent challenges, including oil prices still below pre-2014 levels, political risks, emerging signs of reform fatigue and poor public finance management.

Lengthy and Challenging Adjustment

The process of regional adjustment is far from complete and faces significant challenges despite the progress in shoring up external buffers. This is illustrated by the status of Fitch-rated CEMAC members' IMF programmes. Although the IMF completed its second review for Cameroon ('B', Stable) on 6 July and for Gabon ('B', Negative) on 1 August and approved third disbursements of USD77.8 million and USD100.2 million respectively, programme implementation has been uneven and key quantitative performance criteria have been missed.

Weak growth, weak public finance management and recurrent fiscal slippages, stemming partly from strikes in the public sector, have hampered fiscal consolidation in Gabon. External arrears to bilateral and multilateral creditors have been cleared, but arrears to external commercial creditors are still outstanding, and domestic arrears weigh on the economy and the banking sector. Cameroon missed its consolidation target in 2017, due to higher-than-expected spending and despite better performance of non-oil revenues.

The authorities in both countries have reiterated their commitment to keeping the programmes on track. Gabon's government has taken steps to reduce the wage bill and improve fiscal transparency and cash management. It has also adopted a supplementary budget that incorporates an automatic adjustment mechanism to contain public expenditure if revenues underperform. Cameroon has also adopted corrective measures and revised its fiscal targets and budget for 2018.

Fiscal receipts will also be boosted by recovering economic growth, forecast at 2.0% in 2018 for Gabon and 3.9% for Cameroon, and by higher oil prices. As a result of higher oil price forecasts in our June Global Economic Outlook (USD70/barrel for 2018 and USD65/barrel in 2019), we expect Gabon's fiscal deficit (on a cash basis) to narrow by 2pp in 2018 to 1.4% of GDP, while we forecast Cameroon's fiscal deficit to narrow by 0.9pp to 3.0% of GDP.

But implementation risks are high and compliance with IMF performance criteria remains challenging. Strikes highlight continuing social tensions in Gabon, where legislative elections are set to take place in 2H18, which could entail further fiscal slippage. Cameroon has implemented structural reforms in line with IMF performance criteria, but security issues amid continued protests in the restive English-speaking regions, 2018's heavy electoral schedule, and the financing of the 2019 African Cup of Nations are putting acute pressures on spending.

The Republic of Congo's ('CC') prospects for an IMF agreement remain uncertain. The authorities expected an agreement on an IMF programme in July 2018, but no approval has come so far. If an agreement is reached, IMF support could catalyse additional official funding. However, debt restructuring will remain likely as we expect total financing under the programme to fall short of Congo's sizable needs over the coming years. The government has started negotiations with external creditors over a possible restructuring of loans owed to bilateral official creditors, mainly China, and oil traders. We expect these negotiations will likely result in a temporary suspension of debt service payments and possibly some maturity extensions rather than nominal haircuts.

The recovery in oil revenues from higher prices and the rebound in production volumes coupled with fiscal consolidation will result in Congo's large external and budget deficits registered in 2014 - 2017 shifting to surplus in 2018 and 2019. However, financing needs will remain sizable owing to the concentration of maturities on public debt over the coming three years and the accumulation of large government arrears, while funding options have narrowed sharply.

Monetary Policy Tightening and BEAC Reforms Help Reserves Stabilise

International reserves stabilised in the second half of 2017 and stood at EUR4.9billion at end - December 2017, helped by IMF and other multilateral and bilateral disbursements, fiscal adjustments and import compression. Reserve accumulation, however, underperformed in early 2018, with reserves declining again slightly in 1Q18 due to fiscal slippages, highlighting the key role of national policies in restoring external sustainability.

External reserves should build up gradually as the regional current account deficit narrows further in 2018 to a forecast weighted average of 1% of GDP for the three Fitch-rated member countries from an estimated weighted average of 1.6% in 2017, supported by further import contraction and a pick-up in oil prices, although capital outflows partly offset progresses in the current account balance.

BEAC's role in the response by the six-country bloc to the 2014 oil price shock has been critical. A shift in monetary policy, including most visibly an increase in the policy rate by 50bp in March 2017 and additional administrative measures, have contributed to a decline in imports. BEAC has also stopped providing financing (statutory advances) to CEMAC member governments, which had previously supported high public expenditure with a substantial import component, leading to reserve outflows.

BEAC's revised foreign exchange policy could further help build-up external reserves. The regional central bank intends to revise and reinforce the implementation of FX regulations to increase foreign exchange repatriation. It has also tightened requirements for private companies buying foreign currency for international business transactions, hence reducing imports and foreign-currency outflows.

Regional measures implemented by BEAC have led to a decline in excess liquidity in the banking system. Broad money fell by an estimated 0.4% y-o-y in 2017. The unification of reserve requirements in March 2018 and the implementation of a new, comprehensive monetary and liquidity management framework starting in June 2018 should gradually support further absorption of excess liquidity in the banking sector and improve monetary policy transmission. An Emergency Liquidity Assistance framework came into force in January and is now fully operational, helping BEAC to act as lender of last resort and reducing risks to bank liquidity, although the zone's euro peg restricts BEAC's ability to provide unlimited funding to banks.

BEAC Measures Likely to Compel Fiscal Adjustment

The regional central bank's measures, also designed to compel CEMAC members' fiscal adjustment, should force fiscal discipline as member countries' financing options become more limited. BEAC has replaced refinancing ceilings for sovereign securities banks can use as collateral by progressive haircuts reflecting each national government's creditworthiness, making low-rated sovereign securities less attractive for banks in the region.

Domestic issuance is therefore becoming more difficult, while BEAC also froze statutory advances after the December 2016 Yaoundé summit called to formulate a response to lower oil prices and pressures on the zone's currency peg. The regional central bank further decided in August 2017 to eliminate statutory advances by end-2027 and the current outstanding balances with BEAC have been converted into long-term loans. We believe BEAC may take further disciplinary measures if member countries fail to consolidate their budgetary positions.

Fiscal adjustment could further be hampered by weak public finance management. The IMF estimates external financing needs at USD7.6billion over 2018-2020 for the five CEMAC countries with IMF programmes or with a programme soon to be submitted to the IMF Board, assuming expected fiscal adjustments are made. The IMF is set to cover 20% of these financing needs, but only part of the rest would be covered by other official-sector external creditors.

Substantial Risks to Adjustment Persist, as Reflected by Low Ratings

The stabilisation of FX reserves since mid-2017 underscores our assumption that there will be no break-up of the CEMAC monetary arrangement and no devaluation of the CFA franc against the euro. Nonetheless, the risks associated with the oil price shock and subsequent adjustment challenges are reflected in Fitch-rated CEMAC member countries' deeply sub-investment-grade sovereign ratings.

A new oil price decline or further subdued growth would dampen fiscal receipts and hinder consolidation in the bloc. Although better economic prospects for the region, with growth forecast at an average 2.1% in 2018 for the three Fitch-rated sovereigns, might support the correction in the fiscal and external imbalances, challenges remain high. Elections are due in Gabon, Chad and Cameroon in 2018, security issues persist in Cameroon's English-speaking regions, Central African Republic and the Republic of Congo, while increasing social tensions underscore rising reform fatigue in Gabon.

THE OVERDUE AWAKENING TO EMERGING MARKETS REALITIES

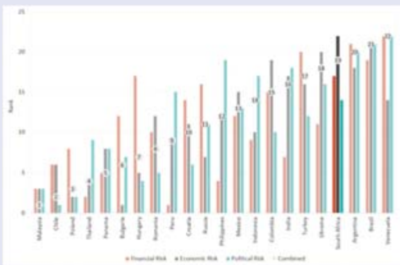
By **Rhandzo Mukansi**, Portfolio Manager, Futuregrowth Asset Management South Africa

As has now been well documented, the Turkish crisis was catalysed by the imposition of US trade sanctions and tariffs given the souring of bilateral relations between the two nations. However, the founding of the Turkish crisis is rooted in the weakness of domestic fundamentals; particularly related to a wide external trade deficit largely financed by short-term borrowing, hampered macro policy credibility and questionable central bank independence.

Despite emerging market assets not being the monolithic beast of old, seemingly isolated emerging market risk events often result in broad peer group contagion. This point holds particularly true for those nations with relatable macroeconomic backdrops. A recent example of this is the Argentine debt crisis in May which resulted in the sizeable sell-off of the peso, rand and peer group sovereign currencies with comparable macro-economic fundamentals.

So then, does the Turkey crisis represent an idiosyncratic sovereign risk event or are the EM dominoes poised to tumble? If so, who's next in line and how far might the strife stretch? We lean on our internal Emerging Market Risk Monitor in our analysis of the health of a basket of emerging market sovereigns and our assessment of economic strength and vulnerability.

Futuregrowth Emerging Market Risk Monitor:



Our analysis highlights the economic and financial vulnerability of likely bedfellows; Turkey, Brazil and South Africa and somewhat less likely peer comparators in Argentina, Ukraine and Venezuela. Of this list, Brazil and South Africa stand out to us as the likeliest to catalyse the next flight from emerging market risk assets. This view is based on the significant dependence on faltering Chinese growth for commodity exports, sizeable external accounts – particularly those funded by volatile portfolio flows, and high fiscal debt burdens in an increasing left-leaning policy environment. These economic vulnerabilities are compounded by high foreign investor holdings of local currency debt instruments across both sovereigns, the gradual tightening of global monetary conditions and the dangerous escalation of tit-for-tat trade tariffs between the US and China.
The erosion of policy credibility has previously been a harbinger to episodes of emerging market financial strife – and this is particularly relevant for both Brazil and South Africa at the moment given the amplification of pre-election leftist rhetoric. Public expenditure containment when confronted by an increasingly populist median voter is a crucial focal point for both nations.

Although the pressures of the Turkey induced emerging market weakness will soon enough fade, the common symptoms endure strongest in Brazil and South Africa. The opportunity for painful but necessary macro-economic reform remains open to policy makers in both countries – before a financial market rebellion starts to dictate terms.

THE STATE OF GHANAIAN ECONOMY AND OUTLOOK

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

Key Highlights

- Fiscal consolidation continued on the back of expenditure restraint as revenue shortfalls persisted
- Inflation drops to hit upper band of central bank's 8% ± 2% target range, expected to end year in single digit despite potential short-term upside risks
- High concentration of foreign investors on Ghana's Treasury bond market exposed the Cedi's vulnerability to external shocks; stable outlook on the back of strengthening fundamentals
- Overall GDP growth in 2018 to drop below 2017 heights but non-oil growth expected to quicken above 5%

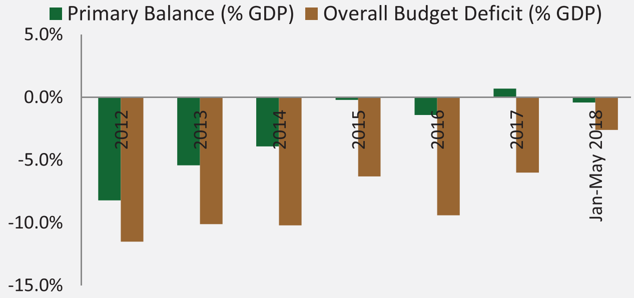
The fiscal framework in 1H-2018: Fiscal operations in the first half of 2018 continued to reply heavily on expenditure restraints (as we observed in 2017) mainly on account of persistent shortfalls in domestic revenue outturn. Fiscal data for the first 5-months of 2018 revealed a 7.6% shortfall in total revenue (incl. grants) at GH¢17.38 billion while total expenditure was GH¢23.76 billion, also lower than the budget limit by 3.2%. Notwithstanding the strict expenditure restraint, the budget deficit for Jan-May 2018 turned out marginally higher-than-expected at 2.6% vs. 2.4% target for the period.

On a year-on-year basis, the outturn for total revenue in the first 5-months represents a 12.3% growth but lags the government's ambitious target by 7.6% while expenditure pressures continue to mount for non-discretionary items. Against this backdrop, the authorities proposed new tax measures which include: converting the GETFund and National Health Insurance Levies into straight levies (independent of VAT, as previous applied), Luxury vehicle tax (for vehicles with engine capacity above 3.0L) and the introduction of additional band for Personal Income Tax of GH¢10,000 and above at 35%. The authorities maintained the 4.5% fiscal deficit target as the new tax measures are expected to raise additional revenue equivalent to 0.56% of GDP coupled with a cut in CAPEX equivalent to 0.28% of GDP.

Fiscal outlook for 2H-2018: We expect the new tax measures to minimize the downside risk to government's 2018 revenue expectations while ongoing efforts to enforce tax compliance and broaden the tax base are expected to yield medium-term benefits.

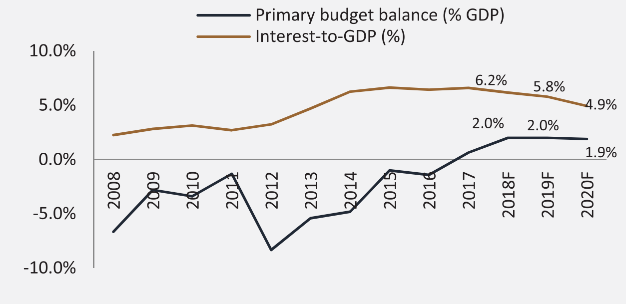
Following the IMF's disbursement of $191 million for budgetary support in April-2018 (rather than the ECF arrangement of strictly BOP support), we expect the remaining tranche of ~$191 million to be channeled into below-the-line items on the 2018 budget. We however perceive mounting expenditure pressures, mainly for non-discretionary items as we observed upward revision to these items in the mid-year review. We believe the government has a limited scope for further cuts in expenditure as pressure mounts to hasten implementation of key intervention programs ahead of the 2020 elections. Against this backdrop, we maintain our fiscal deficit forecast of 4.7% ± 50bps for end-2018 (GOG: 4.5%, IMF: 4.5%).

Exhibit 1: Fiscal Developments in 1H-2018



Source: Databank Research, Bank of Ghana

Exhibit 2: Primary balance and interest payment



Source: Databank Research, Ministry of Finance

Inflation development: Headline inflation drops to the upper band of the Central Bank medium-term target range on the back of stable FX in Q1-2018 Inflation dynamics in the 1H-2018 generally evolved towards the Bank of Ghana's medium -term target range of 8% ± 2%. Headline inflation hit 9.6% in Apr-2018 (vs. 11.8% in Dec-2017) before climbing to 10% in Jun-2018 as a surge in crude oil prices and FX pressures filtered to domestic prices.

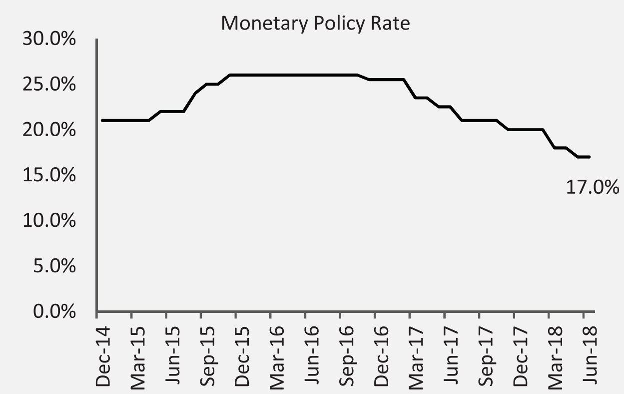
Underlying inflation pressures also eased in line with the headline trend as core inflation (CPI excl. energy and utilities) declined from 12.6% in Dec-2017 to 11.0% in Jun-2018. Key developments which sustained the disinflation in 1H-2018 include: the strong performance of the Ghana cedi in Q1-2018 (+0.26% against the USD) and the change in the Special Petroleum Tax from ad valorem to specific tax in Feb-2018 to limit the upside risk from higher fuel prices

Inflation outlook for 2H-2018: We maintain a downside view on inflation for 2H-2018 as market expectations remain firmly anchored while the policy rate remains appropriately tight.

Notwithstanding the uptick recorded for May and June-2018, we believe the upward pressure would be short-lived with headline inflation anticipated to revert below 10% by end-2018. We expect a return to FX stability and food harvest in Q3-2018 to offset the potential upward pressure from the new tax measures, supporting the expected decline by year end. The major upside risks to the inflation outlook are unanticipated upside shocks to crude oil prices and a sharper-than-expected USD/GHS depreciation.

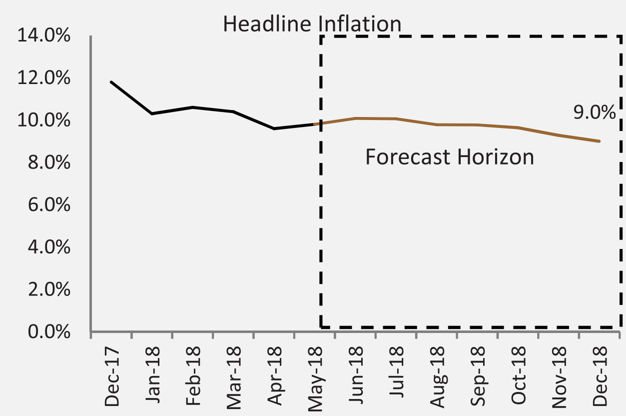
Our analysis of dynamics on the crude oil market indicates that the OPEC-Russia accord favours a Brent price support level of $60pb and a resistance level of $80pb. We expect Brent price to remain within the $60pb to $80pb band during 2H-2018, pointing to a limited upside risk to CPI inflation from crude oil price given that domestic ex-pump prices currently reflect Brent price near $80pb. Recent depreciation of the GHS against the USD could however pose upside risks to inflation. We therefore view the Bank of Ghana's decision to maintain the MPR at 17% as favourable for sustaining investor interest in GHS-denominated financial assets. While the additional tax measures proposed in the Jul-2018 mid-year budget review is a fiscal necessity, we expect these measures to trigger inflationary pressures in the short-term but with a quick reversal to fall below 10% by year-end. Based on our analysis of the inflation outlook, we maintain our end-2018 inflation forecast at 9% ± 100bps. (GOG: 8.9%, IMF: 8%)

Exhibit 3: Monetary Policy Path in Ghana



Source: Databank Research, Bank of Ghana

Exhibit 4: Databank Forecast of CPI Inflation



Source: Databank Research

Exchange rate development: A wave of emerging and frontier market selloffs rocked the GHS stability in Q2-2018 after an impressive Q1-2018.
The high concentration of foreign portfolio inves-

tors in Ghana's domestic Treasury bonds (62% of outstanding medium-term securities as at Jun - 2018) exposed the Cedi's vulnerability to sudden adverse change in the external environment. Following a first quarter appreciation of 0.26% against the USD, the Cedi's stability was rocked by a wave of Emerging Market selloffs and we observed a 14% (GH¢4.51 billion) decline in foreign investor holdings of GHS-bonds between April to June 2018, equivalent to $1.02 billion outflow. We believe this substantial FX outflow exerted immense depreciation pressure on the GHS despite the $1.25 billion Eurobond inflow in May-2018.

Exchange rate outlook for 2H-2018: Improving fundamentals to anchor Cedi stability as offshore selloffs subside.

Ghana's economic fundamentals continue to strengthen, supported by declining inflation, surplus trade balance and narrowing fiscal deficit. The Government of Ghana has submitted a fiscal responsible bill to Parliament to establish a fiscal council and cap the budget deficit at 5% beginning 2019. We believe these prospects of continued improvements in economic fundamentals would sustain investor confidence and aid a return to Cedi stability as the Emerging Market selloffs diminish.

Growth dynamics in 1H-2018: GDP growth commenced 2018 below our 7.8% year-end forecast as key sectors unexpectedly contract amidst slower growth in oil & gas output.

Unexpected contractions within the three main sectors of the economy constrained overall real GDP growth to 6.8% during the first quarter 2018. Although the growth outturn was below our 2018 forecast of 7.8%, the early indications are positive for the Government of Ghana's 6.8% target for 2018.

The persistently high Non-Performing Loans ratio in the banking industry (22.6% as at June-2018) continue to pose systemic risks to the real sector of Ghana's economy as financing for construction, transport, hospitality and general agriculture remained tight. The gross loans and advances in the banking sector expanded marginally by 3.2% Y-o-Y to GH¢38.7 billion in June-2018, broadly reflecting prevailing tight credit conditions as perceived default risk remains high.

Growth outlook for 2H-2018: Higher hydrocarbon output together with anticipated harvest in third quarter would limit the downside risks.

The shutdown for repair works on the Jubilee FPSO in the first quarter and May-2018 exerted a major downward pressure on oil & gas output and overall growth in Q1-2018. We do not expect any shutdown during Q3-2018 (until late Q4-2018) and therefore expect a relatively higher production from the Jubilee field during Q3-2018. The Sankofa field commenced gas production in late June-2018 with a potential output of 180mmscf/d over the next 15-years.

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.

Databank Research Forecast of Key macroeconomic indicators for end-2018

GDP Growth	Inflation	Fiscal Deficit	91-day Yield	USD/GHS FX rate*	Gross Reserve	GSE-CI Return
7.0% ±50bps	**9.0%** ±100bps	**4.7%** ±50bps	**12.0%** ±100bps	**GH¢4.7** ±GHp10	**3.5** Months	**25.0%** ±500bps

Source: Databank Research

"Ghana's economic fundamentals continue to strengthen, supported by declining inflation, surplus trade balance and narrowing fiscal deficit"

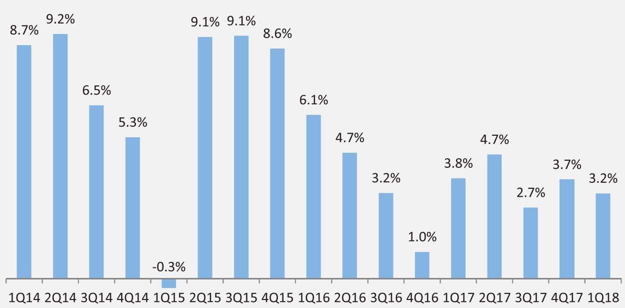
MOZAMBIQUE'S ECONOMIC OUTLOOK REMAINS SUBDUED IN THE FORESEEABLE

Recent Performance

Economic activity in Mozambique has slowed considerably since 2015 chiefly as a result of the sharp decline in commodity prices, namely aluminium and coal (the country's two main exports) and lower FDI. Investor sentiment also deteriorated after the revelation in April 2016 of previously undisclosed public borrowing amounting to nearly US$ 2 billion (about 17.5% of GDP) that lead to donor aid freezes. Real GDP growth decelerated to 3.8% in 2016 (from 6.6% in the previous year) and an estimated 3.7% last year. Despite this hard landing , the country's growth performance remained well above Sub-Saharan Africa's average of 1.4% in 2016 (the region's worst performance in more than two decades) and 2.8% in 2017.

The latest GDP data released by the National Statistics Institute (INE) showed that the Mozambican economy grew 3.2% in the first quarter of 2018 when compared with the same period of last year. This performance was essentially attributable to the robust growth recorded in agriculture and fishing (3.7% YoY), retail (4.7% YoY) and the extractive industry (9% YoY). Agriculture and fishing had the largest contribution to GDP (23.5% of the total) while retail and the extractive industry sector accounted for 11.5% and 5.8% of GDP, respectively.

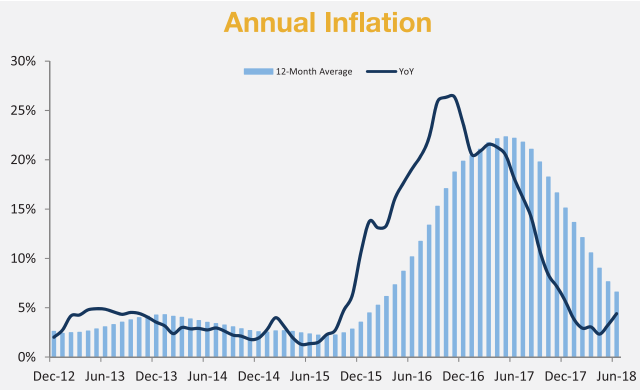
Real GDP Growth (YoY; 1Q14-1Q18)



Source: INE.

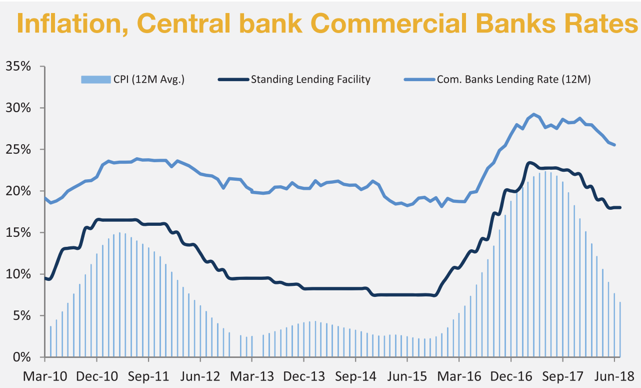
In terms of the second quarter of 2018, the economic climate index released by the INE (considered a forward indicator of economic activity) showed some signs of stabilization in April and May when compared with the levels recorded in the first three months of the year. This evolution reflected better demand expectations and current employment conditions by the managers that take part in this monthly survey and helped to offset weaker employment and price expectations. By sector, the improvement in the economic climate index was witnessed in retail and other services.

Meanwhile, consumer price data collected throughout the first six months of 2018 for the cities of Maputo, Beira and Nampula showed that accumulated inflation stood at 2.59% in June (vs. 3.82% in the same period of last year). This was mostly due to higher transport prices, which had a contribution of 1.56% (out of the 2.59%), followed by restaurants and hotels (0.48%) and utilities (0.19%). Food and non-alcoholic drinks represent a significant part of the consumer basket and had a negative contribution of 0.15% in the first semester of the year. The annual inflation rate reached 4.40% in June (vs. 3.26% in the previous month) whereas the 12-month average inflation rate kept its downward trend intact, standing at 6.59% (vs. 15.11% in December 2017).



Source: INE and Eaglestone Securities.

The latest consumer price data suggest that the central bank's restrictive monetary policy implemented since 2016 proved to be adequate to stabilize the local currency and control inflation. The overnight lending rate was lifted to multi-year highs of 23.25% in early-2017, as inflation remained above 20%. Since then, and also helped by the significant influx of foreign currency from large coal exports, the Metical stabilized and inflationary pressures have receded. This allowed the benchmark interest rate to be gradually lowered to 18% currently. Further monetary policy easing could help support economic activity and partly offset the impact of the fiscal consolidation measures that will have to be implemented in the foreseeable future.



Source: INE and Banco de Moçambique.

Indeed, Mozambique has incurred significant fiscal deficits in recent years, averaging close to 5% of GDP during 2010-17 and undermining debt sustainability. According to the IMF, the overall public debt level stood at 102.2% of GDP in December 2017 after reaching 118.8% in 2016. Most of the debt is also external debt (c85% of the total in 2017), which means there is significant risk to currency fluctuations.

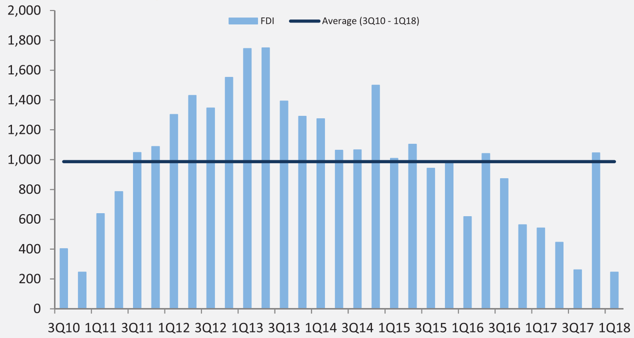
This requires a strong response from the local authorities in terms of implementing fiscal consolidation measures to lower deficits and return public debt to a more sustainable trajectory over the medium-term. In particular, the government stated at the time it released its 2018 budget proposal that it plans to (1) limit the admission of new employees to the public sector, (2) control staff costs and spending on goods and services, (3) postpone some projects like the rehabilitation and construction of public buildings and (4) manage public debt levels. On the latter, it is worth noting that the government met debt holders earlier this year, kicking off what promises to be quite challenging (and likely prolonged) restructuring negotiations judging from the response it received from the majority of the investors. That said, effective steps on this restructuring process remain crucial to restore macroeconomic stability in the country.

On the external front, preliminary trade data show that Mozambique's trade deficit reached US$ 261 million in the first quarter of 2018, down 30% YoY. Both exports and imports rose in the period by 19.7% YoY and 6.0% YoY, respectively. The country mainly exported coal (31.3% of the total) and aluminium (26.3%) whereas imports were more diversified. These included machinery, fuel and cereals (18.6%, 12.5% and 7.4% of the total, respectively). Mozambique's key exporting destinations included India (30.4% of total exports), South Africa (24%) and China (7.1%). On the other hand, the country's main suppliers included South Africa (23.1% of total imports), China (10%) and the Netherlands (9.7%).

Moreover, Banco de Moçambique figures show that FDI inflows have declined sharply since mid-2016, with the exception being the strong recovery in 4Q 2017 that lifted the FDI figure for the last three months of last year closer to the quarterly average of near US$ 985 million recorded since 2010. Specifically, FDI stood at US$ 1,045 million in 4Q 2017 after standing at US$ 541 million, US$ 446 million and US$ 261 million in the three previous quarters, respectively. The most recent figures relate to 1Q18 and show that FDI stood at US$ 245 million in the period, again far below the quarterly average registered in recent years. This sharp fall in FDI levels seen since 3Q 2016 largely reflects the impact that the revelation of the hidden debts in April 2016 had on investor sentiment.

Central bank data also show that nearly 60% of the FDI inflows recorded in recent years have gone to the mining sector followed by transport and communication (10-15%), real estate (5-10%), retail (5-6%) and construction (2-5%).

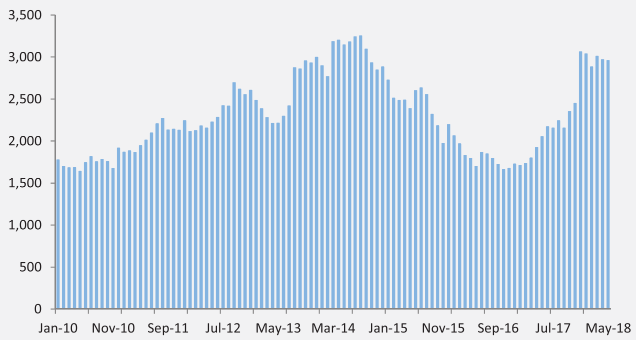
Foreign Direct Investment (US$ Million)



Source: Banco de Moçambique and Eaglestone Securities.

Other data disclosed by the central bank show a strong recovery in net international reserves at the end of 2017 and some stabilization in the first five months of this year. Net reserves stood at US$ 3,062 million in December, up 25% from the previous month and 77% from December 2016, while gross reserves rose to US$ 3,299 million in the same period, enough to cover seven months of imports of goods and services (excluding those of large projects). This compares with three months of coverage at the end of 2016. The sharp increase in the amount of foreign reserves relates to the continued improvement in the country's external position. However, it also reflects the impact of the capital gains tax (estimated at US$ 354.4 million) from the sale of half of Eni's stake in Area 4 of the Rovuma basin to ExxonMobil that was concluded in 2017.

Net International Reserves (US$ Million)



Source: Banco de Moçambique.

Outlook

Mozambique's economic outlook remains subdued in the foreseeable future, with real GDP growth projected to slow down further to around 3% in 2018-19. The agriculture sector and the extractive industry are expected to continue to drive economic activity during this period, benefitting from improved weather conditions and a further expansion in mining and coal exports. The latter should also be supported by a continued recovery in commodity prices.

The country's long-term prospects remain upbeat, however, as a result of the anticipated investments in the natural gas sector in the coming years. The local authorities expect that more than US$ 35 billion will be invested initially in the sector, with the first exports of LNG due to start by the end of 2022. This is huge for a country where GDP currently stands at less than half of that amount.

Mozambique is currently at a crossroad though, as its economic growth perspectives in the next few years remain very much dependent on the outcome of negotiations with debt holders and the normalization of relations with the IMF and other international donors.

The steps taken by the local authorities towards a sustainable peace process in the country and the ongoing developments in the LNG sector are clearly positive for economic activity and investment. Still, they could remain insufficient to reverse the current trend of lower growth that Mozambique has fallen into in recent years.

"The country's long-term prospects remain upbeat, however, as a result of the anticipated investments in the natural gas sector in the coming years."

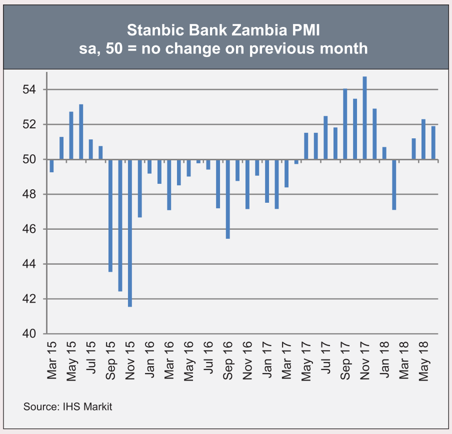
Contributor's Profile

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.

ZAMBIA'S DEBT PREDICAMENT INTENSIFIES GIVEN CONTINUED DELAY IN IMF FINANCIAL SUPPORT

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

Zambia's economic growth is expected to gain some momentum after a relatively soft patch during the first quarter of 2018, the latest Stanbic Bank PMI, compiled by IHS Markit shows. Overall IHS Markit expects GDP growth to average 3.7% in 2018. The risks to the growth forecast have increased nonetheless. Delays in securing an IMF-supported program that will unlock concessional borrowing, delays in restructuring of external debt holdings, changing emerging market investor sentiment and the increasing probability of dry El Niño weather conditions pose the most prominent risks in IHS Markit's view.



Economic activity in the Zambian economy is expected to show a rebound during the second quarter of 2018 following a soft patch during the first quarter of the year. The Stanbic Bank Zambia Purchasing Managers Index (PMI), compiled by IHS Markit, remained close to the 50-neutral level during Q1 2018 as a cholera outbreak disrupted business operations. The PMI index recovered over the Apr-Jun 2018 period, signalling the sustained improvement in private sector business conditions. Employment returned to growth while output and new orders continue to expand, the PMI numbers show. Price pressures gained some momentum, reflecting higher cost burdens and elevated fuel prices.

Official statistics compiled by Central Statistical Office of Zambia (ZamStats) show that headline inflation averaged 7.0% during the first half of 2018, marginally up from 6.8% for the same period a year ago, but well within the Bank of Zambia's (BoZ) inflation target range of 6%-8%. Headline inflation benefited from low food inflation – the largest component in the overall consumer basket – and kwacha exchange rate resilience. The favourable inflation backdrop opened up the opportunity for the Bank of Zambia to cut its policy rate by a cumulative 575 basis points to 9.75% since end-2016.

The looser monetary policy supported private sector credit conditions, which returned to positive growth of 10.1% year-on-year by March 2018 from an average negative growth rate of 8.5% y/y during 2017.

Higher international oil prices combined with the rebound in domestic demand spurred visible import growth during the first half of 2018. Import demand was matched by strong visible exports, dominated by copper and copper related products over the period.

External liquidity conditions in the Zambian economy remain under pressure nonetheless. Zambia's import cover ratio has now trailed below the three months of imports of goods and services threshold to average two months of imports of goods and services.

These external liquidity concerns, amongst others, triggered a downgrade in Moody's Zambian long-term issuer credit rating to Caa1 (possible default on the generic scale) in July 2018. IHS Markit's medium-term sovereign risk rating is currently set at 60 (B3 or speculative on the generic scale) with a Negative outlook.

Since 2017, the Zambian government has been unable to conclude a financially backed International Monetary Fund (IMF) supported programme that will unlock access to concessional lending. IMF concerns over debt sustainability and fiscal remedial actions continue to pose a stumbling block. Speculation over the possible under - recording of the Zambian government's external debt burden has furthermore increased investor concerns over longer-term debt servicing capabilities and the possible misuse of funding. Although the Zambian government has proposed some measures to contain debt accumulation during the near term, including the deferment of non - concessional borrowing, the cancellation of current contracted debt not yet disbursed, and the refinancing of some bilateral loans, particularly with China, actual implementation details are still required. It also remains uncertain if these measures will be sufficient to stabilise the Zambian government's debt trajectory during the medium term, particularly when the Eurobond repayments commence from 2022 onwards.

Zambia has witnessed a sharp acceleration in external debt holdings because of large fiscal deficits, "crowding out" of other government spending because of a rising local-currency debt servicing obligation and a sharp uptick in short - term debt obligations during recent years. In addition, the inability to unlock financing from the IMF has sent a strong signal about the government's apparent unwillingness to bring the fiscal and debt trajectory back on track. The refinancing risk of debt has also increased because of the country's narrow domestic capital market and the potential changing risk appetite of foreign investors.

Zambia's escalating debt concerns could prove growth restrictive in upcoming years. Public sector investment programs could be placed on hold as interest rate obligations derail capital spending objectives. The fast pace of debt accumulation and decline in foreign reserve holdings increases Zambia's non-payment risk, which in the event of a default, will further curtail financial support and government project implementation. The cost of borrowing could also shoot up as a result.

The ability of the government to provide a safety net to the most vulnerable in the economy and address pressing social issues will also be weakened. More than 64% of Zambia's population still live below the income poverty line, (PPP USD1.90/day), the Human Development Index shows. The infant mortality rate is 43.3 per 1,000 live births while Zambia's youth unemployment rate averages 19.7%.

For 2018, IHS Markit is of the view that Zambia's overall GDP growth rate will average 3.7%. The household sector is expected to benefit from a favourable inflation backdrop, faster expansion in private sector credit extension and lower interest rates. The outlook for overall fixed investment spending is becoming increasingly opaque. Tax disputes, uncertainty about obtaining a mining license after the completion of the exploration phase, and the risk of higher electricity costs towards year-end have dampened Zambia's new mining projects pipeline, with the exception of capacity expansion at existing mining projects in the country. The suspension of new government borrowing could also ultimately delay public-sector investment programs. The favourable global economic backdrop combined with higher international copper prices could nonetheless push copper mining production and exports up in the near term, help provide underlying support for the country's foreign reserve position, and improve import cover IHS Markit is of the view that copper production could therefore rise by 5% during 2018.

Risks to near term growth prospects for Zambia remain high. The risk for electricity disruptions and lower agricultural output during 2019 increases as the risk of dry El Niño weather conditions mount. Lack of access to concessional borrowing, delays in debt restructuring efforts, and changing emerging market investor sentiment also pose the most prominent risks in IHS Markit's view.

"Zambia's economic growth is expected to gain some momentum after a relatively soft patch ..."

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.

FISCAL AND MACROECONOMICS CONSIDERATIONS OF THE 2018/19 UGANDAN BUDGET

By **Christine Asiimwe Namanya,** Macroeconomic Policy Analysis Division, Bank of Uganda

This article generally discusses the fiscal and macroeconomic considerations of Uganda's national budget for 2018/19 by looking at the prevailing environment, its influences on the budget proposals and the expected impact on specific macroeconomic variables and the overall economy. The reading of the 2018/19 budget comes at a time when the pace of economic activity is picking up and is expected to improve further over the medium-term. Growth will be driven by increased public spending specifically on infrastructure, better performance of the agricultural sector and higher investment and consumption of the private sector. Rightly so, the 2018/19 budget is premised on three strategies: Commercialization of Agriculture; industrialization and Productivity enhancement and; Financing Private Sector Investment.

Accordingly, total government expenditure in 2018/19 is estimated to grow to 22.7 percent of Gross Domestic Product (GDP) from 20.1 percent in 2017/18. About 74 percent of the increase in public spending will be on account of development expenditure, as Government continues to invest in infrastructural projects. However, expenditure as a percent of GDP will decline to an average of 20.3 percent over the medium term when the large infrastructural projects are finalised. Development related spending is projected at 10.7 percent of GDP in FY 2018/19, before reducing to an average of 8.7 percent of GDP over the medium term. On the recurrent expenditure aspect of the budget, wages and salaries of some public servants will be increased in 2018/19 line with Government's salary enhancement policy.

The large development expenditure coupled with higher wages is expected to result in a positive impulse from public expenditure to economic growth. Public expenditure contribution to aggregate demand can be considered on several fronts. Higher government imports specifically project imports related to the major infrastructure projects that government has been implementing boost aggregate demand In addition, better infrastructure once complete, is likely to attract foreign direct investment. In the medium to long term, faster growth of economic activity is expected on account of the multiplier effect of the completed infrastructural projects. Uganda's economic potential GDP will also improve with better infrastructure which will in turn increase the capacity to produce goods and services.

Government has also laid out strategies to improve private sector investment including: industrialization; commercialization of agriculture; value addition to raw materials; increasing access to long term financing specifically by recapitalizing the Uganda Development bank; and promotion of exports and tourism. In addition, appropriate monetary policies that lead to improvements in private credit extension and an environment of stable prices will support private sector consumption and investment. Higher wages and salaries are also expected to contribute positively to aggregate demand.

The expenditure strategies and benefits for 2018/19 seem clear albeit budget financing is where caution must be taken, not only for Uganda but also other regional economies. The amalgamation of poor domestic revenue performance, rapid pace of increase in domestic and foreign borrowing and the rising global interest rates is a subject that requires serious consideration if fiscal policies are to be sustainable over the medium to long term. Indeed, the cost of borrowing has been increasing over the years and debt sustainability in the medium to long term lies in the balance.

In 2018/19, government will increase its tax effort through additional tax measures and improvements in tax administration as well as reforms to widen the tax base and enhance compliance. The ratio of domestic revenue to GDP in 2018/19 is expected to increase to 14.6 percent. While this is an improvement, it remains below the average of 17 percent for Sub-Saharan Africa (SSA). Moreover, it is yet to be established what the impact of some approved tax measures such as the excise duty on mobile money – an electronic fund system will have on the economy. Generally, collection of domestic revenue in Uganda is hampered by: a large informal sector representing more than 50 percent of the economy; tax evasion which is estimated to lead to a loss in revenue of 4 percentage points of GDP loss in tax revenue as well as tax exemptions. In fact, the issue of investment incentive in form of tax exemptions remains one of contention specifically on whether they actually benefit the economy. Deeper cost benefits analysis need to be conducted on the impact of investment incentives on the overall economy.

Overall, fiscal policy will be expansionary in 2018/19 with the budget deficit estimated to increase to 6.6 percent of GDP albeit expected to reduce to 2.5 percent of GDP by 2022/23. This is in line with the Charter for Fiscal Responsibility (CFR) which underpins the financing of the budget deficit along the following medium term objectives: Fiscal balance including grants of no greater than 3 percent of GDP by FY2020/21; Achieve a 0.5 percentage point increase in the tax to GDP ratio per annum; Gross public debt in net present value terms is maintained below 50 percent of GDP.

One way of financing the deficit will be through issuance of government securities. The domestic public debt strategy which started in 2012, has an advantage in that it is mobilized in the local currency and doesn't suffer the risk of exchange rate variability and the associated valuation gains or losses at the time of repayment. It may also lead to money market development. On the other hand, financing of the budget through issuance of government securities has the potential of crowding out the private sector from accessing loanable funds. Commercial banks tend to prefer to lend to Governments due the low risk of default and less administration costs. Net Domestic financing in 2018/19 is budgeted for at about1.7 percent of GDP but the plan is to reduce it gradually to less than 1 percent of GDP so as not to crowd out the private sector. Government will over the medium be looking at increasing domestic tax mobilization, and may even consider Public Private Partnerships (PPP).

The remaining part of the fiscal deficit for 2018/19 will be funded through external borrowing mainly through project support. 96.4 percent of the external financing will be in the form of project support, while the remaining 3.6 percent is budget support. In 2018/19 as alluded to earlier, project aid support is expected to rise in line with government's infrastructure investment program. It is expected that project aid will decline over the medium term as projects are finalized. The average external debt servicing per annum in the next 5 years is expected to rise and peak in 2022/23 due to repayment of debt currently being acquired to scale up public investments. This is likely to lead to a draw down in foreign currency reserves and contribute to the weakening of the shilling if exports revenue is not rising as fast. Unfortunately, while concessional loans are the preferred option of external financing, there are not many available for infrastructure projects. Government has therefore acquired largely non-concessional loans implying expensive debt serving which will further be complicated by rising interest rates in the advanced economies.

All factors combined the ratio of public debt currently stands at 40.5 percent of GDP as at end June 2018 However, when future debt payment obligations are discounted to today's value, the Net Present Value (NPV), the Public Debt to GDP ratio stands at 30.5 percent lower than the threshold of 50 percent beyond which public debt becomes unsustainable. However, in a period of high infrastructure requirements many economies in the region are struggling to remain with the debt benchmarks. Higher rate of debt accumulation, particularly on non-concessional terms could lead to debt unsustainability in the medium term. In addition, given that the large component of public debt is external debt and need to be repaid in foreign exchange, the economy requires high foreign currency inflows to be able to service debt. The 2018/19 budget discusses ways of raising foreign currency inflows specifically through supporting export growth and promoting tourism.

To conclude, we discuss the impact of the 2018/19 fiscal stance on other macroeconomic indicators such as inflation, exchange rate and interest rates and the overall conduct of monetary policy. The fiscal stance is part of the wider macroeconomic framework where inflation is expected to trend below its medium term target of 5 percent in 2018/19. Inflation will rise over the medium term to trend around 5 percent. The conduct of monetary policy will be guided by the inflation projections which could be affected by the fiscal stance.

THE CURRENT BEARISH SENTIMENTS IN THE EMERGING MARKETS AND ITS IMPACT ON AFRICA'S ECONOMY?

JOHN ASHBOURNE
AFRICAN ECONOMIST AT THE CAPITAL ECONOMICS

SAMIR GADIO
HEAD THE AFRICA STRATEGY TEAM

PAUL CLARK
FUND MANAGER, ASHBURTON INVESTMENTS

SHARAT DUA
FUND MANAGER, FIERA CAPITAL

CAPMARKETSAFRICA: *In your opinion, what is feeding the current bear sentiments in the emerging markets, please?*

JOHN ASHBOURNE: The proximate cause of the recent fears was the crisis in Turkey. The problems there were sparked by external shocks. But investors are worried that Turkey's weaknesses – a wide current account deficit, large debts – might be present elsewhere. If Turkey is so fragile, then where else is?

This is a concern because it is now pretty clear that, broadly speaking, the economic environment is becoming less positive for emerging markets. Growth in China is slowing, which will depress commodity prices. The escalating trade war between the US and its key economic partners threatens to disrupt supply chains and constrict business. And the US Fed is tightening monetary policy, which will discourage capital flows to emerging markets.

In this more challenging environment, people are asking whether other countries which – like Turkey, were stable enough to prosper when the wind was at their back – might now run into trouble in less favourable weather.

SAMIR GADIO: Emerging market (EM) currencies and bonds have faced significant pressure amid generally risk-averse conditions from Q2-18. Part of this correction reflects the stronger USD from early 2018 amid a divergence between the economic performance and monetary tightening of the US and other G10 countries. The re-pricing in EM FX and rates has been associated with local currency fund outflows; the same pattern has affected hard currency EM funds.

Trade tensions between the US and China (and other peers) have also contributed to risk-aversion. Meanwhile, idiosyncratic stories and pressure in core emerging markets (Turkey, Argentina, Russia and possibly Brazil in H2-18) have periodically fuelled market volatility and prevented investors from taking firm positions in cheaper local assets. Eurobond spreads have also widened from tight levels at the start of the year given this (generally) risk-off environment.

This is clearly going to be a challenging year for EM investors, as time is running out to make up yearly losses. That said, it is also fair to say that value appears to have been nominally unlocked in many onshore markets and Eurobonds which, coupled with lighter foreign investor positioning, could be conducive for future relief rallies.

CAPMARKETSAFRICA: *How do the current emerging markets bear sentiments impact African Fixed income and FX markets and where do short and long term opportunities lie, please?*

SAMIR GADIO: In frontier Sub-Saharan Africa (SSA), the Ghanaian cedi (GHS) has lost ground and local bond yields moved significantly higher from the lows reached earlier this year. Even though fundamentals in Ghana have improved, portfolio inflows have dried up in recent months, while large foreign debt holdings make the local market vulnerable to the roll-over of maturities by non-residents.

In Nigeria, USD-NGN has moved marginally higher in recent weeks, but the CBN still has ample reserves to support its policy-managed FX regime. In the absence of lower oil prices, FX weakness could be contained even assuming moderate portfolio outflows and a build-up of opportunistic onshore USD demand ahead of the February 2019 election. The CBN could also allow OMO yields to rise should it want to reverse the portfolio flow position. The recent sell-off in FGN bonds (where foreign participation is low unlike in bills) looks overdone, but risks to the long end come from the trajectory of short-dated rates.

In Kenya, corporate FX demand remains subdued, foreign participation in fixed income is low and the foreign selling of equities has remained manageable, which could insulate the KES from external risk factors, barring a period of pronounced USD strength. In this context, infrastructure bonds could offer low volatility carry for now, especially given that lending rate cap reform may prove harder to push through.

Zambia's local rates have continued to rise in the primary market amid muted demand at the auctions, while fixed income secondary market liquidity has dried up as evidenced by very wide bid-offer spreads. In a sense, this could prevent the large foreign selling of local bonds by offshore investors and delay a likely FX adjustment in line with pressured fundamentals. Even so, an IMF programme is needed more than ever to turn the tide and improve investor confidence.

CAPMARKETSAFRICA: *How does the current emerging markets bear sentiments impacts African economic outlook and which African countries will be losers or gainers?*

JOHN ASHBOURNE: In Sub-Saharan Africa (SSA), the economy with the most to lose is South Africa. South Africa is the most globally-integrated economy in the region, and is the only one with a very liquid and easily-tradable currency. This is the main reason why the rand fell so rapidly in recent weeks. (The country has its own domestic challenges as well.)

Given the increasingly difficult external environment for emerging markets, we now think that the rand will continue to weaken over the remainder of this year. This will keep inflation higher than we'd previously thought. It might also prompt the SARB to raise rates, though we think that this is still unlikely.

Elsewhere, the effect will be more limited. The big headwind facing most SSA economies will be weaker commodity prices. We think that the price of oil and also industrial metals will fall over the coming months, which will depress incomes across the continent.

CAPMARKETSAFRICA: *To what extent are investors concerned about the ability of African sovereigns to service their debt in current market conditions?*

JOHN ASHBOURNE: Across the region, I think that concerns should focus on the risk that African governments have – like Mozambique – misstated their debt figures.

If the official numbers are to be believed, then debt problems should remain focused, at least for the short term, in Mozambique and perhaps Angola. Debt ratios elsewhere are much lower, and growth is picking up across the region. In Ghana, for example, rapid growth and improved fiscal management will probably reduce debt worries over the coming years.

But there are already concerns about the accuracy of the Zambian numbers. Figures on debts are relatively opaque in SSA by international standards, and were additional debts to be revealed in countries that are already quite indebted – such as Angola – this could result in a sharp pullback in capital flows, and a sharp weakening of their currencies, which would raise the cost of servicing debt".

SAMIR GADIO: Public debt sustainability has generally weakened in SSA countries in recent years (despite GDP re-basing exercises that may optically polish the ratios). The accumulation of public debt has been associated with pressured fiscal positions and large infrastructure development requirements. Another trend is the increasing reliance on commercial borrowing (for example from the Eurobond market) to bridge the funding gap. For now, most SSA countries will likely be able to service their FCY debt. But the Eurobond refinancing profile will steepen rapidly from 2022 onwards which makes it critically important to maintain credible policies and anchor market confidence. In a related matter, sound policies are also needed to prevent exchange rate crises that could push FCY debt ratios to unsustainable levels.

So far default events in SSA have been stand-alone stories as in Mozambique, while other issuers in a difficult situation (Republic of Congo) have suggested that Eurobond holders will be exempted from a restructuring. However, investors will likely focus on other selected fragile markets where reforms are urgently needed to prevent a qualitative deterioration in credit metrics. Finally, SSA countries may seek to prioritise Eurobond payments, but, in a number of cases, arrears to bilateral lenders and other private creditors have become another source of systemic pressure in recent years.

***CAPMARKETSAFRICA:** How do the current emerging markets bear sentiments impacts African equity markets and where do short and long term opportunities lie ahead?*

PAUL CLARK: It is a well-known fact that African equity markets are very weakly correlated to global markets. Over the past 16 years the MSCI Africa excluding South Africa index has correlation coefficients of 0.24 and 0.30 to Developed markets and Global Emerging markets respectively. African equity markets have been resilient in the light of the recent weakness experienced in Emerging markets as shown in the table below (as at 24 August).

USD moves	% MTD	% YTD
Africa excluding SA	-1.9%	-5.7%
Frontier	-3.2%	-13.0%
Emerging	-3.6%	-9.5%
China Shanghai	-6.1%	-22.1%

In our view, the reason for this is the relatively delinked growth that is expected from African countries. These economies are transforming and much of the growth is being generated internally rather than driven by global activity.

The improving GDP growth expected in 2018 and beyond is resulting in continuing earnings growth for many of the companies listed on African stock exchanges. We believe that there are many companies where the valuations have become very cheap as markets have stalled while earnings continue to grow. The Tier 1 banking shares in Nigeria are a case in point where dividend yields now exceed 10%. Egypt still offers significant upside and is the largest overweight position in our Fund. Even in smaller markets like Kenya, Centum with real economy investments is trading at half our valuation.

***CAPMARKETSAFRICA:** How would you describe the African equity markets in the first half of 2018 relative to other emerging equity markets*?

SHARAT DUA: African equity markets have once again proven challenging in the first half of 2018, with the optimism from earlier in the year sadly being eroded by the general malaise in Emerging Market equities and currencies. Although ahead of Global Frontier Markets, African markets are down in line with Global Emerging Markets, in a year when we expected positive returns. Unfortunately rising US Treasuries and a strengthening Dollar, alongside President Trump's apparent desire for a global trade war, have led to heightened risk aversion and concerns around growth in emerging economies, and this contagion has hurt African markets and equities.

South African equities began the year at a somewhat elevated level following the euphoria around Cyril Ramaphosa's victory at the ANC conference. However weak economic data led to a reality check and since then the Rand's weakness has added to the negative result. The Egyptian market had a very strong first four months of the year, but has since given up much of that return. The Nigerian and Kenyan currencies have been stable, and markets performed reasonably to the end of June, but have since come under pressure.

***CAPMARKETSAFRICA:** In your opinion, which African equity markets seem to be offering solid investment opportunities? What factors are driving this activity?*

SHARAT DUA: We still believe that Egypt is offering the most attractive investment opportunities on the African continent. The reform programme that commenced with the large devaluation of the Egyptian Pound in 2016 has continued, with the second year of subsidy reductions in fuel and electricity, and the public finances delivered a small primary surplus for the financial year ending June 2018, with a bigger surplus forecast for FY18/19. Interest rates were reduced by 200bps earlier in the year, and a number of new listings are set to come to the market. We are happy that Egyptian policymakers are following the right path, and believe that as long as global pressures do not become too severe, a return to meaningful investment driven growth in the next 18 months will be a major catalyst for the equity market.

South Africa has seen a 180-degree turn, with "Ramaphoria" in the first quarter giving way in recent months to the same old concerns around lack of growth and political uncertainty. We feel this is unfair – President Ramaphosa has begun the hard process of turning things around since deposing President Zuma, but an instant economic uplift was unrealistic. Now critics are pointing at the ANC's decision to look into land expropriation without compensation as an unnecessary risk factor, but failing to understand the nuances behind the ANC's decision to try to take the land issue out of the hands of the more extreme political groups. Overall we see South African equities and the currency as still reflecting the worst fears from Zuma's time in charge when the prospects for the country are much better than before.

KENYAN EQUITY MARKET: 2018 HALF-YEAR REVIEW AND YEAR-END EXPECTATIONS

The first half of 2018 saw an end to the tough electioneering period that caused a continuous economic turmoil in 2017, with a handshake between the President and the opposition leader that has seen political tranquillity prevail in the country. The business environment has been on a recovery path mirroring a stable macroeconomic environment and improved investor sentiments. The USD 2.0B Kenyan Eurobond listed on the London Stock Exchange in February saw a seven - fold oversubscription, a far cry from the opinion of various industry players on the sustainability of the country's debt levels, affirming increased investor confidence in the Kenyan economy.

Average daily traded turnover at the Nairobi bourse surged 32.5% y/y to KES 872.2M in 1H18 with the NASI, reaching an all-time high of 192.17 in 1Q18 (+46.5% y/y) and closing at 175.50 in 2Q18 (+14.8% y/y). Increased activity was driven by a bullish run on Safaricom given its proclivity with foreigners, as investors jostled to take positions in anticipation of its outstanding year end performance. The rally on banking counters was a reaction by investors to speculation of a possible repeal of the rate cap This was further heightened by anticipation of dividend declaration for FY17 which saw increased interest in banks. As counters went ex-dividend, 2Q18 turned bearish which was exacerbated by foreign exits supported by a stronger shilling that saw them gain more in dollar amounts with foreign investors taking profits. The erosion of gains is expected to be felt most by insurance and pension funds who are considerably exposed to equities as an asset class.

With the introduction of IFRS 9, we have seen several banks especially the Tier 1 banks fully adopt the new regulation even with the Central Bank giving an allowance for progressive implementation within a five-year period. While the standard was anticipated to drive down net earnings and cause significant changes in capital, the much-hyped effects have been little felt. We have seen improved numbers for the 1H18 earnings, given a better operating environment and product diversification that has seen banks divest from reliance on interest income to non-funded income sources.

In a bid to review the interest rate cap, the National Treasury drafted a proposed Financial Markets Conduct Bill that will create four new entities to regulate credit access: Financial Markets Conduct Authority, Financial Sector Ombudsman, Conduct Compensation Fund Board and Financial Services Tribunal. The bill seeks to protect consumers from exploitation by financial services providers, by ensuring risk is priced based on a customer's credit profile. The bill has been met by opposition from banking players who feel that that multiple layers of regulation create overlaps and overregulation could increase cost of services. While the bill in its intent will enhance a better regulatory environment, we are of the opinion that it does not address the current credit crunch caused by the prevalent rate cap that has seen private sector credit growth dim to to 4.3% (June 2018) against a CBK target range of 12.0%-15.0%.

Proposed buyouts of various counters to see them delist from the bourse were unsuccessful with some of the minority shareholders unwilling to sell their stakes at prices below book value. Offers made to Unga Group and Express Kenya minority shareholders were deemed by the offerors as a premium above historical market prices.

The mismatch in valuation saw the offerors unable to meet the 75% threshold set for successful buyout to commence delisting. Investors in both instances accused the buyers of discounting the intrinsic value of the stocks. Stanbic Africa Holdings intended to raise its stake in Stanbic Holdings Plc to 74.9% from 60.0%. The acquisition from minority shareholders saw it raise its stake to 68.0% with the firm applying to raise the remaining 6.9% from the open market. The heightened demand on the shares at the bourse may raise the price above the current market prices. These series of events will see these counters maintain their listing on the NSE

A listing drought at the NSE continues to persist with the Kenyan capital market lagging in the continent's Initial Public Offers (IPOs) and other secondary listings in the last five years. The Executive and other stakeholders have been advocating for eased pre-listing qualifications for firms wishing to be enlisted at the NSE and product uptake by ensuring products meet the expectations of issuers and investors to encourage more listings. In addition, there have been calls to enhance the value/quality of listings seeing that the most recent listings have performed dismally in terms of price and turnover. To entice more firms to list, the Capital Markets Authority (CMA) has also proposed introducing a tax amnesty for newly listed firms. Despite the low listings, National Oil Corporation's IPO is anticipated to be held next year, with the firm looking to dual list on the NSE and the London Stock Exchange. In addition, the Bank of Kigali has expressed interest to cross-list on the NSE and the Rwanda Stock Exchange.

However, all is not dull and dreary with the Capital Markets Authority licensing the first online forex trading platform in Kenya and in Africa, EGM Securities, whose platform offers liquid investments in forex, Contracts for Differences (CFDs) and traditional asset classes. We highly welcome the authority's openness to financial innovation and digitization of transactions that has seen the diversification of the number of products available to investors. In its strategic plan for 2018-2023, the CMA has stated ambitious projects to have two licensed commodities exchanges, list about 30 new companies and fully launch derivatives products in the market amongst other products. The Nairobi bourse launched the pilot test on derivative trading with the first phase by stock brokers using dummy cash ongoing. Trading on derivatives is expected to enhance liquidity and portfolio diversification for investors in addition to speculation and hedging of risks on their portfolios. We expect to see enhanced investor awareness on derivatives by players involved and anticipate that this will improve margins for dealers and traders in tandem with boosting investor returns.

Investors remain perturbed by the issue of governance with various scandals encompassing listed counters where the government is actively involved. The elephant in the room remains to be inaction by the government in putting up systems that protect shareholders' interests as graft claims in Kenya Power serve as a reminder of historical trends in counters such as Uchumi and Mumias. This has seen a downward trend in price of Kenya Power amid investors hope that a total clean-up of the management structure will be done.

We maintain a positive outlook of the equities market and currently view this as a buyers' market on account of the current bear run that is seen to be bottoming out. Expected economic rebound with medium term GDP (2018 projected to grow by 5.7%), political tranquillity, a stable shilling and subdued inflation (c 5.0% in 2018) are expected to facilitate a robust operating environment. Discussions around the rate cap are still ongoing with The Parliament's committee on Finance and National Planning proposing to have the floor on deposits removed, while the cap on interest rates remains. The committee has also retained the 4.0% ceiling on loan charges above the Central Bank Rate benchmark. If the Kenya Banks Reference Rate (7.6%) is used as a benchmark, lenders can charge a maximum of 11.6% on loans. The proposed amendments defy expectations of banking sector players, the National Treasury and the IMF.

We encourage exposure in KCB, Equity, Diamond Trust Bank, Barclays Bank and Cooperative Bank. Price dips in Safaricom, Kenol and EABL points to an alluring entry point for value investors.

Contributor's Profile:

Linda Kiraithe joined Apex in January 2018 as a Research Analyst having previously worked as a Financial Advisor. She holds a BSc in Actuarial Science from Dedan Kimathi University. She is currently working toward the Chartered Financial Analyst (CFA) designation. Linda oversees the banking sector and handles macroeconomic research.

NIGERIA EQUITIES MARKET: POLITICAL SCENE TO DICTATE SENTIMENTS THROUGH 2018

By **Jerry Nnebue,** Equity Research Analyst, CardinalStone Nigeria

Nigeria equities market half year review

The Nigerian equities market rode into the year on a high, building on its impressive performance in 2017. Indeed, robust sentiments led to increased buying interest as the All-Share Index (ASI) returned 17.91 percent and the market capitalization reached an all-time high of N16.2 trillion ($53.1 billion) within the first three weeks of 2018. The broad-based recovery and improvement in macroeconomic indicators further heightened the optimism about domestic market. However, the rally was short-lived, as the ASI suddenly began to reverse its earlier gains – triggered majorly by profit taking and interest rate hikes in the US. By the end of H1'18, the equities market only had a marginal gain of 0.09 percent..

Macro conditions still favourable

Notwithstanding the weak sentiments in the Nigerian bourse, macroeconomic fundamentals look good as the economy treads the path towards consolidating recovery. Growth is the overarching macroeconomic theme and policy makers are racing to keep pace with the Economic Recovery and Growth Plan (ERGP). Inflation has moderated steadily over the past months from 18.55% in December 2016 to 11.23% in June 2018. Similarly, there have been improvement in oil prices (from $54.53/bbl in December 2016 to $75.87/bbl in June 2018), and oil production (thanks to a cessation of militant hostilities in the Niger Delta) over the past eighteen (18 months). These, in addition to the beneficial impact of the Investors and Exporters Window, and the Federal government's gradual tilt towards more foreign than local borrowings, have largely benefited FX reserves (from $25.1 billion in December 2016 to $47.6 billion in June 2018), and the currency.

Politics the key theme

With elections coming up in 2019, it is indisputable that politics will take centre stage in the second half of 2018. Though investors have previously expressed wariness over potential political tension in the pre-election year, recent developments – notably, a wave of political defections from the ruling party and a coalition of other opposition parties to field a single challenge against the incumbent – have heightened concerns. We expect further intrigues in the coming months, even as political parties turn their attention to conducting primaries to determine their flagbearers for the Presidential election. In our view, the calibre of candidate that the key contending parties put forward will be key to defining the political rhetoric in the coming months. Overall, we envisage that the prevailing apathy for equities will persist even as most investors choose to stay on the side-lines or repatriate their funds to safer havens.

Bright spots litter, albeit faintly

The implementation of the Pension Fund Administrators (PFA) multi-fund structure, offers a potential bright spot in the Nigerian equities market as we approach year-end. One of the implications of the regulation is that PFA's that are underweight in equities, among other variable income instruments, will have to re-allocate their portfolios to meet up with regulatory requirement. However, while this may potentially spur demand in the market, we assess that it might not be enough to offset the bearish sentiments that abound from heightened political uncertainty. Similarly, several Initial Public Offers (IPOs) had been expected to take place in 2018, notable among them being MTN Nigeria. However, we believe that currently unfavourable market conditions may make this improbable.

Overall, we expect volatility to persist in the equities market through the remaining part of the year, though the earnings outlook for listed companies in Nigeria remains positive. Indeed, we expect cement companies such as Dangote Cement Plc to benefit from the Federal Government's fiscal largesse in H2'18. Similarly, consumer firms look forward to a potential uplift in consumption from increased political and government spending. Banks have turned focus to building their loan assets to cushion the impact of declining interest rates. This, in addition to expected write backs – as recovery improves – and lower impairments, offer a lifeline to bottom line. The Nigerian equities market remains undervalued with a P/E of 10.7x compared to Africa peer average of 14.6x.

Analyst Certification

As to each security or issuer mentioned in this report, the respective primary research analyst(s) covering that security or issuer hereby certify that their views about the issuers and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report

BOTSWANA EQUITY MARKET: 2018 HALF YEAR REVIEW

By **Kaone L. Kebonang,** Equity Research Analyst, Imara Capital Securities Botswana

Market Commentary

The Domestic Companies Index (DCI), contracted by 5.16% in pula terms in H1 18 to 8,402.66 pts at 29/06/18 vs. 8,860.13 pts at 29/12/17. Due to the 4.96% appreciation of the USD against the BWP during the period under review, the DCI was down 9.86% in H1 18 in USD terms. Quarterly, the DCI declined by 3.05% in Q1 18 and 2.18% in Q2 18. The DCI's H1 18 loss was largely attributable to the weakening of some of the large cap stocks, such as First National Bank Botswana (-4.72%), Botswana Insurance Holdings (-5.61%), Barclays Bank Botswana (-8.36%) and Letshego Holdings (-2.13%). The Domestic Financial Sector Index weakened by 2.29% to 1,053.35 pts during H1 18.

4 counters on the domestic bourse closed the half year in the green, 3 were flat and 17 ended in the red. Counters from the tourism and hospitality sector were the top gainers for the half year, those being Chobe Holdings (+9.05%), followed by Cresta Marakanelo (+8.85%) and Wilderness Holdings (+6.36%). Olympia Capital Corporation closed H1 18 as the biggest loser amongst the domestic companies, shedding 40.00% to BWP 0.12. This was reflective of low investor confidence in the counter, following the lifting of its 5-year trading suspension on 15 December 2017. Other notable losers for the six months ended 29 June 2018 were Botswana Telecommunications Corporation (-33.15%), Minergy (-19.05%) and Standard Chartered Botswana (-17.32%).

Bearish activity was also recorded on the foreign bourse, which has 10 listed companies incorporated outside Botswana, 8 being in the mining sector. This was reflected by the weakening of the Foreign Companies Index, which closed the half year 0.24% lower in pula terms at 1,571.12 pts and 5.18% weaker in USD terms. A-Cap Resources (+11.43%) and CA Sales Holdings (+6.84%) were the only counters to register price gains; while African Energy Resources (-21.43%) was the biggest loser followed by Lucara (-13.32%), Botswana Diamonds (-9.09%) and Shumba Energy (-0.86%). Anglo, Investec, Tlou Energy and Raven were flat during H1 18.

Market activity on the domestic bourse increased by 40.60% y-o-y to 363.8m shares worth BWP 907.2m (USD 88.7m) transacted vs. 258.7m shares worth BWP 896.7m (USD 87.7m) at H1 17. There was also a significant upturn y-o-y registered on the foreign board with 47.9m shares worth BWP 177.6m (USD 17.4m) traded from the previous year's 4.1m shares worth BWP 5.7m (USD 556,482) at H1 17. This was mainly attributable to trades CA Sales, which was listed on the BSE on 9 November 2017, accounting for 99.56% of volumes and 99.90% of turnover in the subsector. Total market turnover improved by 20.20% y-o-y to BWP 1.1bn (USD 106.1m) on 411.6m shares traded during H1 18 compared to the BWP 902.4m (USD 88.3m) on 262.8m shares generated at H1 17.

Letshego Holdings maintained its position as the most liquid counter on the bourse, with contributions of 43.64% and 30.86% to volumes and value traded respectively, followed by New African Properties (NAP) with contributions of 22.06% and 26.86%, largely attributable to the 87.5m linked units (14.47% of issued linked units) worth BWP 280.7m (USD 27.5m) that traded on 30 May 2018, having been released by Cash Bazaar Holding – NAP's holding company.

Although, real GDP in Botswana grew by 2.4% in 2017 compared to the higher growth of 4.3% in 2016, the domestic economic outlook remains positive having registered a 4.8% growth in the first quarter of 2018 compared to an increase of 0.9% recorded in the same quarter of 2017. We expect GDP to grow at a faster rate in the short-to- medium term, driven largely by growth in the services sectors and recovery in mining activity, in line with the positive global economic prospects. However, despite the improvement in the local economy, which should augment counters' top-line growth, we are of the view that the domestic equity market will continue to register bearish activity. We see the large cap stocks, mainly comprising of counters in the banking sector and financial services, continue to face trading challenges due to the prevailing all-time low interest rate environment following the central bank's dovish monetary policy stance which saw the bank rate maintained at 5% in June 2018, previously cut by 50 bps in October 2017. We expect to continue to see pockets of bullish activity on the tourism and hospitality sector as forecasts for the Southern Africa tourism sector point north.

INVESTING INTO PRIVATE EQUITY FOR AFRICAN INSTITUTIONS

Institutional investment is a key driver of the development of capital markets. But, in many parts of Africa, institutional investment has been slow to develop and development finance institutions (DFIs) have long filled this gap. In recent years, pension reform in many countries has driven the creation of more reliable forms of savings for individuals. While the assets in African pension funds are still relatively small, most are fast-growing, creating local pools of capital for invest-tment

The traditional pension system works on the premise that members are formally employed, work for 40 years and contribute regularly during this period, resulting in suitable retirement savings. However, an issue that continues to impact the growth of pension fund assets is that in many countries much of the population is employed in the informal sector.

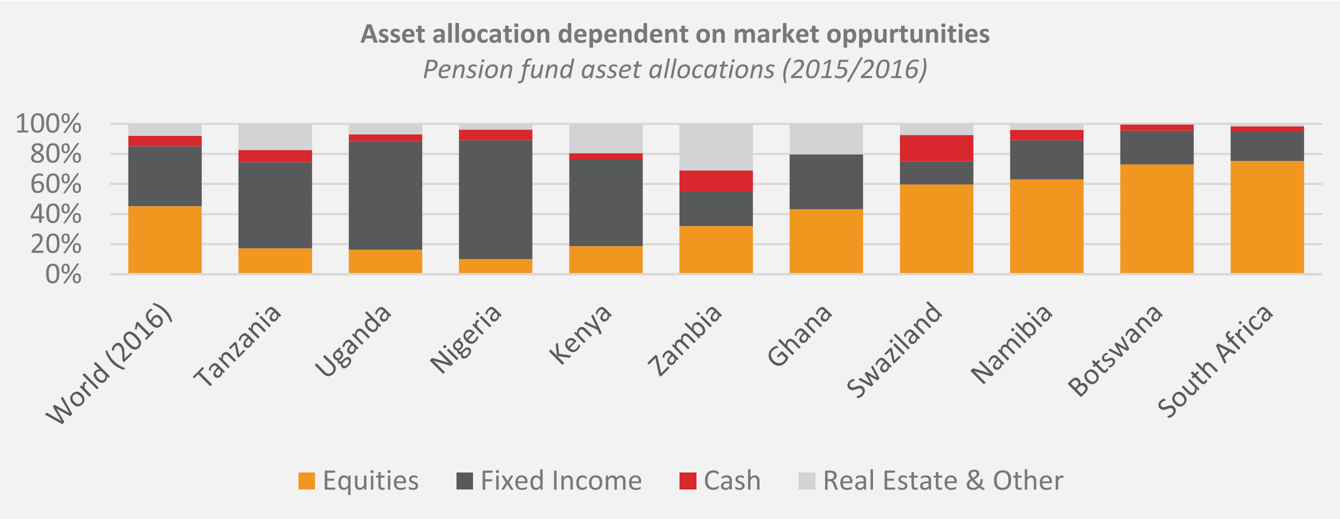
Looking at sub-Saharan Africa, for example, retirement remains the preserve (and luxury) of the few employed by the formal sector. For most, working well past the 'traditional' retirement age of sixty-five is a norm. The United Nations Department of Economic and Social Affairs reports, among those Africans above the age of sixty-five, 52% of males and 33% of females were active in the labour force in 2015. The reality is that the majority of older persons in sub-Saharan Africa have no choice but to continue to work for as long as they are physically able, due to the absence of adequate savings.

The small size of the current pools of capital notwithstanding, there is money to be invested. The question is, where?

In most OECD and many non-OECD countries, bonds and equities remain the two predominant asset classes for pension funds. While globally there is a larger allocation to equities (45%), the picture in Africa is more disparate. Asset allocation in sub-Saharan Africa in particular has favoured equities, which have shown a steady increase enabled by the development of capital markets and regulatory change.

However, liquidity and the cost of trading remain problematic when investing in African listed equities. Outside of the Johannesburg Stock Exchange, Africa's bourses remain stubbornly illiquid, with Egypt's stock exchange, Cairo and Alexandria Stock Exchange (CASE), currently exhibiting the second highest daily turnover across the African exchanges with a total of USD 72m traded daily, compared to the JSE's USD 1 800m.

The next most liquid exchange, by turnover for 2018, is the Moroccan stock exchange (CBSE) followed by the Nigerian stock market (NGSE), at USD 17m and USD 15m respectively, but this still represents less than 1% of the trade on the JSE. In terms of trading costs, it is difficult to obtain reliable information in Africa. Overall, the cost of



trading on African exchanges is considerably higher than developed markets, and a substantial portion of trading fees is made up of brokerage commissions.

When considering the low levels of liquidity and high trading costs in Nigeria and East Africa, it is not surprising that asset allocation is dominated by fixed income allocations in these regions, which predominantly constitute local bonds. When viewed alongside the high asset-growth in these regions, it reflects both regulation and a lack of alternative local investment opportunities. This highlights a key challenge pension funds face; identifying enough appropriate, local investment opportunities to invest ever-increasing contributions.

Local regulation remains one of the main drivers of asset allocation. There are often significant differences between the regulatory allowances for pension funds, size of local capital markets and actual portfolio allocations between regions. This is reflective of a number of factors including familiarity with alternative asset classes, such as private equity, development of local capital markets and availability of investment opportunities. In many countries, assets are growing much faster than products are being brought to market, limiting investment opportunities if regulation does not allow for pension funds to invest outside of their own countries.

Private Equity

One of the ways that the current shortage of investment opportunities can be addressed, is

through investment into alternative assets classes like private equity.

Globally, alternative assets have been increasingly prominent in institutional investors' portfolios, partly driven by the continued low interest rate policy around the world. The vast majority of institutions now commit to at least one alternative asset class, and the level of participation is particularly high across more established asset classes such as private equity, real estate and hedge funds. We are entering a period where alternatives are no longer 'alternative' in the eyes of many institutions, which bodes well for further industry expansion.

While investment in alternative assets in emerging markets has historically come from DFIs, pension funds are slowly joining in. Local institutional investors lend credibility and often serve as a catalyst for greater external interest. Local investors also allow global peers to leverage local knowledge and networks.

Regulation

A number of countries including South Africa, Botswana, Nigeria and Namibia have led the way in investing in alternative asset classes such as private equity. South African pension funds, for example, have been active in African private equity investment, both locally and across the continent, enabled by regulatory change.

According to the SAVCA* 2017 Private Equity Industry Survey (covering the 2016 calendar year), funds under management for the South African private equity industry grew from R158.8 billion in 2015 to R171.8 billion in 2016.

Pension and Endowment Funds were the main source, 40.2%, of all third-party funds raised during 2016, (2015: 35.3%). Governments, aid agencies and DFIs accounted for 20.6% in 2016 (2015: 19.6%) and insurance companies/ institutions made up 19.6% of funds raised in 2016 (2015: 8.4%).

An example of a country where regulatory change has not enabled investment into private equity is Nigeria, where in 2010 the regulator for pension funds, National Pension Commission (PENCOM), made investment into private equity allowable up to a 5% limit, raising hopes for local investment into the industry. Using 2016 figures, represents potential Limited Partner (LP) commitments of an estimated USD 842m. However, PENCOM also prescribes additional restrictions such as a minimum of 75% of the private equity fund to be invested in Nigeria, registration of the fund with the Nigerian SEC, and a minimum investment of 3% in the fund by the General Partners (GP). These regulatory restrictions make it difficult for LPs to find sufficient suitable investments.

Although the less regulated and direct nature of private equity does represent higher risk than traditional asset classes such as bonds and listed equity, being over prescriptive by means of regulations is not a replacement for good risk management processes within an institution.

Deregulation of prescription and sound investment practices by institutional investors will unlock capital flow to suitable investments opportunities wherever they may present themselves in Africa. If African pension funds are to take the lead from DFIs in further deepening the private equity industry, capital must be allowed to seek the most compelling investment opportunities.

Comfort with the asset class

Investment into alternative assets requires specialist knowledge and risk management. For pension funds to invest in these assets classes and still ensure the highest level of care is taken with members' assets, they will need the support of experts. In many markets, the use of asset consultants in this role is still in its infancy and advice is often obtained from actuaries or even asset managers. The private equity industry bodies, trustee associations and regulators will need to focus on providing on-going training to slowly build an understanding of and comfort with the asset class.

Availability of appropriate products

Due to the relatively small size of pensions funds in Africa, it may be difficult to obtain sufficient diversification. Similarly, it may be difficult for the fund to commit sufficient resources to manager research and selection. Normally these would be circumstances in which a fund of fund option could be considered. However, the requirement in many markets for pensions funds to invest geographically within country, makes this difficult. The majority of private equity funds are either pan-African, or at least invest over several key markets.

It is clear that there are a number of enabling factors that are required to ramp up institutional investment into private equity that need to be addressed to create a viable eco-system. Currently capital is being created, regulation is being refined, industry education has started and increasingly players in the asset management industry are looking at how to structure products to enable the participation of local pension funds. One day soon all these factors will come together and leverage investment into this industry to new heights.

Contributor's Profile :

Heleen Goussard has over 14 years' experience, and heads up the RisCura team who provides unlisted investment services for clients across all alternative asset classes such as Private Equity, Infrastructure and Private Debt. In this role, she provides assurance and advice to investors in alternative assets and alternative asset funds including independent valuation, financial modelling, risk and performance reporting and research. This ensures that institutional investors receive accurate reporting and assessment of returns on investments, which in turn allows them to manage their investments more effectively. She joined RisCura in 2012 and has performed and reviewed over 150 valuations since then. She previously worked as a corporate finance partner at PKF Inc.

*Southern African Venture Capital and Private Equity Association

AFRICAN PENSION FUNDS: A NEW CAPITAL SOURCE FOR PRIVATE EQUITY

By **Cindy Valentine,** Partner, International Funds, Simmons & Simmons
Charles Vermeylen, Managing Associate. International Funds, Simmons & Simmons

African pension funds are primed to play a valuable role in the future of the African private equity industry. They are likely to become an increasingly significant capital source for medium and long - term investment and are primed to play a critical role in catalysing African development. With many pension funds accumulating substantial AUM, there is pressure on these pension funds to diversify from traditional investments such as government bonds and listed equities – with private equity providing an attractive proposition.

Expanding source of capital

Africa's pension fund industry is burgeoning – with an expanding young population, the amount of capital that needs to be invested is extensive. An industry which shows an average 10-12 per cent[1] return over the last 10 years can't be ignored – private equity has outperformed public markets and pension funds risk losing out on diversification and significant growth if they don't engage with private equity. It is estimated that there is USD29 billion available for investment by African pension funds in African private equity[2] – a staggering number that has exponential ramifications for sectors such as infrastructure that has a huge demand for capital in Africa. This opportunity has, however, not necessarily translated into commitments, due to barriers to entry which include lack of industry knowledge and understanding, and concerns around mismatches in illiquidity.

Regulatory change

Recent regulatory changes have provided some stimulus for investment in private equity by the pension fund market. In some African countries, the rules surrounding investment into private equity are ambiguous. In Zambia, for example, there is neither a specific prohibition of, nor allocation to, private equity in the pension regulations. However, some reforms have taken place in key markets which are slowly improving the investment environment. For example, South Africa now allows retirement funds to invest up to 10% of AUM in private equity (up from 5%). Nigeria has since 2010 allowed up to 5% of AUM to be invested in private equity, however this is still subject to restrictions including that 75% of capital must be invested in Nigeria.[3] There has been a modest increase in allocations to private equity by larger pension funds (particularly from South Africa, and more recently from Namibia, Nigeria and Kenya), however, the reforms have, to date, failed to dramatically affect allocations.

Illiquidity – solutions?

Private equity investments have an average life cycle of 8-10 years. Moreover, the J-curve means that returns are usually negative in the first few years of a fund's life and increase over time as investments mature and are exited. This presents a theoretical problem for many Western countries, which have ageing populations and relatively short term cashflow requirements.

By contrast, the populations of African nations are young and expanding. Accordingly, the cashflow profile of a PE fund should arguably be less of concern as there are generally no large pension liabilities at present, relative to those of Western countries. Illiquidity concerns can, however, be mitigated through various alternatives, including co-investments. Co-investments allow investors to co-invest alongside a private equity fund (in which they may or may not be invested) and get their returns on these co-investments as and when they are exited, thereby providing a different cash flow timing and risk profile to limited partner fund investments. They can also spread their risk and cash flow profile by investing in a variety of countries and geographies, as well as different sectors, for example, a mixture of investments in sectors

1. Pension Funds and Private Equity: Unlocking Africa's Potential EMPEA/ MFW4A/ Commonwealth Secretariat 2014
2. Pension Funds and Private Equity: Unlocking Africa's Potential EMPEA/ MFW4A/ Commonwealth Secretariat 2014 Chapter 3
3. Pension Funds and Private Equity: Unlocking Africa's Potential EMPEA/ MFW4A/ Commonwealth Secretariat 2014 Chapter 3

such as infrastructure and real estate (which provide income return through the life of the fund), and mid-market funds (which return capital later in the life of the fund).

Survey responses of African pension trustees consistently show that the J-curve effect and illiquidity are the main disincentives to allocation in PE and not, any longer, the regulatory environment.[4] Interestingly, these same surveys often reveal that trustees who have experience with private equity investments are much more enthusiastic than trustees who have no familiarity with the asset class.[5]

Given the concerns discussed above, one possible means for overcoming liquidity may be through investment in hybrid vehicles. There are many such arrangements which can operate in the space between pure open and closed ended structures, through methods such as redemption windows or liquidity events, but the nature of such vehicles is ordinarily largely dependent on the nature of the underlying assets (being income producing or capital gains). These structures can be set up to offer primary or secondary liquidity, and in emerging markets there is a heavy trend towards an ultimate objective of listing as a natural exit.

Sectors such as infrastructure, real estate and financial services lend themselves toward vehicles which are either longer term, with exit options at a point in time when there may be rollover rights, or evergreen type vehicles, which tend to have listing rights, redemption rights or a combination of both, giving investors more comfort and a greater degree of control over their exit options. Liquidity provisions in these vehicles tend to be very bespoke, but specialist legal counsel can normally find an option which is appealing to investors looking for liquidity options, whilst protecting the manager and the investment mandate.

Where to from here?

Alternative structures could act as 'proof-of - concept' for pension fund trustees. However, the down side is that there is already difficulty in getting pension funds comfortable with the standard private equity concept – until there is further engagement between pension funds and the industry, alternative structures may be a harder sell than the classic closed-ended products.

A key factor in encouraging pensions fund investment is transparency and assisting in building knowledge in the industry, including their ability to assess risk, and assess managers so that they feel confident in putting their money in private equity. It is incumbent on the private equity industry to support all pension fund trustees, including by improving communication and presenting innovative solutions.

"African pension funds are likely to become an increasingly significant capital source for medium and long-term investment and are primed to play a critical role in catalysing African development."

Contributors' Profiles

Cindy Valentine is a Partner at Simmons & Simmons, London. She deals with private equity investment fund structuring, fund raising, co-investment arrangements, management buyouts, start-ups and alternative structures including specialised focus on permanent capital vehicles. Her experience covers a wide range of funds, including large buyout and mid-market funds, renewable energy, infrastructure, venture funds, fund of funds and emerging market funds. Cindy advises both private equity houses and investors.

Cindy has a core focus on emerging markets, in particular Africa and she has an in depth understanding of fundraising in African markets. Her diverse range of clients includes blue chip GPs, investors, international finance institutions and development finance institutions. She works on a daily basis with investors targeting emerging markets, including DFIs. This includes extensive experience in negotiating with US investors.

Charles Vermeylen is a Managing Associate at Simmons & Simmons, London. He advises on fund formation, financial promotion, investor participation and ongoing corporate actions affecting alternative investment managers. He has experience with every typical investment vehicle and managed account arrangement extending across private equity, real estate, hedge and other strategies.

4. Pension Funds and Private Equity: Unlocking Africa's Potential EMPEA/ MFW4A/ Commonwealth Secretariat 2014; New Frontiers, Perceptions of and allocations to private equity by Southern African pension funds SAVCA 2016
5. New Frontiers, Perceptions of and allocations to private equity by Southern African pension funds SAVCA 2016 Executive Summary

ZIMBABWE: LIFE AFTER PRESIDENT ROBERT MUGABE

By **Edward Galante,** Executive Director, Mangwana Capital Limited Zimbabwe

In early November 2017, Robert Mugabe was removed from power in what was effectively a bloodless coup. My wife, children and I joined a million people on the streets of Harare in a celebration of pent up joy and elation, the likes of which I can only imagine were equaled by the fall of the Berlin Wall. People were laughing, dancing, running in circles, waving pictures of the army generals who had removed Mugabe, hugging one another and literally crying with relief. It was a wonderful moment of unity, where all races and ages came together to rejoice at liberation from the absolute circus which had become life in Zimbabwe under Mugabe. What was extraordinary, to my mind, was that no one was hurt or beaten, there were no windows broken, and even late into the night the bemused soldiers who were the recipients of much affection and quite a few beers, smilingly turned the revelers away from the streets leading to State House – the official residence of the president. It was a remarkable thing to have been part of, and showed, more than anything, the character of the people and their desire for change.

It wasn't always that way.

After fighting a brutal civil war in the 1970's, Zimbabwe achieved its independence in 1980. At independence the Zimbabwe Dollar was stronger than the US Dollar, trading at one Zimbabwe Dollar to $1.47 US. For a while things went smoothly, at least on the surface. Mugabe buried the hatchet with his former Rhodesian adversaries, although he and his ZANU leadership were ruthless in dealing with the perceived threat posed by the largely Matabele ZAPU faction of the independence struggle. What resulted was Gurukuhundi – or the slaughter of tens of thousands of Matabeles, who live in the southern part of the country. One of Mugabe's lieutenants was a chap named Emmerson Mnangawa – more on him later.

Beaten and cowed, a peace accord was reached and ZAPU was subsumed into ZANU which became ZANU PF (or the Patriotic Front). During this time Mugabe enjoyed the support of the western world which, hungry for a success story in Africa, largely looked the other way. He was knighted by the queen and lauded as a symbol of the new Africa.

Together with many other emerging global economies, Zimbabwe embraced the World bank and IMF mandated Economic Structural Adjustment Programs (ESAP) which accompanied western financial support and embarked on a series of reforms which saw them limiting spending and running the economy on a balanced budget.

I moved to the country in November of 1992. At the time, the Zimbabwe Dollar had eased to $8.00 to $1:00 US Dollar – and shortly thereafter, stimulated by credit provided by the donors and the fiscal discipline imposed by the IMF and the World Bank, the economy started to grow at 6 – 9% per year.

With economic growth, came demands for political change as a newly enfranchised middle class wanted a more representative government. The first to protest about their condition were the former "Liberation War Veterans" who, not having their demands for compensation met under the fiscally austere ESAP program, trapped Mugabe in the Sheraton Hotel Convention Center and demanded large payouts.

On November 14, 1997 Mugabe, who sensed a real threat to his power and authority, capitulated, and paid the war veterans what they were demanding; The Zim dollar sagged an additional 14% on that day and began its precipitous decline.

The ensuing wrangle with the Bretton Woods Institutions, and the currency devaluation, angered the newly enfranchised black urban middle classes and the approximately 4800 white farmers, who had, up until then, been content to farm on their farms. They produced over 20 commodities, chiefly tobacco, maize, soya and wheat. There were large export markets for beef, fresh fruit, flowers and vegetables. The commercial farms contributed 18% to GDP and directly employed 320,000 workers. Nearly 2 million people lived on and earned their livelihood from these commercial farms.

In the late 1990's Mugabe had had several political scares: a constitutional amendment he was proposing was soundly defeated, and a new political party, the MDC, or Movement For Democratic Change was quickly gaining support in the cities and was being actively backed by the commercial farmers. This situation threatened Mugabe's control of power. In 2002 the "Fast Track Land Reform" Program was introduced with devastating consequences. Commercial Farmers (both White and Black) were displaced by gangs of thugs posing as "war veterans" and agriculture, and with it the economy, collapsed.

In 2007, Zim officially devalued the dollar to $30,000 to 1, when the actual black-market rate was over $600,000 to 1. Hyperinflation was a daily fact of life and the country was in the throes of shortages caused by both the economic meltdown and the predictably hopeless government responses of wage and price controls. Goods disappeared from supermarket shelves overnight, and by 2008 the Zimbabwe Dollar was officially $10 billion to $1.0 US Dollar, with the black-market rate being vastly higher.

I clearly remember going into one supermarket, and every shelf was empty of all goods, save for one Isle in the middle which held thousands of jars of Vaseline – I drew the logical inference!

By 2007 commercial maize, tobacco and beef production stood at one third of their 1998 levels and the production of cotton on commercial farms had ceased. Other crops suffered similarly.

The Reserve Bank knocked 12 Zeroes off the currency and even after that – the Zimbabwe dollar plunged to Z $1.0 Trillion to $1.00 US Dollar. By the end of the year, the Zim dollar was largely irrelevant, employers, including myself, resorted to paying their staff in groceries, and the US Dollar, although illegal, was also widely in use.

In 2009, bowing to reality, the then acting Finance Minister, Patrick Chinamasa announced that Zimbabweans would be allowed to officially conduct business in hard currency in response to the crisis. According to the Commercial Farmers Union, Zimbabwe lost about $12.0 billion in agricultural output in the 10 years from 2000 through 2009.

With the introduction of the US Dollar, Inflation stopped hard: By this time the MDC had fought their way to an uneasy power sharing agreement with ZANU PF, and formed a Government of National Unity which put restraints on government expenditure. The slowing down of land invasions and farm seizures in critical industries such as dairy and sugar cane production all conspired to sort of stabilize the situation.

But old habits died hard. Mugabe wrested control of the government back in a subsequent election marred by vote rigging and violence. Mugabe's first and only rule was the preservation of political power. He needed money to pay his civil service – effectively his constituency. In 2014, liquidity started to dry up, in response to governments printing of "Treasury Bills" denominated in US Dollars. In 2016, in response to the inevitable drying up of currency in the system and on the streets, the Reserve Bank introduced "Bond Notes" – effectively again denominated in US Dollars, backed by … The full faith and credit of the Zimbabwe Government! Currency controls were imposed, and a black market rate started again.

Political squabbling and vicious infighting increased. Mugabe's openly ambitious and much younger wife Grace was angling for greater power and politically ZANU was divided. The 93 year old Mugabe was loosing his grip on the day to day running of things and the country witnessed increased political skullduggery, witch hunts and murders. ZANU PF split into two independent factions, the G-40 or generation 40 supporting the much younger Grace Mugabe, and the "Lacoste" Faction supporting Emmerson Mnangagwa or "the Crocodile," so named for his cunning and patience, who had by that time risen to be Vice President.

This culminated in Mnangagwa being fired and having to escape on foot to neighboring South Africa in October of last year in fear of his life.

This was too much for the Military who supported Mnangagwa and who had no intention of being ruled by Grace and who staged a bloodless coup and removed Mugabe from office. Many of you will have seen the events on TV. The military returned Mnangawa to power and he was sworn in as president, pending a general election which is now scheduled for July 31st of this year – in a few weeks.

Through all of the foregoing, as it does in most places, life went on. Businesses operated, kids went to school, people ate in restaurants. There is a common misconception that Zimbabwe has been and remains a culturally backward, dangerous, disorganized place with what people presume is poor infrastructure.

Actually, the exact opposite is true. Both Road and Telecommunications Infrastructure remain good. There is excellent cell phone penetration on the country's 4G cellular networks.

There is a large water resource stored not only in Lake Kariba on the Zambezi, but on countless farm dams around the country. The Electricity generation infrastructure could use upgrading, but distribution is excellent. Ditto with the rail infrastructure. Governance systems are in place; the Police who used to be efficient and well disciplined, and who became predatory under the last days of Mugabe, have been reigned in and are once more respectful and doing their job.

Tourism numbers are increasing, particularly in the Victoria Falls area where a recent brand-new airport built to accommodate the landing and take of every class of large passenger aircraft in the world, was recently completed. And tourist numbers in the Falls are skyrocketing. One of my clients in the Falls reports that he has never had such good occupancies – last month his occupancies were over 80%. His forward bookings are equally jammed.

There is also one of the oldest and largest (in African Terms) Stock exchanges in the country so mobilization and deployment of capital is possible quickly.

So what's changed since Mugabe left?

Elections for parliament and the presidency have been called for the 31st of this month. Unlike his predecessor, the acting president has called for international election monitors to monitor the process.

The atmosphere of fear around speaking your mind, has completely evaporated. We have a free press – although not yet completely free airwaves – where political debate and scandals are aired daily. A month ago, I had a long conversation with the publisher of The Daily News, a newspaper whose printing presses were bombed in the 2000's by Mugabe's henchmen – and he is extremely positive about the prospects for a government under Mnangagwa; Surprisingly, he is contemptuously dismissive of the MDC candidate – notwithstanding that his paper had for years supported the opposition party.

Previous human rights abuses have been virtually eliminated, and independent candidates, as well as opposition ones are standing for various parliamentary seats in virtually all constituencies.

People in Zimbabwe's diaspora, almost three million of them, are starting to return. We have friends who are doctors and lawyers as well as farmers who are returning to the country – it is difficult to get a last-minute flight into Zim these days– the airplanes are full of potential investors and donors, all waiting for the outcome of a free and fair election, before committing capital and resources.

Most tellingly, the hallways of the Ministry of Lands are full of primarily white, South African farmers, all wanting to get in line to get back on what they know to be some of the best, most productive farmland in the world.

There are several hurdles which will have to be overcome:

The country has to first and foremost convince the international community of the freeness and fairness of their elections. There will, in my judgement, be a small amount of electoral fraud, but this will occur across the political spectrum, and my prediction is that the perception of the elections which will be held in a few weeks - will be free and fair. This will unlock hundreds of millions in pent up donor support and will ultimately lead to Zimbabwe being readmitted to the Commonwealth and welcomed back with a seat at the IMF / World Bank Table.

The most pressing hurdle is economic. Mugabe left an economic mess. As of April, there was $221 million of US Dollars in the formal banking system and $6.7 Billion in reported "Zollar" deposits plus an additional $4.0 Billion of LOCAL government Debt – the fiction of a 1 to 1 ratio of the US dollar is just that – a fiction. Add to this about $13.0 billion of Paris Club, and Bretton Woods foreign debt which should be either written off or rescheduled or at the very least – redenominated into the Rand.

Solutions include the introduction of an IMF Backed currency board or joining the Rand Common Monetary Area – both of which surrender sovereignty to either the Bretton Woods Institutions (which the ruling party has fought against for 25 years) or the South African Reserve Bank – which the early settlers, the Rhodesians and ZANU PF have all historically opposed. This will be a tough choice and the road ahead here is opaque.

Overcoming Distrust. One worry is that the impetus for change rarely comes from those who have entrenched power. One of the main criticisms I hear is that since Emmerson Mnangawa was Mugabe's deputy, it will be more of the same under his rule, should he win. Well, so was Gorbachev in the Soviet Union, and FW DeKlerk in South Africa -

change can be effected by those in power who have seen which way the wind is blowing, and who want to get on the right side of history – time will tell, but in word and deed so far, it seems that Mnangawa is very much of this world view.

The Tribal Issue which could lead to trouble: There is clearly a Karanga takeover of the Sezuru hegemony (both Tribes within the larger Shona Tribal grouping). The Matabeles have quietly taken control of the military and any payback for Gurukahundi needs to be watched carefully for a resurgence of violence which is unlikely but ever - present. There is NO question however that a modicum of discipline has returned to the country with the Army instilling discipline in its line functions – and I view any tribal violence as a remote possibility.

Remember too, that notwithstanding that it has no coastline, geographically Zimbabwe is strategic – the US embassy has just built a 250 million dollar embassy. It is an English speaking state which is centrally located from a command and control standpoint for all of southern Africa.

So what is the way forward?

A) On the plus side, the County has amazing human and natural resources. Literacy rates are amongst the highest in Africa, and Agriculture, Mining and Tourism – together with perhaps financial services will drive the resurrection of the economy. If things go right and a modicum of sanity is brought to the currency situation, Zimbabwe could be looking at 6 – 9% real GDP growth for the next 5 – 7 years. One estimate is that Mugabe's land reform program cost Zimbabwe $92 billion in lost GDP growth – Zim used to be 3x Zambia's Economy; now Zambia is 3X Zim. So – there is absolutely nothing but upside.

B) South Africa is beginning its descent into Post-Colonial/ Post Independence Chaos – a slide which, in my view, will continue over the next 10 years – Zim could profit hugely from this with enlightened leadership taking capital and brain power from its southern neighbor. The downside to this of course is that the South African chaos could spill over into Zim; but for a variety of reasons, many of them cultural as well as social, I don't believe this will happen.

C) The independence of its judiciary. This is everything. Any foreign aid in the short term should go to bolstering an independent impartial judiciary;

D) The reintroduction of a commercially rational Exchange Rate – right now there are at least four – the RTGS to US Dollar cash Rate; The RTGS to offshore Transfer Rate; The RTGS to Bond Note Rate; The Bond Note to Physical US Dollar rate …. You get the picture. A solution to the short and intermediate term problem must be found – I believe it will be the introduction of a currency board, but even if it is the adoption of the Rand, that will restore trust to a discredited banking system.

E) Addressing compensation for the Farms – some estimate that this is a $US 6.0 billion problem; I am reliably informed that talks are well developed in regards to addressing this problem – perhaps not with the direct return of the farms, which I don't believe will happen, but with some compensation being paid out to dispossessed farmers which will be reinvested in the country.

F) Finally – we need the return of many of the 3.0 million of the diaspora – the wonderful talented Zimbabweans who have left and have acquired real world skills over the past 30 years. The point about the diaspora is important – Zimbabwe has its citizens scattered around the globe, virtually all of them anxious to see Zimbabwe succeed – and all of them goodwill ambassadors for their country.

I believe that the present Mnangagwa led government, should it win in July, will look to a Rwanda/ Uganda/ China model which delivers impressive economic growth while curtailing effective political dissent –not a bad thing for emerging economies. Other emerging economies both in Africa and around the world, have shown us that we need a strong hand on the tiller; one that can enforce discipline and coordinate economic development. Should Mnangagwa be elected, as I believe he will be, I am confident he will lead in this manner. Should the opposition triumph, they will be the beneficiaries of much goodwill and donor support.

On balance – I am more excited than I have been in 20 years – in my view Zimbabwe has a bright future. Correctly led and effectively assisted, with a positive election result behind it, and with the support of the US, Britain and the Donors, it can fulfill the promise it had at independence in 1980.

FAST-CHANGING ARCTIC AND NORTH ATLANTIC CONDITIONS BRING ROUTE RISKS

By Allianz Global Corporate & Specialty

There was another milestone for Arctic shipping in early 2018 when a specially-designed LNG tanker became the first commercial ship to travel the Northern Sea Route in winter and without the assistance of an ice breaker. The Eduard Toll successfully journeyed from South Korea to Montoir, France via northern Russia, shaving around 3,000 nautical miles off the traditional transit via the Suez Canal.

It followed the transit in August 2017 of another specially-designed tanker, the Christophe de Margerle, which became the first merchant ship to sail across the Arctic Ocean without the aid of an icebreaker. It took just 19 days to reach South Korea from Norway, almost a week faster than going via the Mediterranean.

Arctic ice has been thinning and retreating over the past 40 years, bringing new opportunities for shipping, but also serious environmental concerns. Research shows the mean center of shipping activity moved 300km north and east— closer to the North Pole- over a seven-year span°0

As a result, a growing number of vessels are sailing in Arctic waters. For example, cargo volumes on the Northern Sea Route (NSR) increased by nearly 40% to 9.7 million tons in 2017, the biggest annual volume ever, according to the Russian Federal Agency for Maritime and River Transport[2]. This is expected to rise to 40 million tons by 2022, reflecting the development of oil and gas fields, and 70 to 80 million tons by 2030. “Climate change could open up new shipping routes in the Arctic, such as the North West Passage, and routes across Russia and Canada. These routes will have advantages as well as disadvantages. For example, a collision in a remote hostile environment like the Arctic could prove challenging, and would be a long way away from salvage teams,” says Volker Dierks, Head of Marine Hull Underwriting, AGCS Central & Eastern Europe.

In February 2018, China announced plans for an “Arctic Silk Road” by developing shipping lanes opened up by global warming. China said it would encourage infrastructure development and conduct commercial trial voyages in Arctic waters, with plans to build its first Polar expedition cruise ship by 2019[3]. At the beginning of 2017 the International Code of Safety for Ships Operating in Polar Waters (Polar Code) came into force. The code introduces mandatory requirements for shipping in Polar regions, principally relating to ice navigation, manning and ship design.

“The Polar Code continues to be refined,” says Captain Andrew Kinsey, Senior Marine Risk Consultant, AGCS. “Arctic conditions are fast-changing and the normal International Maritime Organization review updates are too slow. For these new shipping routes we need to find faster ways to disseminate information and the lessons of successful transits.”

Ships operating in Arctic waters are bound by the Polar Code, but ice is also posing a significant hazard for shipping elsewhere.

Outside the Arctic and Antarctic, a number of so-called conditional areas also carry a higher risk of ice, including the Gulf of St. Lawrence, Alaska, Sakhalin, Russia and the Baltic Sea. Trading in these areas has also been increasing with global warming.

There is also a threat of ice hazards in more southerly shipping routes from icebergs. At the end of 2017, the US Coast Guard’s International Ice Patrol warned shipping companies that an unusual number of icebergs were drifting into shipping lanes. It found that over 1,000 icebergs had drifted into North Atlantic shipping lanes in 2017, marking it the fourth consecutive season where the danger has been classified as “extreme”[4].

“Such extraordinary conditions require complementary training for crew, as well as additional routing support,” says Arnaud Gibrais, a Senior Marine Risk Consultant at AGCS, based in Paris.

“A melting Arctic could lead to an increase in icebergs affecting trade routes, although this has not yet been a problem for the major north, south, east or west shipping lanes. But this might become more of an issue in the future,” adds Dierks.

Climate researchers at the University of Manitoba, Winnipeg have also claimed more Arctic sea ice is entering the North Atlantic Ocean, increasing the level of hazard for ships in late spring. Arctic sea ice blocked normally open areas of ocean around Newfoundland in May and June 2017. The ice cover trapped many ships and even sunk some boats when it punctured hulls, the research found[5].

1. NASA Earth Observatory
2. Safety4Sea.com, Record cargo volumes shipped on Northern Sea Route in 2017, January 2018
3. Reuters, China building up Arctic Cruise Ship For Polar Silk Road, March 2018
4. GCaptain, Ice Patrol, More Than 1,000 Icebergs Drifted Into N.Atlantic Shipping Lanes in 2017, December 2017
5. University of Manitoba, Arctic Sea Ice Becoming A Spring Hazard For North Atlantic Ships

WHAT ANALYSTS ARE SAYING ABOUT AFRICA'S ECONOMIC OUTLOOK AND FINANCIAL STABILITY

Sub-Saharan Africa Growth Outlook Facing Several Challenges

Financial services provider ABSA projected real GDP growth in Sub-Saharan Africa (SSA) to accelerate from 3% in 2018 to 3.6% in 2019, mainly due to monetary policy easing, improved weather conditions and higher commodity prices. It expected economic activity to vary across SSA economies. It projected Ethiopia's real GDP growth at 10.1% in 2018 and 9.5% in 2019, supported by strong investment inflows and improved consumer and business confidence. While it forecast Ghana's economic activity to remain strong at 6.8% in 2018 and 6.5% in 2019 despite oil output disruptions, driven by monetary policy easing and ongoing infrastructure investment. At the same time, ABSA expected Angola's real GDP to grow by 2.2% in 2018 and 2.5% in 2019, supported by the increased availability of foreign currency, as well as higher global oil prices, domestic oil production and public spending. Whereas, it projected Nigeria's real GDP growth to increase from 1.9% this year to 2.6% next year, but it anticipated the country's economic recovery to be constrained by political tensions ahead of the February 2019 general elections.

In the same vein, the regional African bank Ecobank projected real GDP growth in Sub-Saharan Africa (SSA) to accelerate from 2.8% in 2017 to 3.4% in 2018, supported by stronger activity in several major economies, including Ghana, Nigeria and South Africa. It forecast East Africa to post a real GDP growth rate of 6.5% in 2018, driven by improved weather conditions, by stronger activity and higher FDI inflows in Ethiopia, by higher agricultural production in Uganda, as well as by improved activity in Kenya, Rwanda and Tanzania. In contrast, it projected Central Africa to register a growth rate of 1.8% this year, reflecting the region's improving but still weak economic environment, fiscal slippages and weaker fiscal reforms amid heightened political pressures in Gabon, Chad and Cameroon. Overall, it expected the SSA region's growth to remain challenged by a subdued economic recovery in the Eurozone, persistent power supply shortages, political and security risks, volatility of the region's capital and currency markets to tighter global financial conditions, weaker growth in China, as well as fluctuations in commodity prices.

Angolan Sovereign Ratings Affirmed, Outlook 'Stable'

S&P Global Ratings affirmed at 'B-' Angola's long-term foreign and local currency sovereign ratings, with a 'stable' outlook. It indicated that the ratings balance the country's relatively low economic wealth and the sustained increase in the public debt level, with the expected implementation of macroeconomic reforms to support economic growth and reduce debt levels. It projected real GDP to grow by an average of 2.8% annually in the 2018-21 periods relative to a contraction of 2.5% in 2017, mainly due to higher oil prices and output, as well as improved non-hydrocarbon sector activity amid the new administration's economic and governance reforms. It forecast the average inflation rate to reach 20% in 2018 amid an expected depreciation of 30% in the Angolan kwanza this year and to moderate in coming years as the currency stabilizes.

Egyptian Sovereign Ratings Affirmed on Reforms

Fitch Ratings affirmed Egypt's long-term foreign -currency Issuer Default Rating (IDR) at 'B', with a 'positive' outlook. It indicated that the rating balances Egypt's strong commitment to its reform agenda, greater macroeconomic stability and improving external finances, with the country's wide fiscal deficits, elevated public debt level and weak governance. It added that the 'positive' outlook reflects the improving trend across a number of Egypt's credit metrics. It expected the average inflation rate to regress from 13% in 2018 to 11.6% in 2019. It anticipated the current account deficit to average 2.5% of GDP annually during the 2018-20 periods, while it expected foreign currency reserves to remain adequate, covering on average six months of current external payments. Further, it said that improved balance-of-payments dynamics have led to a sharp increase in foreign currency reserves that continued to grow in 2018. It added that foreign currency reserves reached $44.3bn at the end of June 2018 compared to $36.3bn at end-2017 despite the $5bn in capital outflows since May, due to investors' sell-off from emerging markets.

Namibia's Credit Profile Balances Improving Growth Prospects

The Government of Namibia's (Ba1 negative) credit profile reflects its small and relatively diversified economy and its moderate but gradually improving growth prospects over the medium term set against rising public debt levels and external vulnerabilities, Moody's Investors Service said in an annual report this week. Moody's expects real GDP growth of 0.9% in 2018 and 2.1% in 2019. However, moderate average real GDP growth and a high level of wealth are counterbalanced by growth volatility linked to commodity exports. The economic recovery hinges on continuing growth in agriculture and mining, as well as gradually improving manufacturing, which should offset contraction in the construction sector. Moody's could change the outlook on the sovereign rating to stable if the government were to demonstrate commitment to fiscal consolidation that results in a deceleration of debt accumulation and an eventual decline in debt levels.

Sub-Saharan African Monetary Policy May Be at Turning Point

Monetary policy in Sub-Saharan Africa appears to be at a turning point and is likely to become more hawkish in 2H. Regional divergences are likely to persist. Central banks in Angola and Nigeria are still struggling with high inflation and weak economic activity, while their peers in East Africa have cut interest rates in 2017-18 amid relatively strong GDP growth, which should support domestic demand this year and going into 2019. The South African Reserve Bank remains among the most hawkish in emerging markets. Bloomberg Economics expects it to keep its policy rate on hold this year after a 25-bp cut to 6.5% in March, with higher energy prices and pressure on emerging-market assets reducing the likelihood of another reduction in interest rates.

South Africa Is Likely to Hold Rates as Inflation Accelerates

The South African Reserve Bank is likely to keep the key policy rate on hold in 2H. It took a more hawkish stance in July, despite a unanimous vote for keeping its key repurchase rate at 6.5%. The central bank cut its forecast for 2018 growth more sharply than expected, while raising its inflation projections for 2018 and 2019 on a higher oil price assumption and a weaker rand. A rate hike now seems less likely given the continued undershoot of inflation and expectations for weaker growth. Still, this may change if the rand depreciates further. A rebound in domestic food prices could lead to an upward adjustment in the SARB's inflation forecast, but a more extended breach of the ceiling's target interval seems unlikely.

Botswana's Central Bank Likely to Keep Rates on Hold This Year

The Bank of Botswana will probably keep its policy rate on hold this year amid a diminishing risk of inflation undershooting its 3-6% target, mainly because of a weaker exchange-rate. The monetary policy committee held the key rate at 5% on Aug. 23 after a 50-bp cut in October 2017. Inflation eased to 3.1% year-on-year in July from 3.3% in May, when they were pushed higher by rising transport costs. The MPC expects inflation to remain within its target in the medium term, which is also Bloomberg Economics' forecast following recent weakness in the rand and higher prices. The composition of Botswana's pula basket was maintained in December 2017 after an increase in the weighting of the IMF's special drawing rights to 55% from 50% a year earlier. The weighting of the rand in the basket was cut to 45% in January 2017.

DR Congo Central Bank May Cut Rate Again, Currency Reserves Rise

An improved balance of payments, largely thanks to higher copper exports, should allow the Central Bank of the Democratic Republic of Congo to cut its policy rate further in 2H. The monetary policy committee held interest rates steady at 14% at its July 10 meeting after a 600-bp cut in April, saying that inflation was expected to end the year at 10.7% versus a medium-term target of 7%. Foreign-exchange reserves rose to $1.19 billion in 1H, the committee said, indicating a weaker pace of accumulation since its meeting in May. It's still a marked improvement from a nadir of $667 million in September. Reserves covered five weeks of goods and service imports.

Tunisia's Central Bank Turns More Hawkish Under New Governor

Tunisia's central bank Governor Marouane El Abassi will probably continue to pursue a more hawkish monetary policy than his predecessor in order to preserve dwindling foreign-exchange reserves and support the dinar. Tunisia's central bank held its key policy rate at 6.75% on Aug. 29 after raising it by 100 basis points on June 13. The CBRT cited the continued increase in the trade balance, which largely reflected higher global oil prices, outpacing increased tourist and remittance revenue. Prime Minister Youssef El-Shahed said on July 24 that Tunisia would seek to issue international bonds in September. A Eurobond is urgently needed to finance a substantial fiscal deficit and boost foreign reserves, which dropped to $4.2 billion in July.

AFRICAN EQUITY MARKET INDICATORS AS AT 31-AUGUST-2018

Country Name	Index Name	Index at 31-August	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Botswana	BSE DCI	8,132	-2.27	-8.22	-9.10	8,132	8,985	5.745
BRVM	IC Comp	207	-2.74	-14.97	-13.88	197	246	6.571
Egypt	EGX 30	16,009	2.75	6.59	19.33	13,195	18,414	16.725
Ghana	GSE ALSI	2,783	-2.52	7.86	16.47	2,280	3,536	8.690
Kenya	FTSE NSE15	168	-1.68	-2.11	-0.93	155	197	11.837
Malawi	MSE ALSI	31,284	0.07	44.85	56.04	19,186	31,943	n.a
Mauritius	SEMDEX	2,222	-0.86	0.89	1.31	2,151	2,310	4.695
Morocco	MORALSI	11,546	-1.70	-6.80	-6.86	11,308	13,388	8.060
Namibia	Local	1,316	-0.71	1.28	12.94	1,113	1,461	21.817
Nigeria	NIG ALSI	34,848	-5.86	-8.88	-1.85	33,882	45,322	14.332
Rwanda	RSEASI	132	0.03	-1.36	5.08	125	133	0.223
South Africa	JSE ALSI	58,668	2.15	-1.41	3.80	53,027	61,777	18.401
Swaziland	SSX ALSI	416	0.00	2.31	5.12	396	416	0.396
Tanzania	DAR ALSI	2,215	-4.22	-7.56	2.70	404	2,490	13.111
Tunisia	TUNIS	8,418	0.12	34.01	32.68	6,068	8,458	6.699
Uganda	USE ALSI	2,046	-0.64	2.26	12.19	1,660	2,293	11.742
Zambia	LuSE ALSI	5,231	-4.23	-1.82	6.73	4,817	5,608	n.a
Zimbabwe	IDX (USD)	394.64	2.70	21.81	67.91	244	534	n.a

SELECTED AFRICAN CURRENCY EXCHANGE Vs. US DOLLAR AS AT 31-AUGUST-2018

Country Name	Currency Name	Index at 31-August	1-month % Δ	YTD % Δ	1-Year % Δ	1-Year Low	1-Year High	30 Days Volatility %
Algeria	Dinar	118.09	0.16	-2.82	-6.61	109.97	119.37	3.596
Angola	Kwanza	276.87	-6.21	-39.32	-39.43	165.77	276.87	12.394
Botswana	Pula	0.09	-4.85	-9.15	-6.86	0.08	0.11	11.197
CFA Franc	CFA Franc	564.97	1.58	-0.14	-1.73	527.24	592.54	8.310
Egypt	Pounds	17.93	-0.30	-0.85	-1.65	17.57	17.97	3.414
Ethiopia	Birr	27.56	0.46	0.07	-14.71	23.37	27.75	3.887
Ghana	Cedi	4.84	-2.08	-6.62	-8.43	4.29	4.90	21.594
Kenya	Shillings	100.65	-0.27	2.51	2.56	99.87	103.91	1.441
Malawi	Kwacha	725.20	0.03	0.04	0.03	715.41	738.55	5.079
Mauritius	Rupee	34.42	0.09	-2.45	-4.13	31.74	35.23	7.106
Morocco	Dirham	9.44	0.35	-1.19	-0.69	9.09	9.60	4.576
Mozambique	Metical	59.79	-3.21	-1.94	2.71	57.57	62.95	9.643
Nigeria	Naira	362.58	-0.20	-0.71	-1.96	353.00	363.50	2.685
Rwanda	Franc	876.50	0.45	-2.57	-3.64	834.70	891.34	13.575
South Africa	Rand	14.86	-10.32	-16.65	-12.69	11.51	15.55	21.223
Tanzania	Shilling	2,285.00	-0.13	-2.20	-1.81	2,224.70	2,286.41	2.215
Tunisia	Dinar	2.77	-1.70	-10.93	-11.22	2.35	2.80	6.626
Uganda	Shilling	3,766.25	-1.75	-3.27	-4.45	3,552.25	3,905.00	6.206
Zambia	Kwacha	10,268	-3.3601	-2.8420	-11.31	9,085	10,400	9.431

SELECTED AFRICAN GOVERNMENT INTERNATIONAL BONDS AS AT 31-AUGUST-2018

Country Name	Maturity	Price at 31-August	Mid-Yield at 31-August	1-month Yield Chg (%)	YTD Price Change (%)	Price 1-Year Low	Price 1-Year High	Amount Outstanding (US$ M)
Angola	12-Nov-25	110.712	7.538	0.390	-4.279	106.788	118.576	USD
Cameroon	19-Nov-25	102.997	8.923	0.696	-14.422	101.448	122.002	USD
Congo	30-Jun-29	78.712	9.137	0.503	-11.010	74.489	89.100	USD
Cameroon	19-Nov-25	102.997	8.923	0.696	-14.422	101.448	122.002	USD
Egypt	30-Apr-40	86.497	8.218	0.486	-14.603	84.329	103.215	USD
Ethiopia	11-Dec-24	98.163	6.989	0.579	-6.568	95.515	107.070	USD
Gabon	16-Jun-25	92.232	8.476	0.403	-11.432	88.713	106.780	USD
Ghana	14-Oct-30	123.044	7.776	0.528	-10.790	118.065	141.231	USD
Kenya	24-Jun-22	98.419	7.210	0.621	-7.777	97.997	108.350	USD
Ivory Coast	31-Dec-32	90.329	7.470	0.669	-9.868	88.007	101.626	USD
Morocco	11-Dec-42	106.278	5.048	-0.113	-6.608	101.586	116.038	USD
Namibia	29-Oct-25	94.297	6.250	0.365	-7.764	91.459	105.604	USD
Nigeria	12-Jul-23	100.029	6.365	0.527	-5.980	97.582	107.418	USD
Rwanda	02-May-23	100.833	6.412	0.375	-3.975	99.522	106.237	USD
Senegal	30-Jul-24	100.365	6.174	0.099	-7.412	96.631	109.777	USD
South Africa	24-Jul-44	87.503	6.366	0.326	-12.932	85.053	103.430	USD
Tanzania	09-Mar-20	101.186	7.702	4.457	-3.785	100.879	105.657	USD
Tunisia	19-Sep-27	107.158	7.160	0.052	-3.081	107.139	111.481	USD
Zambia	30-Jul-27	72.714	14.523	3.408	-35.443	72.564	114.654	USD

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