INTO AFRICA

A publication from Capital Markets in Africa

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REVIEWING 2019 AFRICAN OUTLOOK

SUB-SAHARAN AFRICAN FRONTIER DEBT MARKETS: PROSPECTS

SOUTH AFRICAN RAND: WHAT IS THE POSSIBLE NEW NORMAL?

HOW INTEREST RATE CAPS SHAPED KENYA'S DOMESTIC DEBT MARKET

MACROECONOMIC PROSPECTS: MOZAMBIQUE, UGANDA

EQUITY MARKETS: KENYA, MAURITIUS, NIGERIA, TUNISIA

INVESTING IN AFRICA: MITIGATING FRAUD AND CORRUPTION RISKS

CONTENTS

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Welcome to the September 2019 edition of *INTO AFRICA*, a publication written by the professionals, for professionals, investors, policymakers … Advancing and providing fresh insight into Africa's emerging markets through renowned thought leadership and peer-to-peer knowledge-sharing. The edition is titled: ***Reviewing 2019 African Outlook***.

According to the July 2019 Word Economic Outlook, the growth in sub-Saharan Africa is expected at 3.4 percent in 2019 and 3.6 percent in 2020, 0.1 percentage point lower for both years than in the April World Economic Outlook. As strong growth in many non-resource-intensive countries partially offsets the lackluster performance of the region's largest economies. Higher, albeit volatile, oil prices have supported the outlook for Angola, Nigeria, and other oil-exporting countries in the region. But growth in South Africa is expected at a more subdued pace in 2019 than previously projected following a very weak first quarter, reflecting a larger-than-anticipated impact of strike activity and energy supply issues in mining and weak agricultural production.

South Africa avoided a second recession in two years, with the economy growing by 3.1% in the three months to end-June. Whereas, Nigerian economic growth slipped to 1.94% in the second quarter of 2019 compared to a revised 2.10 per cent growth in first quarter of 2019. Likewise, the economy of Angola and Botswana shrank 0.4 percent and 1.50 percent year-on-year in the first quarter of 2019. Kenyan, Ghanaian, Uganda, Mauritius and Tunisian economic expanded by 1.66%, 1.60%, 0.30%, 0.30% and 0.01% respectively in the first quarter of 2019 over the previous quarter.

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.

SAMIR GADIO (Head of Africa Strategy, Standard Chartered Bank, London) explores the performance and the prospect of the frontier Sub-Saharan African (SSA) debt markets. He stated that the markets have experienced a strong run so far in 2019, both in external and local bonds. **VARUSHKA SINGH** (Fixed Income and Currencies Strategist, South Africa) reviews the state of South African Rand. As well, the **RESEARCH TEAM** (Vetiva Capital Management Limited Nigeria) examines the health of the Nigerian economy.

Still on the economic fundamental, **RENALDO D'SOUZA** (Head of Research, Sterling Capital Limited Kenya) assesses how interest rate cap is shaping the Kenyan debt market and investment in Government securities is a key benefactor. Still on Kenya, **EVA WANJIKU OTIENO** (Africa Strategist, Global Research, Standard Chartered Bank) looks at Kenyan fixed income reaction to the FY20 budget. **TIAGO DIONISIO** (Chief Economist, Eaglestone Advisory, Portugal) moves the discourse forward by offering an insight into the future of Mozambique's subdued economic outlook. Likewise, **CHRISTINE ASIIMWE NAMANYA** (Economist, Macroeconomic Policy Analysis Division, Bank of Uganda) dissects the Ugandan macroeconomics fundamentals and prospects and **ITUMELENG MUKHOVHA** (Corporate M&A Associate Baker McKenzie South Africa) provide a focus on Ghanaian economic growth and development.

Furthermore, **SARAH WANGA** (Head of Research, AIB Capital Limited Kenya) and **BHAVIK DESAI** (Head of Research, AXYS Stockbroking Limited Mauritius) provide 2019 half-year review and year-end expectations for the equity markets in Kenya and Mauritius respectively. Besides, the **EQUITY RESEARCH TEAM** (CardinalStone, Nigeria) looks at the Nigerian equity markets in the first half of 2019. In a similar light, the team from **TUNISIE VALEURS**, Tunisia give an insight into the Tunisia equity market performances.

JOHN ASHBOURNE (African Economists, Capital Economics, London), **STUART CULVERHOUSE** (Head of Macro and Fixed Income Research at Exotix), **CAVAN OSBORNE** (Portfolio Manager, Old Mutual Investment Group) and **OLIVER BELL** (Lead Portfolio Manager and Frontier Markets Equity Strategy at the T. Rowe) share their views on what is feeding the current emerging markets bearish sentiments and the impact African economic outlook and markets (equity, debts and FX).

And still more, **ARM ADLY** (Assistant Professor, the American University in Cairo, Egypt) opines that economic reforms is making many Egyptian poorer. While **ALEXANDRE RENE** (Partner, Ropes & Gray Washington, D.C), **PATRICK WELSH** (Counsel, Ropes & Gray Boston) and **SCOTT GRANNEMANN** (Associate, Ropes & Gray Boston) examines how to mitigate fraud and corruption risks in Africa.

On a final note, we bring you exclusive interview with the **PETER OLADELE ASHADE** (Group Chief Executive Officer, United Capital Plc.), who stated that there is no doubt, the Nigerian investment management industry still has room for growth.

Tunde Akodu

Editor

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SUB-SAHARAN AFRICAN FRONTIER DEBT MARKETS: PERFORMANCE REVIEW AND OUTLOOK

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

Frontier Sub-Saharan African (SSA) debt markets have experienced a strong run so far in 2019, both in external and local bonds. The SSA Eurobond rally has been fuelled by expectations of Fed easing, lower US Treasury yields, flows into emerging market (EM) hard currency funds and improved risk appetite, and initially attractive valuations after pressured market conditions in 2018. Granted, average EMBI spreads have compressed as a whole, but the SSA region has outperformed the broader EM credit class due to its high-yield features.

The outlook for the remainder of the year is largely contingent on external factors and global risk metrics. Given the already significant compression in EM credit spreads, the magnitude of further SSA Eurobond gains and/or outperformance could be moderate, even assuming constructive global market conditions. Overall, this suggests that carry will drive Eurobond returns. The market will likely also prefer issuers with robust balance sheets and decent fundamentals or those offering pockets of relative value and an entrenched spread pick-up versus peers.

For these reasons, we think investors' overweight positions in Nigeria's Eurobonds will likely persist given the country's low foreign-currency debt payments and large FX reserves, despite subdued oil prices and limited reform momentum. We also think investors will continue to like Côte d'Ivoire's external bonds. Their wider spreads relative to fair value reflect a political premium ahead of the 2020 elections, but so far uncertainty has not resulted in instability; while the country's fundamentals remain strong by regional standards. Cameroon's Eurobond performance will likely be monitored, as it has lagged CEMAC peers, despite a more diversified economy and decent IMF fourth review; its spread to Côte d'Ivoire is very wide and sticky, which appears to reflect perception risk (for example, given the media coverage of the Anglophone crisis) more than economic fundamentals. Investors will likely continue to focus on the risk/reward of Zambian Eurobonds given still relatively low cash prices; Zambia's ability to resume fiscal consolidation and make progress on a debt restructuring with China will be key to improving confidence amid pressured FX reserves and unsustainable foreign currency debt service.

Local currency frontier SSA debt markets have also generally performed relatively well, albeit not uniformly. Nigeria delivered robust returns (nominally and on an FX-adjusted basis), as yields compressed amid portfolio inflows in Q1 and less regular open market operation (OMO) bill issuance afterwards; the Nigerian naira (NGN) remained well supported until a recent bout of local FX demand. Kenya's regular bonds also generated decent returns as the curve bull-steepened on issuance being skewed to the long end; onshore demand was supported by loose liquidity and infrastructure bonds gained on foreign inflows. So did Uganda's bonds, especially at the longer end of the curve given recent withholding tax changes. Elsewhere in the region, modest compression in Ghana's bond yields has been offset by a weaker currency this year. In Zambia, fixed-income yields have risen to extreme highs (but have stabilised) amid a challenging macro backdrop, tighter liquidity, limited offshore demand and subdued local appetite for duration.

The outlook for local rates in the remainder of H2 could be constrained by richer levels in Nigeria's debt market, especially at the short end of the curve where long-dated bills are trading just above 12% as of late July. The authorities' dilemma is to contain the stock of OMO bills (which has risen substantially in recent years) and to prevent a disorderly move lower in yields, which could trigger profit-taking by foreign investors and eventually result in a sharp back-up in rates. Although special OMO sales targeted at investors (where banks bid on behalf of customers rather than for their own balance sheets) could clear at a yield pick-up to secondary-market levels, such issuance is unlikely to be large enough to reverse recent yield downside. Granted, the recent loan-to-deposit circular (requiring a 60% ratio maintenance by September) could constrain banks' bid for OMO bills in the secondary market (where bills are fungible), but their overall demand will still likely persist. If yields fall further, the risk of a market boom-and-bust could be even greater as large OMO bill maturities will need to be refinanced from September (they will exceed USD 6bn/monthly between December and February). Bonds offer a yield pick-up around 14%, and longer-dated auctions have seen good demand given the bull-steepening of the curve. But any rates volatility at the short end will likely impact bonds, perhaps less in terms of nominal yield moves, but more from a price change standpoint given the duration effect.

In Kenya, regular bonds probably have limited room for further yield downside from expensive levels, barring some catch-up effect in longer tenors (that could still be constrained by supply). Infrastructure bonds also look richer (11.15%/10.85% for the KENIB 38) and cannot realistically gain much. The recent bout of Kenyan shilling (KES) pressure, albeit still contained in a broader EM context, will make further duration-driven returns challenging. Infrastructure bond gains in June were fuelled by portfolio inflows, but foreign investors will likely wait until KES pressure recedes (and perhaps better rates levels emerge) before adding to their positions. Thus, bond carry will likely drive returns in the remainder of 2019. Although a removal or significant amendment of the lending rate cap could pose upside risks to bond yields, it looks unlikely in the short term given the cap's public appeal and parliament's reluctance to accept such changes.

In Uganda, the yield curve has bull flattened significantly after the authorities announced a reduction of the withholding tax for longer dated bonds (from 10Y in the primary market), which attracted strong local and offshore demand at recent auctions. The curve is now effectively flat in 5Y-15Y, which stills implies a pick-up for the 10Y-15Y part on a net yield basis. That said, at these levels, further duration gains may be modest, even if bill yields have less room to compress given their marginal spread to the policy rate. Uganda's liberalised FX market means that investors' and banks' direct involvement in carry in forwards and swaps will likely continue; Ugandan shilling (UGX) resilience should support left-hand-side FX positions, despite subdued implied yields. A weaker USD would have supported the UGX, although it has remained sticky despite expectations of Fed easing; meanwhile, medium-term risks to the UGX may come from a wider current account deficit driven by infrastructure development and its increasing funding via commercial financing sources in recent years.

In Ghana, bond yields have compressed from their Q2 highs, as local demand supported rates and indeed contributed to the oversubscription of auctions, including at the long end, amid contained primary-market issuance sizes. However, bond rates remain robust, with bid yields in 5Y-15Y just shy or 20% in late July. Further bond yield compression and/or curve flattening could prove challenging. Foreign investors remain by far the largest holders of long-dated debt securities (despite some pick-up in local investor participation) and could remain cautious in the post-IMF programme period and ahead of the general election scheduled for late 2020. Their holdings of local bonds have declined gradually since April 2018, but remain large (c.USD 5.1bn, including short-term pledged securities) relative to the liquidity of the fixed-income and FX markets. If bond coupons and redemptions are not mostly rolled over by non-residents, this could anchor elevated bonds yields and periodically weigh on the Ghanaian cedi (GHS), subject to the consistency of Bank of Ghana FX supply. So far the authorities have committed to fiscal discipline and reforms, although a wider than targeted fiscal deficit in H1-2019 could add to perceived risks to policy before the election and may also contribute to bond yield stickiness (or even upside).

Finally, in Zambia, primary and secondary-market fixed income yields are very high (exceeding 30% in some bond tenors), but have stabilised in recent weeks. This reflects limited demand for bonds at auctions (T-bill sales have seen better up-take) and investor concerns about fragile fiscal and public debt fundamentals that have eroded FX reserves. Despite these bottlenecks, the Zambian kwacha (ZMW) has demonstrated surprising resilience in recent weeks (after recouping its May losses), but most foreign fixed-income investors are likely to be wary of an exchange rate catch-up with fundamentals and will stay on the sidelines, despite nominally attractive local yields. For risk perception to turn favourable, more tangible progress towards debt restructuring with China, fiscal consolidation and ultimately a funded IMF programme will likely be needed.

SOUTH AFRICAN RAND: WHAT IS THE POSSIBLE NEW NORMAL?

By **Varushka Singh,** Fixed Income and Currencies Strategist, South Africa

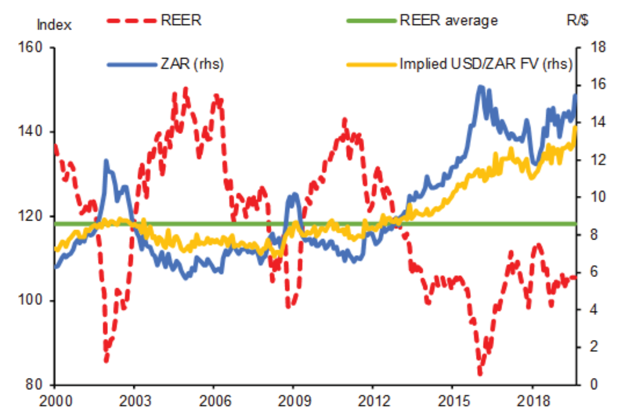
The rand has come up against both global and local challenges over the course of the year. Looking back, uncertainty reigned around South Africa's general elections, which was paired with bad news from rating agencies, a poor first quarter GDP print and continued concerns around the SOEs' funding needs. As if things were not bad enough at home, global factors such as the US-China trade war escalations and the global growth slowdown hit the high beta-currency hard.

Between 23 July and 14 August, USD/ZAR moved from the 13.90 level to 15.40. A R1.50 move based on an influx of both economic and political news presents a question: are current levels above 15.00 the new normal for the exchange rate?

In answering this question, we consider the rand's real effective exchange rate (REER), which is the nominal effective exchange rate adjusted by the effective foreign price ratio. The REER is obtained by weighting the exchange rate between the rand and currencies of South Africa's major trading partners – using each country's share in South Africa's total foreign trade as weights.

If we use the long-term REER average starting from 2000 to infer strength or weakness, we find that the currency is 10.7% undervalued. When using the post-GFC (global financial crisis) REER average of 112.6, the rate is 6.3% undervalued (Figure 1). Applying both these levels of undervaluation to the exchange rate 15.42 (end of day figure for 14 August), the implied USD/ZAR fair value is 13.76 using the REER's long-term average and 14.44 using the post-GFC average.

Figure 1: REER vs. long-term average and implied fair value



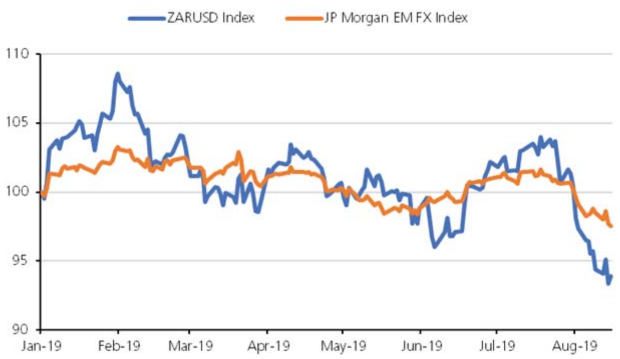
Source: Bloomberg, RMB Global Markets (data as at 14 August 2019)

Even though these values point in the direction of rand appreciation, rand volatility cannot be disregarded.

What characterises the rand?

The rand forms part of the emerging markets currency complex. It makes sense then to compare it to its peers to find clues as to whether it is being steered predominantly by global or local factors. When looking at JP Morgan's EM currency Index over the course of this year, we see that the rand has underperformed significantly (Figure 2). You could argue that the catalyst for weakness has been a combination of global and domestic factors. Yet, the extent of depreciation suggests that the underperformance experienced relative to the EM basket can be explained by more than just the ongoing trade war and global growth slowdown, and has been exaggerated by local factors such as weak economic data and challenges to structural reform. This could explain why the rand has broken through a number of resistance levels (Figure 3) this year resulting in the growing likelihood of USD/ZAR15.00 becoming the new normal.

Figure 2: Inverted exchange rate vs. JP Morgan's EM currency Index (indexed: Jan-2019 = 100)



Source: Bloomberg, RMB Global Markets (data as at 14 August 2019)

Figure 3: USDZAR movement over 2019 year-to-date

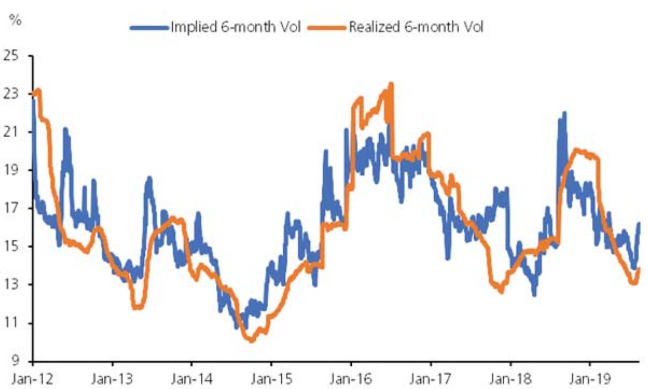
Source: Bloomberg, RMB Global Markets (data as at 14 August 2019)

Rand volatility cannot be overlooked

The rand is a high-beta currency, therefore it is an important exercise to analyse the currency's volatility. Realised volatility (the actual movement in USD/ZAR over a specific past period) tends to track the implied volatility (current market price for volatility) quite closely. Since 13 August, higher realised 6-month volatility was recorded (Figure 4). After trending lower at the start of 2019, the 6-month implied volatility began to rise at the start of August. This infers that the market expects the exchange rate's volatility to increase further. In many cases, the rand's volatility when it depreciates tends to be higher than when it strengthens.

This is best represented if we take the rand's daily moves since the start of 2014 and look at the annualised standard deviation for all points highlighting rand weakness and all the points showing rand strength. The annualised standard deviation for the currency's weakness was more than that of rand appreciation, which confirms that volatility is greater when the rand is depreciating.

Figure 4: USD/ZAR implied 6-month at the money volatility vs. USD/ZAR 6-month realized volatility



Source: Bloomberg, RMB Global Markets (data as at 14 August 2019)

A possible new normal

Even if the local currency possibly steps up to a new normal above 15.00 (Figure 5), we should be mindful that the volatile currency can move below this level during periods of risk-on. A likely trading range over the next six months is 14.20-15.50 – bearing in mind that spikes and slight breaches of these bounds are a given with normalisation within the bounds occurring relatively quickly. We expect the rand to end 2019 at 15.00. Despite the expectation of sizeable moves, we believe the balance of risks and the skew in rand movements will be to the upper-end of the range.

Strength will, however, be hard won with myriad local factors to contend with. Eskom's funding woes and pressure on the fiscus remain concerns. Moody's will decide the sovereign's fate in November and, although a downgrade to sub-investment grade may already be priced in, spikes on the back of actual event outcomes are to be expected. Over the next six months, the global environment will play a significant role in steering the rand. Persistent uncertainty over trade tensions and expectations of further global monetary policy easing in response to slowing growth will be the main factors swaying the risk environment.

Figure 5: USD/ZAR since the start of 2014

Source: Bloomberg, RMB Global Markets (data as at 14 August 2019)

Contributor's Profile:

Varushka Singh is a Fixed Income and Currencies Strategist and is part of RMB's Global Markets Research team. She has been a research analyst for 7 years. During this time the asset classes she has covered include currencies, corporate credit and fixed income; servicing institutional clients in South Africa, US and Europe. She holds an Honours degree in Advanced Mathematics of Finance from the University of the Witwatersrand and a BSc degree in Actuarial Science from the University of KwaZulu-Natal.

01. The article was written on 14 August and the data reflects as at that date.

NIGERIA

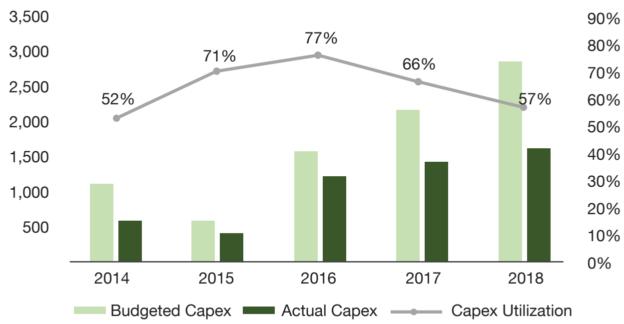
By **Vetiva** Capital Management Limited Nigeria Research Team

SECOND-HALF OF 2019 OUTLOOK FEEBLE FEET ON THORNY GROUNDS

Expanding budgets not equivalent to an expansionary fiscal policy

In a bid to resuscitate the economy, the Nigerian government has enacted larger budgets every year for the past few years, with budgeted government expenditure rising from N5.1 trillion in 2015 to as high as N9.1 trillion in 2018. Though growth in budgeted spending has been skewed in favour of capital investments in the period (125% growth in CAPEX vs 81% growth in Recurrent spending), actual spending has not reflected this given sustained inconsistent CAPEX implementation; average CAPEX implementation at 65% vs 94% for recurrent spend in the past four years. Thus, we believe the impact of overall fiscal policy in the past years has delivered limited economic stimulus and possibly only had a stronger impact on worsening the nation's fiscal imbalances and financial fragility. More so, consistent lags in fiscal decisions (budgets passed an average 6-months forward) and implementation (capex disbursements typically inconsistent plus weak execution) have contributed to the reduced impact of increased government investment. Notably, despite the N2.87 trillion budgeted capex spend in 2018, the President's budget speech revealed that a total of N820 billion had been released for capex as of December 2018 (6 months following budget passage in June 2018). Given that Q1'19 was overrun by political activities, we believe fiscal slippage would have persisted, with very low capex implementation levels for the 2018 budget. Though expedient, we believe the lack of complementary loose monetary policy for most of the past few years as well as the Government's concurrent push to raise taxes (excise duties) may have contributed to delivering a

Weak capex implementation trails expansionary budgets



Source: Budget Office, Vetiva Research

weaker fiscal stimulus package, possibly widening the output gap in certain parts of the economy.

Nigeria's fiscal realities remain dire

With the trend in higher government spending in the past few years delivering limited economic benefits but successfully weakening Nigeria's fiscal position, the government's fiscal strategy in the coming years is highly critical to navigate the thorny terrain. Notably, while higher than budgeted oil prices will support oil revenues in 2019, this remains insufficient in offsetting the underperformance in budgeted oil production. Though Nigeria's drive to diversify revenue sources has seen the FG budget higher Non-oil revenues every year, actual performance shows only a modest ramp-up in non-oil revenues amid sustained weakness in tax revenue. Meanwhile, Nigeria's recurrent expenditure continues to rise at a faster pace than capex, with the disparity expected to widen following the higher minimum wage implementation. Overall, given that high debt servicing costs is a key risk to Nigeria's debt sustainability, managing Nigeria's feeble fiscal structure remains paramount to ensuring stability.

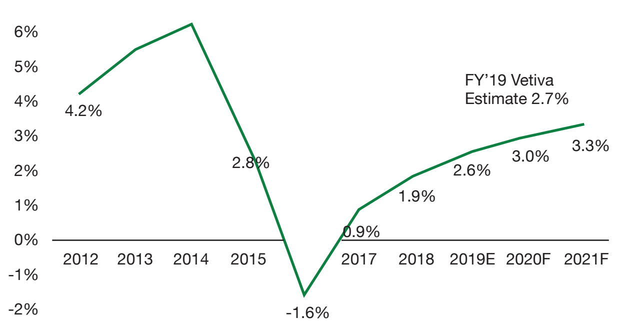
Low-single digit growth only likely reality in mid-term

Nigeria's core economic growth remains weak and below potential in 2019, with first quarter GDP figures showing a 1.9% y/y growth (2018: 1.9%), below Consensus estimate of 2.5%. While the postponement of general elections led to sizable disruptions to business activity, the subdued growth pace continues to reflect lack of sufficient fiscal and private investment to jumpstart the economy following the 2016 recession. Though reduced inflationary pressures and stable foreign exchange conditions will continue to support dovish monetary conditions for the rest of 2019, sufficient complimentary fiscal support is unlikely until the final quarter of the year amid sustained lags in budgeted capex spending. While we expect the aforementioned factors to keep growth in the non-oil sector subdued, given our revised expectation of a strong performance from the oil sector (supported by a rise in oil production y/y), we maintain our growth forecast of 2.7% y/y GDP growth rate for 2019 (Bloomberg Consensus: 2.6%, 2019 Budget: 3.0%, World Bank: 2.1%). Growth trajectory for Nigeria in the medium-term is dampened by a lack of drivers for real structural adjustment. Specifically, the absence of concrete policy direction on key issues that make Nigeria's business environment challenging, as well as the concerted will to carry out major reforms outlined in the Economic Recovery & Growth Plan support our dismal outlook. This, coupled with a vulnerable foreign exchange system, will continue to keep much needed foreign direct investments required to spur new capacity at bay in the medium term. Consensus analysts project growth of 3.0% and 3.3% in 2020 and 2021 respectively – both below previous 5-year average growth rate of 5.0% pre-oil slump.

Fixed income to persist as investors' toast

In H1'19, foreign portfolio investments favoured

Tamed growth forecasts for Nigeria in medium term



Source: NBS, Bloomberg, Vetiva Research

Nigeria's the fixed income market, with apathy for Nigerian equities due to the less than impressive economic growth outlook. That said, yields likely to moderate further in H2'19 Initial expectations of an advancement in yields in the fixed income market were subdued in H1, with benchmark bond yields declining 82bps, while T-bills yields declined 293bps in Q1'19. This was mainly as a result of increased interest from investors, both local and international, who sought an exit from the poorly performing equity market, but still wanted to maintain exposure to the Nigerian market, and thus shifted focus to the more stable fixed income market. Another reason for this was the dovish stance by the U.S. Fed, a departure from the hawkish rhetoric observed at the end of 2018, as weak economic growth and weaker than expected inflation put paid to the apex bank's plans for further rate hikes in 2019. Notably, demand strengthened across both Treasury Bills and Bonds, with DMO auctions seeing oversubscriptions by c.N300 billion in Q1'19 (Compared to oversubscriptions of c.N207 billion in the final quarter of 2018), while the T-bills space also saw significant demand (PMAs in Q1'19 were oversubscribed by a total of c.N1.7 trillion). Overall, we expect a 25 to 50bps moderation in yields in the third quarter, driven by increased FPI flows and stable government borrowing on the back of dovish global policies. However, we foresee room for an uptick in yields in Q4'19, due to increased inflation, bringing FY'19 yield movement to -25bps.

Shock MPC decision in line with lowered yields

Yields moderated following the unexpected decision of the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) to cut the Monetary Policy Rate (MPR) by 50bps to 13.50% in March. This decision was majorly reflecting already lower secondary market rate, moderating inflation rates and fairly positive economic activity, stable crude revenue, and the slowdown in policy normalization by the U.S. Fed and ECB. These factors have continued to set yields on a generally downward trend. We believe there is weaker potential for lower yields to trigger a market sell in H2'19. Notably portfolio flows have remained strong through most of Q1'19 (FPI inflows stood at $7.75 billion as at end of March, up 65.6% y/y from the same period in 2018 ($4.68 billion), especially since the Fed (and later the ECB and BOE) signalled a pause to its planned policy normalization program, at least until the end of 2019. As such, we expect this dynamic to put downward pressure on bond yields in the second half of the year, driven by stable, albeit lower bond supply.

Deficit financing still the main driver of supply

Government expenditure is expected to increase further in H2'19 following the passage of the budget, currently set at ₦8.83 trillion, with a planned fiscal deficit of ₦1.9 trillion to be majorly funded by domestic and foreign debt. Added to this, the recent passage of the new national minimum wage bill will have a significant effect on recurrent expenditure, already high at 60% of federal revenue. We expect that the implementation of the new wage, which could drive higher-than-budgeted recurrent expenditure, will spur further borrowing by the executive in order to meet the ever-increasing costs amidst sticky revenue levels. While the government has indicated an interest in rebalancing the nation's debt portfolio to a 50:50 split (N1.6 trillion in new debt) between foreign and domestic debts, the issue of a new round of Eurobond debt would require Senate approval, although not a deterrent, it could be a cause for slight delay.

HOW INTEREST RATE CAPS SHAPED KENYA'S DOMESTIC DEBT MARKET

By **Renaldo D'Souza**, Head of Research, Sterling Capital Limited Kenya

Kenya's public debt stood at KES.5.8Trillion equivalent to US$56Billion as at the end of June 2019 the end of the 2018/19 fiscal year. Of this, US$29Bn or 52% is external debt compounded by the successful issuance of the US$2.1Bn sovereign issue in May 2019.

Kenya's public debt has risen rapidly in recent years, from US$17.3Bn in 2013 to current levels a trend attributable to multiple factors including a significant increase in infrastructure spending and allocation to county Governments following the promulgation of a new system of Government in 2010. The development of the US$3.6Bn Standard Gauge Railway (SGR) is the single biggest infrastructure project in the country, an expenditure item that is as costly as much as it is divisive in terms of its return on investment.

Government expenditure continues to grow at a faster pace than its revenue resulting in an ever growing budget deficit and by extension overall public debt. While the Government has looked for alternative ways to finance this deficit including external borrowing through commercial loans and sovereign debt, domestic financing remains the main source of budget deficit financing.

Interest rate caps were introduced in September 2016, a move by Members of Parliament meant to "protect the Kenyan borrower" from exploitation by financial institutions regulated by the Central Bank of Kenya (CBK). According to the new legislation, the maximum allowable lending rate would be 4% above the Central Bank Rate (CBR) while the minimum interest rate on customer deposits would be at least 70% of the CBR. This meant that the highest allowable interest rate at the time would be 13.5% while the lowest deposit rate would be 6.35%.

The new legislation has far reaching implications to the country's financial sector, largely affecting the banking sector's profitability and operations, public debt and overall economic growth. In this case we focus solely on the impact of interest rate caps on public debt and specifically the domestic debt market.

One of the most evident impacts of the introduction of interest rate caps was a decline in commercial bank credit to the private sector in favour of investment in Government securities. Private Sector credit growth averaged 2.3% in 2017 the first full year of interest rate caps compared to 20.2% and 9.4% in 2015 and 2016 respectively. In contrast net credit growth to the Government increased to 19% in 2017 from 7.8% the previous year.

The impact of this crowding out effect is clear not only from the private sector credit growth statistics but also on economic growth statistics. Kenya recorded a Gross Domestic Product (GDP) growth rate of 4.9% in 2017, the lowest in five years. This was partially attributed to a decline in private sector credit which in turn adversely impacted both private investment and consumption.

To understand bank investment strategy I draw attention to two factors, risk and return. With regards to return I refer to lower interest margins while in risk I refer to deteriorating asset quality. Interest rate margins in Kenya (the difference between the lending and deposit rates) were amongst the highest in the continent prior to the introduction of interest rate caps. The interest rate margin averaged 9.2% and 9.5% in 2016 and 2017 respectively before declining to 6.1% and 5.2% in 2017 and 2018 respectively following the introduction of the interest capping law.

Not only were interest margins affected but also asset quality with banks recording an increase in Non-Performing Loans (NPLs) especially amongst SMEs that relied heavily on bank credit for operating capital and additional investment. As if this was not enough, a prolonged electioneering period and adverse weather conditions worsened an already bad situation. The average NPL for commercial banks moved from 6% in 2015 to 8.4%, 10.1% and 12.1% in 2016, 2017 and 2018 respectively.

Average commercial bank liquidity averaged 38.7%, 38.6% and 41.1% in 2014, 2015 and 2016 respectively, this prior to the introduction of interest rate caps. This rose to 45.2%, 47.4% and 50.3% in 2017, 2018 and the first half of 2019 respectively, evidence of rising liquidity. This rise contrasted with private sector credit during the period meaning that while customer bank deposits were rising, most of this was not turned into loans and advances but channeled towards investment in Government securities.

Kenya's domestic debt market is dominated by few players with commercial banks holding 54% of total issued domestic debt. Pension funds are the second largest holders of domestic debt with 28% of total outstanding domestic debt. Domestic debt holding statistics are unlikely to change in the near future as the debt market remains highly skewed towards the investor segments that hold the most capital.

While commercial banks prefer to hold short and medium term securities, two to ten years, pension funds and insurance companies prefer to hold longer dated securities (fifteen to twenty five years) that match the tenor of their clients' policies or investor mandates.

The introduction of interest rate caps have created a dilemma for the issuer the CBK as one of its mandates is ensuring that public debt remains within manageable levels by increasing its maturity profile. That is although there is high appetite for Government debt, the biggest purchasers of this debt have a preference for shorter dated investment securities. The uncertainty regarding the interest rate capping law's legality as mentioned by the high court in March 2019 hasn't helped reduce investor anxiety as to the next direction of domestic interest rates that are currently at six year lows.

The Government is arguably the biggest beneficiary of interest rate caps in terms of access to low cost budget deficit financing even in the face of revenue numbers that continue to consistently fall below set targets.

Ultimately, the question at the back of every Kenyan's mind is how sustainable is Kenya's public debt. Is the country borrowing too much? Is it borrowing for the right purposes? Is the borrowing translating to increased economic activity, wealth generation and increased revenue?

The answers to these questions remain inconclusive. On the basis of numbers alone (Debt to GDP I particular at 58%), the country remains well within debt sustainability thresholds set by the International Monetary Fund (IMF) or the National Treasury. However, the increasing proportion of the country's revenue allocated towards debt service and the very nature of the capital investments many of which have questionable return on investments of longer than acceptable payback periods will be of great concern.

Today, Kenya's debt is more than three times it was 7 years ago. GDP has grown at a slower pace. Interest rate caps have reduced the average cost of domestic debt but the aggregate cost of debt has risen. With no end in sight to the interest rate debate we are left to wonder whether we are approaching a level low enough to change the tide towards private sector lending or will bank remain true to their preference for risk aversion.

Contributor's Profile

Renaldo D'Souza is the Head of research at Sterling Capital Limited. Renaldo has 10 years' experience in the financial services sector having worked in different companies and capacities during the period.

He began his career as a research and investment analyst with on offshore investment advisory company before moving to Genghis Capital a local stockbrokerage house covering local capital markets rising to the position of Head of Research.

Renaldo also has experience in investment advisory having worked in Wealth Management at Standard Chartered and commercial banking at Chase Bank Kenya Ltd. He has great interest in fixed income research and analysis with a bias to African debt markets. He joined Sterling Capital Limited where he heads the research department which also covers equities and macro-economic research.

Renaldo holds Master of Business Administration (MBA) - Strategic Management & Bachelor of Commerce post and undergraduate degrees respectively from the Catholic University of Eastern Africa.

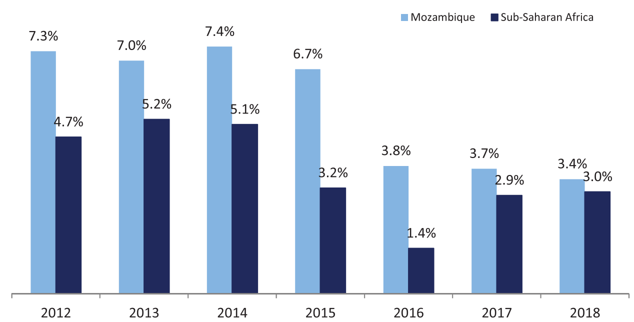
MOZAMBIQUE: MACROECONOMIC PERFORMANCE AND PROSPECTS

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

Review of 2018

The Mozambican economy slowed to 3.4% in 2018 from a real GDP growth rate of 3.75% in the previous two years and an annual average of about 6% in the previous decade. This was mainly due to a weaker expansion in the mining industry (10.7% from 32.1% in the previous year), which nevertheless remained the fastest growing sector. Data from the National Statistics Institute (INE) also showed that agriculture (by far the largest sector of the economy representing just over a fifth of the country's GDP) advanced by 3.1% in the period (from 4.0% in 2017). Despite the deceleration in economic activity, the country continued to outperform the average of 3.0% for Sub-Saharan Africa, as the region struggled to recoup from a prolonged deceleration in recent years.

Real GDP Growth (2012-18)



Sources: INE and IMF.

Data from INE also showed that average consumer price inflation declined to 3.91%. This is the lowest figure since end-2015 and compares with 15.1% in the previous year. Prices for the majority of product classes saw very modest increases while the cost of food items and non-alcoholic drinks, which is the largest product class of the consumer price index, remained unchanged from 2017. Lower inflation allowed the Banco de Moçambique, the central bank, to continue easing monetary policy. The reference lending rate (FPC) was cut three times during the year for a total of 325 basis points (bps) (to 17.25%) while the interbank reference lending rate (MIMO) dropped 525bps (to 14.25%) in four rate cuts.

Meanwhile, the country's current account deficit widened significantly to 30.2% of GDP from 20.5% in the previous year. This deterioration was mainly due to a higher deficit in the services and trade balances, with the latter nearly doubling in the period. More positively, foreign direct investment (FDI) in the country saw a sharp recovery when compared with recent years. This was particularly felt in the last three months of 2018 after a recovery in FDI levels in the extractive industry (coal, oil, gas and minerals).

Other central bank data showed that net international reserves stabilized after seeing some downward pressure and volatility for most of 2016-17. Although net reserves were down 7% YoY at US$ 2,844 million in December, they recovered nearly 65% from the levels recorded in end-2016. Gross reserves stood at US$ 3,041 million, enough to cover almost six months of imports of goods and services (excluding those of large projects).

On the fiscal front, the budget execution showed that the government reached a deficit of 6.5% of GDP after grants. This is better than the deficit expected in the budget proposal (7.3%), but materially higher than the 2.2% recorded in 2017.

Recent Performance and Prospects

Economic activity remained relatively subdued in the first three months of 2019. Real GDP growth stood at 2.5% YoY after the mining sector continued to see a sharp slowdown from its recent impressive performance. This mainly reflected the dual impact from a drop in coal prices in international markets and the heavy rains in the centre region of the country (before cyclone Idai) that hurt coal production. Adverse weather conditions also impacted the performance of the electricity and water sector as well as transport and communications while agriculture recorded a modest deceleration. On the other hand, manufacturing and construction showed some signs of recovery, namely the latter, as it had witnessed a contraction in the previous three quarters. All in all, real GDP growth for the 12-months ending in March 2019 stood at 3.1% (down from 3.4% in 2018).

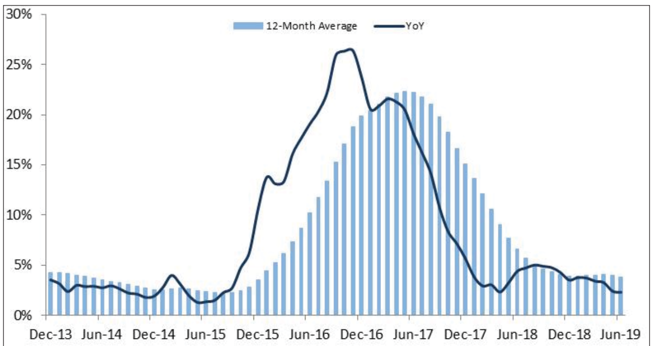
REAL GDP GROWTH (YoY)			
SECTORS	**1Q 2018**	**4Q 2018**	**1Q 2019**
Agriculture, Livestock	3.3%	2.7%	2.6%
Fishery	6.4%	1.0%	3.8%
Mining Industry	7.7%	15.2%	2.0%
Manufacturing Industry	2.1%	0.0%	2.9%
Electricity and Water	-2.4%	0.6%	-7.1%
Construction	2.8%	-1.1%	1.2%
Retail and Services	0.2%	1.4%	2.6%
Hotels and Restaurants	4.4%	7.0%	1.1%
Transports and Communications	5.0%	7.2%	3.3%
Financial Services	2.2%	5.6%	2.7%
Public Admin. Education and Health	5.2%	3.3%	1.5%
Others	4.5%	4.7%	4.9%
Total	**3.7%**	**3.0%**	**2.5%**

Source: INE.

More recently, the economic climate index saw a slight recovery in April and May after a sharp fall in the previous month due to cyclone Idai. This was particularly reflected in the industrial production and construction sectors, which came in line with the performance recorded earlier in the year. It is worth noting, nevertheless, that confidence levels remained below the levels witnessed in the months prior to the latest climatic shocks that took place in Mozambique. As a result, it is highly likely that economic growth continued to slow in the second quarter.

Average inflation remained at close to 4% in the first half of 2019, with inflation standing at just 2.3% YoY in June. The recent inflation performance reflects (1) a relatively stable metical exchange rate against the currencies of the country's main trading partners, (2) a downward revision in administered fuel prices in April and (3) an increase in the supply of domestic agricultural products. This allowed the central bank to cut interest rates further in June, lowering the FPC and the MIMO by 100bps to 16.25% and 13.25%, respectively.

Consumer Price Inflation



Source: INE.

All in all, the Mozambican economy is expected to lose momentum this year due to the devastating impact of Cyclones Idai and Kenneth which struck in March and April. Real GDP growth is forecasted to remain at 1-2% (at best) this year and recover to a level above 5% in 2020. As a result, and with inflation risks likely to remain contained (and in single-digits this year and next), there is likely to be room for further monetary policy easing going forward. Meanwhile, the country's fiscal and current account deficits are likely to widen further due to the reconstruction costs from the storms. The government estimates these costs could amount to US$ 1.5 billion (roughly 10% of GDP), putting further pressure on the already elevated public debt burden.

The country's medium to long-term prospects will largely depend on three key topics. First, the latest developments on the LNG sector saw U.S. energy giant Anadarko Petroleum recently approving its LNG project worth about US$ 23 billion in Area 1 of the Rovuma basin in the northern part of the country. A similar sized venture has also been approved by the local authorities for another consortium led by Italy's Eni operating in Area 4 of the same Rovuma basin, whose final announcement is expected to happen by the end of the year. These natural gas projects are the largest in Africa and are expected to go into production in about five years' time. They are forecasted to boost the country's economic growth to more than 10% by 2024. Some studies also show that Mozambique could become the world's second largest LNG producer while revenues from this sector could amount to US$ 3 billion annually from 2030 onwards.

Second, the government reached an agreement with private creditors to restructure Mozambique's Eurobond and previously hidden debts. An agreement in principle with a group of Eurobond holders was reached last November, but revisions to this accord were recently made. The most significant change is that income from the LNG projects will no longer be used to pay off part of the hidden debt that was considered illegal. This agreement is particularly relevant since it could help the local authorities put public debt levels on a downward trajectory and assist in normalising relations with the IMF and other development partners.

And third, encouraging steps have been taken by the government and the main opposition party, Renamo, toward durable peace in the country. Indeed, both parties recently signed an agreement aimed at disarming and reintegrating the Renamo party fighters. This is especially important as it comes ahead of the parliamentary and presidential elections in October.

UGANDAN MACROECONOMIC FUNDAMENTALS AND PROSPECTS

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

Uganda's growth, as in most East African economies has been strong over the last two financial years (FYs) with positive prospects. Growth has been supported largely by increased public expenditure on physical infrastructure over the past five years. Notwithstanding the high growth rates, inflation also remains low in Uganda reflecting the prudent monetary policies but also that the growth stimulus from public investments which are financed by foreign borrowing. Private sector consumption has now started to pick up supported by growth in private sector credit. Exchange rates have been stable and the level of foreign exchange reserves remains at adequate levels of above 4.5 months of import cover. The article[1] will critically review Uganda's macroeconomic fundamentals and the prospects thereof.

Economic activity in Uganda remains strong estimated at 6.2 percent and 6.1 percent in 20017/8 and 208/19, respectively. Over the past five years the economy has grown on average, by 5.2 percent supported largely by growth in the services and agricultural sectors which hold shares of 51.9 and 21.4 percent of Gross Domestic Product (GDP), respectively. Productivity of the Agricultural Sector rebounded two years ago following prolonged drought conditions in 2016/17. Growth in the industrial sector has largely been supported by private and public sector investment in construction as well as the newly commissioned industries for manufacturing.

Inflation has remained low and stable, and within Bank of Uganda's (BOU) medium-term target of 5 percent. In the 5 years to June 2019, headline and core inflation averaged 4.7 percent and 4.6 percent, respectively. Subdued inflationary pressures have been on account of BoU's ability to balance the inflation objective while supporting economic growth declining food crops prices following good harvests due to favourable weather conditions. Low global oil prices have also contributed to subdued inflation. The outlook is for inflation to stabilise around the 5 percent target in the medium term. However, there are risks to the inflation forecast including the possibility of a more depreciated exchange rate given the possibility of heightened volatility in the global financial markets resulting from further escalation of trade disputes and uncertainty surrounding Brexit. In a small open economy like Uganda, the pass-through of the exchange rate to inflation is usually very strong and therefore exchange rate depreciation is inflationary. Inflation may also rise if adverse weather conditions materialise, food prices would rise much faster than predicted.

Furthermore, there are several risks as the political election cycle approaches. On the downside, the softening momentum in global growth resulting from escalation of trade disputes could weaken the global economy and lead to a decline demand for oil and other commodities. Consequently, this could lead to lower imported inflation and external demand, a combination of which would result in lower than projected inflation.

In line with low inflation projections the BOU pursued an accommodative monetary policy stance to support economic growth. BoU is committed to maintaining low and stable inflation and continues to assess economic developments to inform the monetary policy setting.

Interest rates have evolved in line with the BOU's monetary policy stance. Short term money markets rates and yields on Government securities strongly reflect the monetary policy stance. However, there are periods when news on changing financing needs by the government has led to volatility in inter yields on government securities. Commercial bank lending interest rates have also declined in line with the accommodative monetary policy stance since April 2016. The lending interest rate on local currency denominated loans declined to 19.0 in June 2019 from 24.5 percent in May 2016.

Private sector credit extension has been relatively strong, with an average annual growth of 14.3 percent in the quarter to June 2019 reflecting

1. The article contains excerpts from the June 2019, Sate of the Economy Report by Bank of Uganda,

recovery in economic activity. Credit growth is evident across the major sectors of the economy with, a rebound specifically, in the lending to manufacturing and building, mortgage& real estate sectors. Growth in lending may also be attributed to continued, improvement in asset quality and relatively lower interest rates. Cognisant of the adverse impact that financing the fiscal deficit domestically could have on private sector credit extension, the Government of Uganda capped its net issuance of government securities in a given Financial Year (FY) at about 2 percentage points of GDP. This cap should allow commercial banks to lend to the private sector and to Government as well.

Fiscal policy is anticipated to be expansionary in FY 2019/20 and over the next few years as government continues to implement physical infrastructural projects. The fiscal deficit in FY2019/20 is estimated at 8.7 percent of GDP on account of spending on infrastructure projects such as oil and tourism roads, the National Airline and power transmission lines. The deficit will be financed largely through external borrowing, and to a lesser extent through domestic borrowing. Government is also enhancing its tax efforts through tax administration measures. As such, the projected tax to GDP ratio is estimated at 15.4 percent of GDP in FY2019/20 a higher than the 14.1 percent in FY 2018/19. Moreover a larger percentage of the fiscal deficit is financed through external sources.

Like in most of the SSA countries, public debt in Uganda has been on a rapid increase. Total Public debt in is projected to increase to 45.7 percent of GDP in FY 2019/20, and to continue rising until the major infrastructure projects are completed. The recent Debt Sustainability Analysis (DSA) indicates that Uganda's debt is sustainable over the medium and long term on the assumption that: infrastructure investments yield the envisaged growth dividend; domestic tax revenue collection improves by ½ percent of GDP per year over the next five years; and oil exports commence. However, uncertainties loom large specifically on likely additional spending pressures, contingent liabilities, or even a growth shock that could push public debt above the debt ceiling of 50 percent of GDP in net present value terms.

Uganda's external position continues to weaken especially given the continued deterioration in the current account deficit due to stronger domestic demand. The worsening of the current account deficit was on account of imports rising faster than exports. Indeed, increases in both private sector and public sector imports for investment have been report. A further breakdown indicates that imports of intermediary and capital goods are rising faster, a factor that could contribute to more sustainable growth. The surplus on the financial account has improved supported by higher foreign direct investment (FDI) inflows, as well as loans to government. With the financial account financing the current account, the balance of payments remains a surplus and thus a build-up in International reserves. International reserves now stand at 4.1 months of import of good and services cover and the exchange rate remains stable, appreciating by about 1 percent on year on year basis.

Overall, prospects for the economic growth in the near term to medium term are strong. Growth is projected to remain above 6 percent over the medium term, supported by: strengthening private sector activity, in part driven by growth in private sector credit growth in line with the accommodative monetary policy; public investment in infrastructure; higher agricultural output due to favourable weather and government efforts in improving agriculture; pick-up in activity in the extractive industry; improved regional security specifically in South Sudan and the Democratic Republic of Congo (DRC) which could boost Uganda's exports as well as commencement of oil exports.

However, there are downside risks to the outlook, including: widening fiscal deficits and associated debt financing risks; persistently high non-performing loans in agricultural sector which have potential to curtail further investment in the sector; Weather conditions and climate change risks to agricultural output; the regional security situation; rising global trade tensions which could weigh on growth and put pressure on the exchange rate as well as further delays in the start of oil production.

"Growth has been supported largely by increased public expenditure on physical infrastructure over the past five years."

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

STUART CULVERHOUSE
Head of Macro and Fixed Income Research at Exotix

JOHN ASHBOURNE
African Economist at the Capital Economics

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

JOHN ASHBOURNE: There are three key factors driving the current pessimistic attitude towards emerging markets.

First, the escalating trade war between Washington and Beijing has increased risk-off sentiment and caused financial conditions in some economies to tighten. And while US tariffs might eventually cause firms to move some production from China to elsewhere in Asia, in the short term reduced confidence and investment has hurt manufacturing economies like Korea and Taiwan.

Second, evidence is building that key global economies are faltering. Growth in China is continuing to slow as the economy gradually reduces its reliance on unsustainable levels of investment. And recent figures show that the economies of Germany and the UK both contracted in Q2. A disorganised Brexit could further disrupt output in Britain and – to a lesser extent – elsewhere in the EU. Slower growth, or outright recessions, in key economies will depress demand for EM exports, and push down key commodity prices. (Other than gold.)

Third, recent shocks in several EMs are adding to pessimism. Argentina's recent primary election, for instance, increased the chance of a debt default and caused markets there to plummet. The escalating crisis at South Africa's Eskom has also rattled the rand. Given the worsening global backdrop, these crises are scaring already sceptical investors.

STUART CULVERHOUSE: Current bearish sentiment towards emerging markets is being driven by weaker global growth and concerns over the ongoing US-China trade war. The US-China trade war has hit business and consumer confidence, investment decisions and disrupted global supply chains and while some third countries may benefit from trade displacement, the overall impact on the global economy is negative. Weaker global growth has prompted looser monetary conditions, especially in the US, amid recession fears, but so far the negative growth impact has outweighed the benefit of additional central bank liquidity, while prospects for any near-term resolution of the trade war have diminished.

***CAPMARKETSAFRICA:** How does it impacts African economic outlook and which African countries will be losers or gainers?*

STUART CULVERHOUSE: While the direct trade channel is weaker in Africa than in other regions, we think African countries have been hit by three main channels. First, a weaker outlook for global growth means lower demand and hence lower commodity prices, especially for key commodities such as oil and copper which are highly correlated with the global economic cycle. Lower commodity prices mean lower export and government revenues for many commodity-dependent African countries, which could put pressure on the current account and government budgets. Second, an increase in investor risk aversion because of weaker global growth has led to higher bond yields and increased borrowing costs for African governments and corporate borrowers. Third, the stronger US dollar (benefiting from its safe haven status) has meant weaker African currencies, which may put pressure on official reserves for those defending fixed exchange rates, or it could stoke inflation for those with floating currencies. Oil exporters with fixed exchange rates, such as Nigeria, Angola, and Gabon, would therefore be amongst the losers in this environment (although the impact will also depend on other factors, what buffers they have, and policy actions), while those that are less dependent on oil imports, or less indebted, may benefit, such as Kenya or Cote d'Ivoire.

JOHN ASHBOURNE: Compared with EMs elsewhere in the world, most African economies are less tightly integrated with global capital markets and supply chains. This is a serious problem during global booms, but it does mean that slowdowns elsewhere in the world have less of an effect on the region.

South Africa is the obvious exception here, it's widely traded currency and large external imbalances leave it highly exposed to shifts in global sentiment. The rand has already weakened sharply – though this was also caused by domestic factors – and the currency will probably continue to weaken. We've pencilled in ZAR16.5/US$ at the end of the year.

Elsewhere, the way that the global slowdown will affect Africa will be via lower commodity prices. This is already weighing on oil exporters, like Nigeria and Angola. But the bigger risk might be to industrial metal exporters, like Zambia and the DRC. Both are already facing very weak growth, while Zambia is struggling to deal with a drought and a worsening public debt crisis.

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

JOHN ASHBOURNE: Zambia is the most exposed. It has large public debts and is facing a series of shocks, including a drought, low copper prices, and disputes between the government and key investors. We've long argued that it faces a choice between an acute debt crisis and an IMF programme.

Elsewhere, problems in Kenya are increasingly worrying. The country borrowed heavily to fund large infrastructure programmes. But with growth now slowing – and key projects facing fiscal problems – the situation is fragile. We still think that an outright crisis will be avoided.

Over the longer run, Nigeria's debt position is unsustainable. The actual debt level is low as a share of GDP, but tax revenues are so small that Abuja already devotes the vast majority of its revenue to servicing debt. The country could face a debt trap at a lower level of aggregate debt than other EMs.

South Africa is in a very different position because most of its debt is in local currency and the government has a much greater ability to raise revenue; there's little worry about it servicing its debts. But persistently slow growth – and the need for further support for Eskom – suggest that the country will eventually lose its last investment grade rating.

STUART CULVERHOUSE: The rise in public debt burdens across many African countries over the past five years has become a cause for concern amongst investors and international financial institutions alike, although those that have borrowed mainly on concessional terms may be seen as perhaps at less risk than those that have relied on commercial borrowing, including international bond issues, which tend to be more expensive. Those countries that have relied on bond issues may be at greater risk of payments problems if they suffer from lower reserves (because of capital outflows or lower export revenues) and/or are unable to refinance bonds when they fall due in a situation of greater investor risk aversion. However, for many new African borrowers, their debt service profiles remain favourable, while investor confidence can be reinforced by maintaining sound macroeconomic policies.

"The US-China trade war has hit business and consumer confidence, investment decisions and disrupted global supply chains."

KENYAN EQUITY MARKET

2019 HALF-YEAR REVIEW AND YEAR-END EXPECTATIONS

By **Sarah Wanga,** Head of Research, AIB Capital Limited Kenya

During the first quarter of 2019, the Kenyan equity market generally trended upwards supported by increased local institutional investor interest. The NASI, NSE 25 and NSE 20 closed the quarter up 12.2%, 10.8%, and 0.4%, respectively. Most of these gains were eroded in the second quarter of the year as local investors shied away from the market while foreign investors remained net sellers. The NSE 20 share index closed the first half of 2019 down 6.5% while the NASI and NSE 25 were up 5.6% and 0.6% respectively.

The market sentiment was negatively affected by unfavorable FY'2018 earnings reported by a number of companies. Consumer demand remained muted as access to credit became a challenge due to the commercial bank's reluctance to lend in the interest rate cap environment. The Insurance, Construction, and Commercial & services sectors were negatively affected as their earnings declined. The banking sector, however, recorded an increase in earnings supported by a rise in non-interest income and lower loan loss provisions.

The Nairobi Securities Exchange (NSE) launched its derivatives market in July 2019, the first in East Africa and the second in Africa, after the Johannesburg Stock Exchange (JSE) in South Africa. Investors will initially be offered an equity index futures and single stock futures targeting five liquid stocks (KCB, Equity, Safaricom, EABL and BAT). The uptake of stocks has been slow but is expected to pick-up as the NSE's investor education efforts continue. Institutional investors haven't been active in this space as several IPSs (Investment policy statements) don't allow the fund managers to invest in derivatives. Many fund managers have already started engaging their clients in a bid to change their IPSs.

Economic growth is expected to slow down to 5.7% in 2019 from a growth of 6.3% in 2018 as growth in the agricultural sector is expected to decline due to unfavourable weather conditions in H1'2019. However, growth in other sectors is likely to increase as the business conditions improve. Private sector credit growth had remained muted since the introduction of interest rate caps in 2016 (average growth of 2.5% in the past 2 years versus a 2 year average of 19% before the introduction of the rate cap) but picked up in January 2019. We mainly attribute this to an increase in the risk-adjusted rate of return. Demand for government paper had remained elevated due to the relatively high-risk free rates. T-bill and bond rates have, however, been declining and are currently at low levels making lending at the current cap rate of 13% attractive.

The Central Bank of Kenya is expected to maintain its accommodative monetary policy stance. Inflation is expected to remain relatively stable during the forecast period, registering a marginal increase in 3Q19. Meanwhile, the shilling is expected to continue to depreciate against the USD. Activity in the local equity market could increase as local investor participation rises. Local institutional investors have previously focused on the fixed income space where yields have remained attractive; however, their attention is likely to shift to the equity market as yields continue to decline. The decline in prices has made valuations attractive. The market is currently trading at a P/E of 11.5X below the historical average of 13.4X. Company earnings are also expected to improve this year.

Currently, foreign investors may be a bit wary of participating in the equities market due to concerns over the exchange rate. The shilling has depreciated against the USD touching a low of 104.2 at the end of July 2019 from a high of 99.6 in March 2019. We attribute this to an increased demand for the dollar due to the current demonetization efforts. The trend is likely to continue until the end of September when commercial banks stop accepting the old notes. The shilling could later appreciate against the dollar as the country's balance of payment position to improve. Exports have increased since the beginning of the year buoyed by an increase in horticultural goods while imports have remained relatively flat. Diaspora remittances have also supported the shilling.

In the equity market, the banking sector is expected to perform well this year as companies report an increase in earnings. The sector had previously been affected by the interest rate caps as companies struggled to operate in a rate cap environment. Several banks had stopped lending to the private sector as they focused on risk-free assets where returns were favourable. As the risk-free rate declines, commercial banks have increased their lending to the private sector.

The banking sector has also witnessed a number of mergers and acquisitions. Kenya Commercial Bank (KCB) has acquired a local bank: National Bank of Kenya (NBK), local banks NIC and CBA merged, while Equity bank is expanding to regional economies following a share swap arrangement to exchange certain banking assets of Atlas Mara Limited in four African countries (Rwanda, Zambia, Tanzania, and Mozambique) for share in Equity Group Holdings. KCB's acquisition of NBK could help the bank lower its cost of funds due to access to NBK's cheap government deposits but profitability ratios could decline in the short run. In the Equity bank transaction, we view the expansion into Rwanda as positive but are concerned about the entry into Zambia and Mozambique and the expansion in Tanzania as Equity's subsidiary in Tanzania is currently making losses and has high NPLs (non-performing loans).

Safaricom, a local telecom company, is also likely to record double-digit growth as M-Pesa continues to be the key driver of growth. Although the M-Pesa is shifting from high margin business which includes transfers and withdrawals, M-Pesa is expected to record double-digit growth as the money remains within the ecosystem and the number of transactions increase. The launch of its new product, Fuliza-an overdraft facility, is likely to revenue as its uptake was quite encouraging.

A slowdown in the real estate sector has affected the performance of the construction sector. Since 2017, both cement consumption and production have declined. A number of cement companies have had to shut down their factories. Bamburi Cement has reported a decline in earnings for two consecutive years.

Contributor's Profile

SARAH WANGA joined AIB Capital in October 2018. She previously worked in the research department of ICEA LION Asset Management. She has over 6 years' experience in equity, fixed income, property, and macroeconomic research. She has a bachelor and master's degree in Economics from the University of Nairobi and is a member of the CFA Institute.

MAURITIUS EQUITY MARKET | 2019 HALF-YEAR REVIEW AND YEAR-END EXPECTATIONS

By **Bhavik Desai,** Head of Research, AXYS Stockbroking Limited Mauritius

At the start of the year we provided our view for 2019, which from a technical perspective suggested – as indicated by our momentum indicator – the Mauritian market was sliding into a “bearish” phase. This has since been confirmed by the Stock Exchange of Mauritius’ (SEM’s) YTD performance. Unfortunately, it is among the worst performing markets of 2019 in USD terms out of over 90 markets tracked by Bloomberg. There were 5 falls for every 3 gains driving the SEMDEX (-2.6%) and ALEX 20 (-2.0%) into negative territory. This poor performance stems directly from domestic macro-conditions, which led to the Mauritian bourse being at its most decorrelated from the MSCI Frontier Markets Index since before the Great Crisis.

At the start of the year we expected non-traditional names to be among the top performers construction companies to fare well given major public infrastructure works being carried out, sugar farmers and millers to experience another difficult year amid the prevailing low prices on the world market, and hoteliers who experienced unexpected headwinds in late 2018 early 2019 to not be able to make up for lost ground. Our expectations have been mostly realised with construction stocks gaining on average ~10% boosted by improved financials, sugar conglomerates and farmers shedding ~16% with a couple of noteworthy exceptions, and with the tourism industry coming off a cyclical peak after two good years were heavily sold off resulting in ~18% losses for every listed hotel running beach resorts. Other major contributors to the bearish sentiment include: SBM (-8%) which continues to suffer from 2018’s exceptionally large impairments; and the fresh amalgamated ENL who experienced selling pressures both on speculative profit taking and the unlocking of previously unlisted shares.

As is typical on the Mauritian Bourse, corporate actions or events have the potential to heavily influence stock price performance. The top performer in 2019 is insurer MEI (+35%) which has been rebranded to “Eagle Insurance” and is the subject to a conditional takeover at Rs122. The 2nd largest company by Market Cap, IBL (+10%) – which owns 60% of MEI and also announced its intent acquire General Construction, one of the largest contractors on the island, to generate synergies with its existing contracting arm (Manser Saxon) – unsurprisingly rallied even peaking at a record high Rs60 intra-day. Similarly sugar conglomerate MEDL (+18%) after announcing its intent to transition from the SEM’s “Development & Enterprise Market” (DEM) to the SEM’s “Official List”. BMHL (+16%) was boosted by a ~$20M rights issue whose proceeds would be used for deleveraging purposes. Among non-traditional top performers, penny stock GOLI recouped one US penny ($0.01) and the Africa Import-Export Bank’s DR (AFREX) which bounced back by 25% after a major exchange of ~6% of total DRs starting in March.

2019 remains a special year because the current Government’s term expires in December which inevitably means that Mauritius is gearing up for General Elections. Investors typically adopt a wait-and-see stance during the run-up to elections, we therefore expect the market to rebound after the inauguration of a new Government in 2020 or late 2019. From a technical perspective, our Momentum Indicator continues to show that we are in a bear-spell, but its current levels suggest that we are more than halfway through the cycle. While we would continue to favour non-cyclical and construction companies in the coming months, we do believe that a select few companies are currently hovering at multi-year lows due to macro-economic circumstances and therefore represent interesting entry points for a medium-term investment.

Contributor’s Profile:
Bhavik Desai is the Head of Research at AXYS Stockbroking Ltd and joined AXYS in early 2010 to drive innovative local equity research and valuations. He has introduced scientific rigour and logic to the process, and will guide you in your investment decision making process. He will also assist you with securities trading. Prior to joining AXYS, Bhavik worked on the implementation and monitoring of corporate strategies at SAP Labs LLC in California. Bhavik holds a Double Bachelors in Arts in Physics and Astrophysics from the University of California, Berkeley.

NIGERIA
EQUITIES MARKET

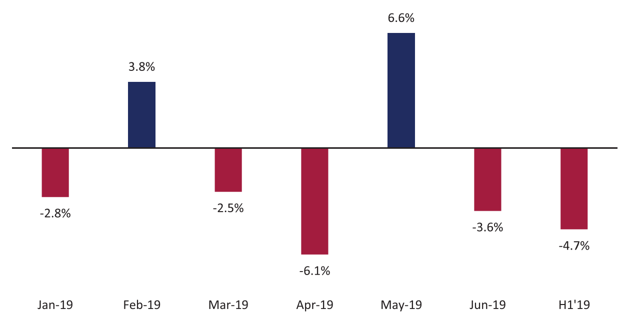
By **CardinalStone** Research Nigeria

CORPORATE ACTIONS MAY FAIL TO STALL ANOTHER EQUITIES SLIDE IN 2019

Pre-election excitement and MTN rally were not enough for Nigerian equities in H1'19

The Nigerian equities market shed 4.7% in H1'19 (vs. +0.1% in H1'18 and -17.8% in FY'18), as investors stayed largely bearish after the pre-election rally in February 2019. Aided by a relative stable currency, the All Share Index (ASI) also recorded a loss of 4.7% (in dollar terms) in H1'19, underperforming African markets such as South Africa (+12.5%), Egypt (+16.0%), and Kenya (+5.3%) as well as the MSCI Emerging (+11.9%) and Frontier Market (+9.2%) indices. Notably, the market experienced an upturn in May (+6.6%) following the listing of MTN Nigeria, but bear sentiments returned in June to force the domestic bourse down by 3.6% despite excitements around other corporate actions and an MSCI re-weighting exercise. The other corporate actions reported in the review period included the release of FY'18 & Q1'19 financial scorecards, the listing of Skyway Aviation Handling Company Plc, the merger of Access and Diamond Banks, the proposed acquisition of Dangote Flour Mills Plc by Olam International Limited, as well as Lafarge Africa's proposed divestment from Lafarge South Africa Holdings (LSAH).

Figure 1: April/May represented the best/worst months for Nigerian equities in H1'19



Source: Bloomberg; CardinalStone Research

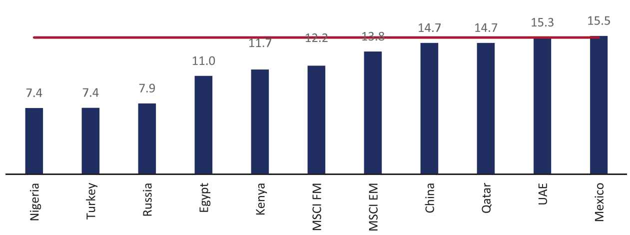
Equity investors continue the oil chase as ASI slumps further into the red zone

In our view, the H1'19 equity market decline mirrored a rebalancing of portfolios from equities to fixed income on mixed inflation outcomes across frontier & emerging markets; as well as weaker than expected earnings of listed companies on fragile economic recovery. In addition to the mentioned, a slowdown in dovish monetary policy implementation in markets developed may have slightly dried up funds available to investors seeking alpha in frontier and emerging markets. On weaker company fundamentals, we note that c.50.0% of our coverage companies reported either a decline in profit after tax or a loss position in Q1'19. Post the election excitement, investors may have also redirected their attention to more fundamental concerns, so much so that even a positive wave of corporate listings failed to prevent the equity market decline of H1'19. As at May 2019, the equities market had recorded a net foreign portfolio outflow of ₦42.8 billion in 2019 (compared to a net outflow of ₦28.6 billion in the corresponding period of 2018).

Nigeria's ASI is likely to continue trading at a greater discount to peers in H2'19

In view of the selloffs, the Nigerian equities market is now trading at a significant discount to emerging and frontier markets, from a price to earnings (PE) standpoint. Specifically, as at end of H1'19, the PE for Nigeria's broad equity index stood at 7.4x compared to MSCI Emerging and Frontier Market averages of 13.8x and 12.2x respectively. This implies that the combined price of the constituents of the ASI was almost 7.4 times the net earnings produced over the past year. That said, as at end of H1'19, the earnings yield of Nigeria's equities market (13.5%) slightly lagged the 14.3% yield on the 10-year NGN bond, suggesting a largely bearish equities market and scope for some stock market selloffs in the future. Such selloffs may force the PE to remain at a discount to peers in H2'19, in our view.

Figure 2: ASI was at a discount to peers from a PE standpoint in H1'19



Source: Bloomberg; CardinalStone Research

All in, we see the following as key factors which are likely to shape the direction of markets in H2'19: 1) The monetary policy orientation in developed markets & MPC reactions; 2) MCSI Review & corporate earnings performance across sectors; 3) The trajectory of crude oil prices; 4) The pace of macro recovery in Nigeria; 5) Likelihood of market stimulating reforms being enacted by the federal authorities.

TUNISIA EQUITY MARKETS

HALF-YEAR 2019: BACK TO A WAIT AND SEE APPROACH

By **Tunisie Valeurs,** Tunisia

H1 2019: The slowdown following last year's euphoria

The Tunisian stock market fell short of expectations during first half of 2019. The stock market showed a general slowdown during the six first months of the year following a remarkable performance in 2018. The two main indexes, the Tunindex and the Tunindex 20, have both known a decrease of 1,7% and 3,2% respectively since the beginning of the year.

Most of this decrease took place during the first quarter of the year (-4,7%). The market was back up since the month of May yet without being able to regain a positive overall performance. The year-to-date (YTD) the stock exchange performance has seen quite some difficulties due to the following reasons: a sharp increase in interest rates, a tough competition of monetary investments, a political chaos due to the approach of the two legislative and presidential electoral meetings as well as a frail economic activity.

The traditional drivers of the market recovery over the last few years have been at a standstill on the first half as big caps like SFBT, Poulina, SAH Lilas, and Delice Holding have recorded mitigated performances, while the banking sector has been penalized despite of satisfactory results in what has become a challenging economic environment.

The market capitalization decreased by 3,2% to 23,6 billion dinars led by the banking sector (an underperformance of 2,2% for the sector index). All the sectorial indexes were down with the exception of the raw materials index, insurance, agri-food and drinks as well as the distribution sector index.

The first six months of 2019 have been similar to the first half of 2018 as far as traded volumes go. Here again, it is the big caps which fell short to expectations. An average daily volume of 6,7 billion dinars has been recorded over the first half of 2019 which is a decrease of 12,6% comparing to the six first months of 2018. The most traded stocks were UNIMED, BT and SFBT. Volumes on these blue chips were enhanced by block market transactions: 115,2mTnd for UNIMED, 60,9mTnd for the BT and 18,6mTnd for the SFBT. The primary market knew a slowdown in fund-raising despite of a strong comeback of capital increases. Indeed, four capital injections have been barely closed or are currently in the course of subscription in the market in order to finance investment programs (Land'Or), clear the balance sheet (SAH Lilas), increase cash and clean up the accounts (BNA), restore its solvability (Tunisie Leasing & factoring and ATL). We also note that no new listing has been planned or announced since the beginning of the year.

The fixed income activity has seen a drastic drop in liquidity. Despite the crucial needs of cash, the leasing companies and banks haven't been active. At the date of writing this note, only two bonds were launched and closed in the first semester of the year for a total amount of 60mTnd against six operations and a total of 152mTnd during the same period of 2018.

The foreign investment reduced were down as the market adopted a selling trend (a flow of c. TND 23m). This selling pressure is due to the deterioration of the economic situation, to the fears about further depreciation of the dinar and to the attraction of competing markets such as Egypt.

Investment schemes knew the launching of 2 new funds promoted by ***Zitouna Bank*** and ***Attijari bank***. Net assets has stalled at TND4 billion due to the below par performance of the stock market, also due to ever more attractive monetary investments and the competition of banks on short maturities.

What to expect by the end of the year?

After a first half marked by a technical correction, Tunindex should be torn between attractive valuations and the lack of economic and political visibility. Fundamentally speaking, our market shows attractive ratios (a P/E 2019e of 9,9x and an average yield of 3,7% estimated for 2019. Comparing with similar markets like the Moroccan market (a P/E 2019e of 19,2x*) allows us to better value our market.

The achievements of the listed companies in 2018 show a surprising resilience of the private sector and the adaptability of their management to the economy. Private companies have globally managed to improve their turnover (a growth of 9,5% of total income with the exception of financial companies in 2018), to preserve their margins, curb the inflationary context and seek for new sources of growth in exporting or by challenging the imports). Their fundamentals have some-how resisted to a tense bank liquidity and to the soaring cost of debt.

Currently, the heavy weights of the market trade at multiples that do not reflect their latent profitability while the banking sector is showing flat valuations (6,2x expected benefits in 2019 and 1x their equity of 2018).

The end of the year is still quite a blur. It will be disturbed by the two electoral meetings and the political dealings. However, we are staying optimistic in the medium term. We think that 2020 could be a year of catching up for several listed companies which had suffered from an exaggerated correction, disconnected from their real fundamentals, their latent profitability and their quality of management.

Which investment strategy to adopt in the months to come?

Stock picking" remains the keyword in this difficult economic environment and stock market context. We favour stocks with strong fundamentals and low risk such as the following:

1) The exporters: The exporting companies will remain the target of investors because of their growth potential outside the borders that they have and the immunity of their margins against the risk of change. Stocks like ***One Tech Holding***, ***TPR*** and ***SOTUVER*** form pillar of our exporting stocks selection.

2) The defensives: The defensive sector will continue to compete successfully in the current gloomy environment. The consumer goods sector (***SFBT*** and ***SAH Lilas***) and the pharmaceutical sector (***UNIMED***) will be the targets of investors.

3) The "cheap" industrials: Our recommendations focus on companies with a leadership position in the local market, with a competitive advantage and

Key figures of Tunis Stock Exchange

	2016	2017	2018	June 2019
Market cap (in billion Dinars)	19.3	21.9	24.4	23.6
In % of GDP	21%	23%	23%	22%
Number of listed companies	79	81	82	82
Foreign investment	24.5%	23.4%	24.9%	25.0%

Source: BVMT and Tunisie Valeurs estimates.

which remain strong in front of the entrance of the competition. Companies like ***SOTIPAPIER*** and ***MPBS*** learnt from the past. They have a good market position and have been able to improve their production tools over the years and through their quality they are able to penetrate the export market and remain at the forefront of local and imported competition.

4) The financial "best in class": The banking stocks suffered from a strong correction since the decision of the central bank to limit loans in accordance to deposits and reduce refinancing. Our current advice is to stay away from this sector. We opt for a "flight to quality" approach because the monetary restrictive policy imposed by the central bank and its prudential measures which prepare the transition to Bâle 3 are naturally reinforcing the selection between the banks. ***UIB*** and ***BIAT*** display discounted valuations, rigorous management and a prudent approach.

Moreover, concerning the financial stocks, we advise the purchase of ***STAR***. The insurer is the best way to be exposed to the listed insurance sector. Its valorization is quite attractive and underestimates the quality of the strong fundamentals of the company and the promising development plan that the new manager wants to set up.

We have decided to remove the "small caps" for reasons of liquidity and yield values due to the current context of high interest rates i.e. ***Cerealis***, ***SAM***, and ***ARTES***. But these stocks remain highly recommended when looking for smaller tickets.

Finally, our stock picks' performance during the beginning of this year have stalled (+1,3%), mainly due to the selling pressure on our main banking stocks (***Attijari Bank, BIAT, UIB***) as well as the below par performance of ***SAH Lilas***.

AFRICAN EQUITY MARKETS SAW MIXED PERFORMANCE IN THE FIRST HALF OF 2019

CAVAN OSBORNE
Portfolio Manager, Old Mutual Investment Group

OLIVER BELL
Lead portfolio Manager/ Frontier Markets Equity Strategy at the T. Rowe

***CAPMARKETSAFRICA:** How would you describe the African equity markets in the first half of 2019 relative to other emerging equity markets?*

OLIVER BELL: African equity markets saw mixed performance in the first half of 2019.

Egypt and Kenya were the key outperformers, both relative to other African markets and versus the broader MSCI Frontier Markets and Emerging Markets indices.

After disappointing returns in 2018, Egypt saw a reversal in the first half of 2019. The annual inflation rate has been slowing in recent months and declined to 8.7% in July, the lowest level since August 2015. Inflation slowed despite fuel subsidy reforms, as directed by the IMF loan program. This increases the likelihood of a continuation in monetary policy easing in coming months, which should provide a boost to investment.

Kenyan stocks performed well against a backdrop of stronger business confidence, a buoyant tourism sector and FDI inflows. On 20th March, the government announced the auctioning of a 25-year infrastructure bond to go towards the funding of major development projects.

The Nigerian market underperformed over the period. President Buhari was re-elected on 23rd February, beating his main rival, Atiku Abubakar, who had a more market-oriented reform agenda. This put a dampener on stocks which rallied before falling post-vote. Oil industry contraction also weighed on the market. The macroeconomic environment remains challenging and we look for a stronger focus on economic progress during President Buhari's second term.

CAVAN OSBORNE: Using the MSCI equity indices as a reference, African equity markets were up 9% in the first half compared, very similar to the 10% gain of the broader global emerging markets. If the dominant South African market is excluded, then the other African markets rose a more modest 6%.

Of course, the aggregate performance hides the often-wide range of performances across countries. The top performing markets in Africa were Kenya, Egypt and the BRVM (which represents many of West Africa's French speaking countries) all advanced more than 10%. Zimbabwe was in also in this group but given that there are repatriation problems the market is largely uninvest able at this time. Egypt remains on its post Arab Spring recovery path, and Kenya is experiencing a modest recovery in the economy as it gets to grips with the interest rate caps imposed in 2016.

All of Zambia, Ghana and Nigeria fell during the six months. In the case of Zambia and Ghana weaker currencies further pressured the outcome. The Nigerian economy hasn't seemed to have recovered from the oil price lows of 2016. At the same time, there has been political paralysis, so the government has not been driving any growth through public spending. The Zambian economy is over indebted, the government's behaviour is not encouraging further investment, particularly in the important copper mining sector.

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

OLIVER BELL: Overall, the outlook for African markets remains robust, driven by some of the world's most attractive demographics, rising urbanization and levels of infrastructure investment, and a strong asset base in natural resources. While many emerging markets are undergoing a growth slowdown, many African countries are seeing an improvement following an oil and commodity correction, driven by structural domestic demand. This is translating into strong corporate earnings growth that we believe can be sustained by various businesses in the years ahead.

Following a tough first half of the year, Nigeria offers attractive valuations. The Naira currency is at a more appropriate level, the oil price is recovering alongside better oil production, and the security situation has improved. The economy is emerging from a two-year recession, but fragilities remain. We are focussed on companies which are set to benefit from improved consumer spending, and well-run banks.

In South Africa, our long-term belief is that the election of Cyril Ramaphosa as president marks the end of a decade low of politics and economics in South Africa and the backdrop will improve from here. We are finding value in well-managed franchises with exposure to fast-growing Sub-Saharan economies, in addition to domestically focused staples names. We also like financials, which provide exposure to the country's well-developed banking system and a high beta exposure to economic improvement.

In Egypt, we hope that the more stable political situation and the IMF loans and reform programme, alongside healthy private consumption, will continue to drive economic activity. We seek to hold companies that are well positioned to benefit from the improving macroeconomic backdrop.

CAVAN OSBORNE: Our focus is on those countries which have a stock exchange. Egypt is still experiencing a strong recovery that began around 4 years back. The consumer has taken a hit in the last 3 years following a major currency devaluation and staggered reduction of government subsidies – particular for fuel, and for some food. With the final fuel price adjustment having taking place in mid-2019, we expect the consumer sector to start its recovery. At the same time, interest rates in Egypt are expected to fall, which should drive further investment which will ensure that its growth persists.

Nigeria is also looking interesting, but in the case of Nigeria, its valuation driven. The stock market has come under pressure, and some shares are now offering expected dividend yields in excess of 10%. The underlying economy is not showing remarkable growth as oil prices are no longer at the elevated levels seen a few years back, and at the same time oil production has been very static. The consumer sector is experiencing down trading to cheaper products and it certainly seems like there is elevated competition.

STOCK MARKETS WAITING TO BE DISCOVERED BY THE MAINSTREAM

Africa's political and business elite are young and well educated. Long-term structural growth opportunities are beckoning them. These opportunities are becoming more evident in North and Sub-Sahara Africa, regions that have long been shunned by investors. If the reform efforts witnessed thus far continue, Africa experts expect above-average long-term growth to result, especially in the countries of North Africa and Sub-Saharan Africa. This is particularly true in non-commodity sectors of the economy, for example, in the banking, insurance, telecommunications and construction sectors.

The emerging stock markets in North Africa and Sub-Saharan Africa were long neglected by investors and yet modern stock exchanges have been established in these countries in recent years. Meanwhile share prices on these exchanges are not determined by international capital flows but by local investors. Consequently, market performance can show a high degree of autonomy. Investing in regional markets therefore offers substantial diversification benefits. That said, investments in emerging markets are known to be subject to higher levels of volatility and temporary downturns. Africa is thus most suited as a component of portfolio diversification. Investors should have a multi-year investment horizon.

KENYAN FIXED INCOME REACTION TO FY20 BUDGET: REVIEW & OUTLOOK

By **Eva Wanjiku Otieno,** Africa Strategist, Global Research, Standard Chartered Bank Kenya

Kenya has been on a fiscal consolidation path in recent years. The fiscal deficit as a percentage of GDP has narrowed to c.6.8% in FY19 from c.8.8% in FY15. The authorities hope to reduce this further to 5.6% in FY20, although this is a slower pace than was expected. The FY20 budget announced in June did not include significant revenue- generation measures. Those that were included – such as an increase in capital gains tax, taxation of the digital economy and sin taxes – are unlikely to materially compensate for historical fiscal underperformance. The budget outlined a 10% increase in spending despite pressure for faster fiscal consolidation to provide reassurance on debt sustainability.

However, the Kenya eurobonds (KENINT) have compressed since the FY20 budget reading. The narrower FY19 fiscal deficit announcement during the FY20 budget reading came at a time when investors were keen on pricing in constructive developments given supportive external risk metrics. For Kenya to have experienced a fiscal consolidation trajectory regardless of whether the government hit its targets was good enough. Indeed, the KENINT complex has outperformed its peers since then on a relative-value basis. The KENINT 24-CDI 24 Z-spread (i.e., CDI trading tighter to Kenya) differential has compressed since the budget was read. Kenya tends to be compared to Côte d'Ivoire due to their investment hub status in the East African and WAEMU regions, respectively, and both have similar credit ratings (B2/B+/B+ for Kenya and Ba3/NR/B+ for Côte d'Ivoire). Investors are also pricing in political risk premia in CDI bonds given the more uncertain outlook ahead of the 2020 elections.

Kenya is also compared to Ethiopia given that they are both large economies in eastern Africa that have issued Eurobonds. The ETHOPI 24 bond had historically traded tighter than Kenya despite its weaker fundamentals, including a wide current account deficit that has contributed to significant FX shortages and a less vibrant private sector than Kenya. The coup attempt in Ethiopia in June resulted in a spread reversal and since then the ETHOPI Eurobond has traded wider to KENINT.

The Kenya FY20 budget included a commitment to remove the rate cap that resulted in a lending rate ceiling of CBR + 400bps. Removal/amendment of the rate cap would impact both hard currency and local currency (LCY) bond performance in different ways.

In the Eurobond space, investors would perceive it as a constructive reform that would improve the quality of Kenya's economic growth and credit environment.

In the local currency space, amendment or removal of the cap may result in an adjustment higher in the yield curve. The rate cap has become a de facto ceiling for yields since it came into force in 2016. We have seen a parallel shift lower in the yield curve with every policy rate cut. In 2018 when the policy rate was cut to 9% from 10%, the yield curve shifted lower by c.100bps over the same period. Hence the yield curve may shift higher after removal/amendment on the perception that banks may resume credit lending, thus reducing the demand for local currency debt; this could result in higher yields. Although structural issues in the banking sector have impeded credit growth, capping rates exacerbated this. Despite the modest recovery in private-sector credit growth to around 5% y/y in June 2019 from c.2% in 2017, it is still below the historical average of c.20% in 2015 (before the rate cap).

Supply has shifted to the longer end of the LCY curve in a bid to extend the maturity profile of local currency debt to well above five years. Participation has also improved at that part of the curve, with strong bid-to-cover ratios. Demand has been boosted by limited supply of short-dated bonds and, more recently, ample interbank liquidity. Indeed, the overnight rate has ranged between 2% and 4% in recent months. We think that the authorities' payment of VAT refunds of around KES 10.9bn as outlined in the FY20 budget has contributed to the liquidity increase. If the government continues to settle its supplier arrears, that would improve the credit environment. Government arrears have contributed to the upward trajectory in the non-performing loans (NPL) ratio, which stood at 12.7% as of June 2019.

Our H2 outlook is influenced by several factors. In the credit space, US-China trade tensions and concerns about global growth may exacerbate the risk-off sentiment among Eurobond investors that started after the less dovish-than-expected Fed cut in July. If so, the KENINT complex and SSA Eurobond complex could come under pressure. The leadership at the Finance Ministry will also be closely watched to gauge whether the fiscal consolidation path will be maintained. In the local currency space, we expect the yield curve to remain stable unless there are headlines regarding amendment or removal of the lending rate cap.

NO DOUBT, THE NIGERIAN INVESTMENT MANAGEMENT INDUSTRY STILL HAS ROOM FOR GROWTH

PETER OLADELE ASHADE, GROUP CHIEF EXECUTIVE OFFICER OF UNITED CAPITAL PLC

CAPMARKETSAFRICA: *Firstly, let's talk about you. Please tell our readers more about your background and what motivated your choice of career path?*
PETER ASHADE: I'm Peter Oladele Ashade, the Group Chief Executive Officer of United Capital Plc, an integrated financial service group currently operating in four main business areas: Investment Banking; Asset Management; Trustee Services; and Securities Brokerage Services.

I hold a Bachelors' degree in Banking and Finance, an MBA in Marketing and an MSc in Finance. I am also an alumnus of the Lagos Business School's Chief Executive Program. I am a Fellow of the Chartered Institute of Bankers; the Institute of Chartered Accountants of Nigeria and the Institute of Capital Market Registrars. Also, an Associate of the Chartered Institute of Taxation of Nigeria and the Institute of Directors.

I am currently the Chairman of the Lagos Branch of the Chartered Institute of Bankers. I am a Trustee of the Investors Protection Fund of the Nigerian Stock Exchange; the Treasurer of the Institute of Capital Market Registrars. I'm also a member of various capital market reform committees of the Securities and Exchange Commission.

I started my career in the capital market 30 years ago at Union Bank of Nigeria Plc – Registrar, the capital market unit of the Bank. Before now, I was the MD/CEO at Africa Prudential Plc, a leading share registration and investor services firm where I spent 12 years of my career. During the period, the company experienced significant growth and transformation in its operations.

CAPMARKETSAFRICA: *Now, let's talk on broader issues but still on finance. In your view, what are the key areas requiring improvement for the Nigerian investment management industry to attain their full potential?*
PETER ASHADE: No doubt, the Nigerian investment management industry still has room for growth. In my opinion, the key areas that require some improvement range from the need to deepen the level of financial literacy in the market and increase retail investors participation. In addition, there is a need to increase the depth of the market in terms of financial instrument offering. Finally, in order to instil investor's confidence, continued strengthening of regulatory bodies and improvement in overall corporate governance structure in the markets cannot be overemphasized.

CAPMARKETSAFRICA: *Investment is all about risk and reward. How do you convince investors that Nigeria is the place to put their money and that UNITED CAPITAL PLC is the preferred partner to do this?*
PETER ASHADE: Nigeria, the largest economy in

Africa with a young population, despite the existence of structural bottlenecks, is a huge market for both short term and long-term investors. For instance, investors with a safety bias will be glad to know that the nation's fixed income market distinctively provides a mixed blend of high yielding debt papers in a stable exchange rate environment. The attractiveness of the market was evident in the recent Q1-19 capital importation report, where foreign portfolio investments in fixed income instrument stood at a whopping $6.5bn. If annualized, the number is estimated to sit at $26.0bn by the end of the year. For investors with an appetite for risk, the case for a rebound in the Nigerian equities market is increasingly compelling from a technical standpoint as the market valuation seems to be trading at its lowest discount to both its peer and historical average.

Meanwhile, United Capital Plc remains at the forefront of attracting investors into the Nigerian market through innovation, expertise and technology. For instance, in 2018, the firm, in a move to drive financial inclusion in the country and serve its customers better, launched its mobile App, “Invest Now”- a platform that enables potential investors have easy and direct market access to different investment products on their mobile phones from the comfort of their homes with the trusted guidance of experienced professionals at market competitive cost.

Commendably, we have been able to process over a N100mn online payment on the App since it was launched. Also, as a way of keeping our clients well informed and abreast of latest financial market opportunities, our research team is saddled with the responsibilities of consistently providing latest and useful market updates.

CAPMARKETSAFRICA: *Have Nigerian banks overcome their aversion to lending and what areas of the economy would you increase lending to?*
PETER ASHADE: Nigerian Banks have remained largely averse to aggressive loan growth despite continuous improvement in deposits. Clearly, appetite for loan growth is weak due to constraints in the operating environment as well as poor economic outcome. However, recent regulatory pronouncement compels the banks to do more. From all indication, the new regulatory guideline on Loan/Deposit ratio and the SDF window is meant to force banks to lend. As far as the CBN is concerned, this regulation is necessary to rebalance credit distribution in the country, which currently favours the Oil & Gas (31.1%), Manufacturing (13.7%) and the Public (9.0%) sectors. This is at the Expense of the more strategic sectors such as Agric (4.0%), SMEs (2%) and Retail (11%) sectors. So, broadly, the CBN is right, the sector to really consider for credit expansion should include the retail sector, SMEs and Agric. But more importantly, something must be done to the cost of capital as well as the capacity of the private sector to drive this growth with minimal state intervention or what is now called back door lending.

CAPMARKETSAFRICA: *Given the prominence of counterparty credit risk in financial markets deals, to what extent can this risk be mitigated as well as managed in Nigeria, please?*
PETER ASHADE: Credit risk is inherent in every financial market; however sound regulation can play a key role in reducing the extent of failed transactions. Also, the advent of credit enhancement outfits such as InfraCredit is noteworthy here. These are companies that provides local currency guarantees to enhance the credit quality of debt instruments issued to finance creditworthy infrastructure assets or so. While vulnerabilities in the economy remain concern, as this continue to increase the probability of counterparty risk, influx of more of credit enhancers or guarantors will go a long way in mitigating counterparty risk in Nigeria.

CAPMARKETSAFRICA: *What, in your view, should the federal government and policymakers be doing to attract Foreign Direct Investment (FDI) and promote private sector-led infrastructure development in Nigeria?*
PETER ASHADE: In our view, the major challenges bothering investors in Nigeria include constraints around; ease of doing business, infrastructure deficit, getting electricity, regulations, multiple exchange rate regime, fiscal/debt sustainability, and security. According to The World bank’s latest Doing Business Report, Nigeria continued to rank outrageously low in critical indices such as Registering Property, Trading Across Border, Getting Electricity, Paying Taxes, Starting a business and Dealing with construction permit, averaging 158 across these metrics compared to 190 countries surveyed. Based on the above, the key policy reforms identified for Nigeria to attract investment (FDIs) that would be important to support macroeconomic advancement of Nigeria include the need for the acceleration of the economic diversification agenda; Upholding of a stronger counter-cyclical fiscal policy stance to guard against oil price shocks; Reform of the petrol subsidy regime to improve the fiscal operation of the FGN, Improvements in the domestic revenue (particularly non-oil) mobilization; Unification of all exchange rates in the economy; And finally, a massive

investment in infrastructure.

***CAPMARKETSAFRICA:** Disruptive social, technological, economic, environmental, political and regulatory changes are megatrends reshaping the competitive environment for firms and the markets they operate. How are you leveraging the positive impacts and mitigating against the negative influences of these megatrends, please?*

PETER ASHADE: The Group is bullish on product development and process improvement to keep in touch with the mega trends the world over. Technology is one of the most pervasive mega-trend and has led to a lot of innovation on the back of it.

The Group is leveraging on these technology trend by providing robust digital platforms where our customers can easily log on and execute all their transactions from the comfort of their homes or office. Our InvestNow platform is a fully integrated investment platform which enables users to invest in a variety of investment products including mutual funds, online wills, securities trading, amongst others.

We are also aware of the cyber threats that come with digital innovation and we always ensure that our platforms are highly secure to protect our customers at all times.

***CAPMARKETSAFRICA:** Looking ahead, what is the strategic plans do you have in place to maximize profitability as well as enhance shareholders' value? And where do you see UNITED CAPITAL PLC in five years from now, please?*

PETER ASHADE: We continue to push innovative frontiers towards providing best-in-class financial, investment and capital-raising solutions for our highly diversified client base while creating value for all stakeholder groups. Innovative product development is a key lever of our corporate strategy towards serving broader pool of clients and driving financial inclusion in our operating environment. We recently rolled-out some unique offerings over the past few months and intend to ramp up our activities in these areas. For example, we rolled-out an SME financing portal on our flagship digital platform [InvestNow] to enable Small and Medium-sized businesses to gain access to finance through our partnerships with some Development Finance Institutions.

We also launched our new Heritage Trust which allows parents and guardians set up an investment trust to be applied to the education and general welfare of their children or beneficiaries. We also have some interesting products in the pipeline which will be publicized in due course. In the coming months, the Group will ramp up its product development initiatives while increasing our engagement with regulatory bodies towards improving the depth of our market.

The Group is committed to its corporate goal of being the financial/investment role model across Africa. Our focus is to grow and expand our businesses to ensure that all customer segments have access to financial and investment advisory services while remaining profitable and competitive.

***CAPMARKETSAFRICA:** The Continental Free Trade Area (CFTA) sets out to be a powerful tool to foster growth, employment and industrialization. What is your thoughts – challenges and suggestions, please?*

PETER ASHADE: Certainly, the AfCTA is expected to foster economic growth across the continent via increase in intra-regional trade. One way to look at this is the fact that increased trade within the region will boost production, increase trade financing activities and create Job. However, there are structural issues that must be fixed for these benefits to come to fruition. Chief amongst these challenges is the gapping level of power and transportation infrastructure across the continent. Travelling within the region remain very expensive due to poor intra-regional connectivity. Another way to look at this is however that the Free Trade agreement will boost investment in these structures. And we have begun to see this. Recently, The African Development Bank Group said that it is co-sponsoring the construction of 9,022km long Trans-Sahara Highway that will connect Lagos (Nigeria) to Algiers (capital of Algeria); and Dakar (Senegal) to Djibouti City (capital of Djibouti).

Another issue is that of predominance of primary activities across the continent. For trade to work, different large economies like Nigeria, S/Africa and Egypt will benefit only it they prioritise and accelerate the development of their secondary sectors. Nigeria need to enhance its industrial capacity to become what the German economy is the EU, in Africa. Otherwise, we will loose our spot as the largest economy on the continent to a more industrialised S/Africa.

***CAPMARKETSAFRICA:** To bring the interview to an end, what do you do in your spare time, when not busy managing UNITED CAPITAL PLC?*

PETER ASHADE: Outside of work, I like listening to contemporary music, traveling, meeting people and watching sports.

A FOCUS ON GHANA: ECONOMIC GROWTH AND DEVELOPMENT

By **Itumeleng Mukhovha,** Corporate M&A Associate Baker McKenzie South Africa

After a strong growth in 2017 and early 2018, the global economy is losing momentum and expected to slow down from 3.6 percent in 2018 to 3.3 percent in 2019 before returning to 3.6 percent in 2020. This slowdown is attributable to a confluence of factors affecting major economies. The factors weighing down on growth prospects include, the elevated trade tensions between the United States and China, the natural disasters in Japan, the introduction of automobile fuel emission standards in Germany, the tariff increases enacted in the United States and China earlier this year, the sovereign and financial risks in Italy, the weakening financial market sentiment as well as the deeper-than-envisaged contraction in Turkey.

In spite of the challenges affecting major economies, economic recovery in sub-Saharan Africa is set to continue. In particular, the Ghanaian economy is expected to grow at 8.8 percent in 2019, thus doubling the pace of emerging economies and outstripping the growth of advanced economies. Ghana's economic growth and development have been heightened by the growing population, the emerging middle-class, increasing urbanization, the achievement of significant macroeconomic gains over recent years—with single digit inflation, strong exports of cocoa, gold and oil, higher reserve and capital requirements, fiscal consolidation and the banking sector "clean-up". As a matter of fact, the World Bank Group's latest Doing Business Report regards Ghana as the most attractive and conducive investment destination in the West African sub-region, due to the relative political stability and improved macroeconomic conditions, over the last two decades.

Whilst Ghana's economic growth declined to a mere 1.6 percent in 2015 due to a combination of declining commodity prices, energy rationing and a fiscal crisis in 2013—the increased oil production, the commencement of production in the Sankofa-Gye Nyame oilfield, the recent discovery of oil in commercial quantities off Sekondi-Takoradi and macroprudential policies, are expected to propel Ghana's overall real gross domestic product. The new gross domestic product series also present major adjustments in the agriculture, industry and services sectors. In fact, Ghana's 2019 half-year fiscal performance was primarily driven by the industry sector—especially oil, gas and mining.

Ghana is endowed with an enviable amount of minerals, including, gold, bauxite, diamond and manganese. The country's largest mineral deposits, particularly gold, are found in the Western, Ashanti, Central, Brong-Ahafo and Eastern regions. As the second-largest gold producer in Africa, Ghana's mining industry accounts for 5 percent of its gross domestic product and 48.7 percent of the total exports. Thus mining is a major contributor to the country's economic growth. Although gold production was expected to increase in 2018 after a 54 percent in output from 2015 to 2016, total gold output was 4.1 million ounces attributable mainly to artisanal miners.

Ghana's heavy reliance on primary commodities, including cocoa, gold and oil (which are all prone to the volatility of international commodity prices) create uncertainty about its actual future paths for growth, inflation, export receipts and domestic revenues. In an attempt to improve the economy's competitiveness for the private sector-led investments in non-natural resource sectors, the government has introduced a number of agriculture and industry related policy initiatives that are expected to drive economic growth. In particular, agriculture is the leading sectors for the diversification of the Ghanaian economy and has a very large multiplier effect on employment—creating over 750 jobs for every additional USD 1 million of output. Its contribution to the gross domestic product over the past three years has ranged from 19.1 percent in 2016 to 19.7 percent in 2017 and 19.2 percent in the third quarter of 2018. In spite of the marginal decline in its share of Ghana's gross domestic product, the agriculture sector is estimated to employ approximately 46.6 percent of Ghana's labour force, most of whom are land owners engaged in subsistence farming. Although Ghana has an expense of arable land with relatively favourable climate conditions, the country is still a net importer of food. In 2014, Ghana imported more than USD 1.6 billion worth of agricultural products comprising USD 329 million of rice, USD 155 million of poultry meat and USD 123 million of wheat. Evidently, the agriculture sector requires massive investments in terms of time and other resources to enable it to reach its full potential. To this end, successive governments have instituted a series of programmes, policies and initiatives in order to maximise the full potential of the sector. Key examples of the programmes and initiatives aimed at achieving market-driven growth of the agriculture sector include the Food and Agriculture Sector Development Policy, the Planting for Food and Jobs Programme and the Akufo-Addo Programme for Economic Transformation.

Furthermore, Ghana offers a very open economy with few areas closed off to foreign participation. Restricted segments are typically aimed at ensuring employment opportunities for Ghanaians at the lower end of the income scale, rather than protecting largescale industries from foreign competition. Ghana has been making intensive efforts to attract foreign investment since the introduction of the Structural Adjustment Programme in 1984 and more recently, through the Ghana Investment Promotion Centre Act 865 of 2013 (GIPCA). Under the GIPCA, various incentives are available to encourage strategic and major investments in the country, particularly in the areas of agriculture, manufacturing, construction, mining and tourism. Incentives generally include exemption from customs import duties on plant and machinery, favourable investment and capital allowances on plant and machinery, guarantees against expropriation by the government, guaranteed free transfer of dividends or net profits. In addition, companies that operate in sectors other than mining, petroleum or timber can obtain a license from the Ghana Free Zones Board (GFZB), to operate as a free zone entity. Registration with the GFZB enables companies to enjoy a tax holiday for a period of ten years and thereafter, such companies will be required to pay corporate tax not exceeding 25 percent on local sales and 15 percent with respect to exports. To qualify for this, a company needs to export at least 70 percent of its annual production of goods and services.

Although the country is experiencing rapid growth, Ghana is running a large fiscal deficit and a large balance of payments deficit. In spite of the growing revenues from the oil and gas sector, the fiscal deficit surged to 3.7 percent of the gross domestic product at the end of March 2019 and public debt level inflated to 59.6 percent of the gross domestic product, over the same period. This is largely due to the high capital imports for the development of infrastructure and the petroleum sector, on the one hand, and the government's increased spending on public sector wages and subsidies, on the other. As such, Ghana's economic prospects over the medium term lie in its ability to regain and sustain its economic stabilization program. In an attempt to strike a balance between addressing development needs and containing public debt levels, Ghana has used favourable global financing conditions to improve the maturity structure of debt by replacing short-term debt with longer-term debt, thus reducing rollover risk. In addition to steep fiscal consolidation (as evidenced in the half-year fiscal performance), there is a need to invest Ghana's current natural resource wealth in non-natural resource sectors to ease the effects of the anticipated decline in oil production and achieve sustainable growth in the medium-to-long term.

Contributor’s Profile

Itumeleng Mukhovha is a Corporate M&A Attorney at Baker McKenzie, Johannesburg, a Global Shaper of the World Economic Forum, a writer and a philanthropist who is making positive contributions in disadvantaged communities in South Africa. She was listed as one of the Top 200 Outstanding Young South Africans in 2018 by Mail and Guardian; and was included on Avance Media’s list of the Top 100 Most Influential Young South Africans, also in 2018.

ECONOMIC GROWTH IS MAKING MANY EGYPTIANS POORER

By **Amr Adly,** Assistant Professor, The American University in Cairo Egypt

Reforms championed by international agencies have stabilized macroeconomic indicators, but they're not creating jobs.

If Egypt is the Middle East's fastest-growing economy, why are so more and more Egyptians becoming poorer? The question has exercised economists since the country's statistics authority released figures on poverty rates indicating a 5% rise over the past three years. This is a period in which growth has spiked, thanks in no small part to a continuously rising foreign debt.

It is easy to interpret the poverty numbers as the social impact of the International Monetary Fund-prescribed reform program that kicked off in November 2016, including the massive devaluation of the pound, followed by rounds of subsidy cuts and increases in consumption taxes. These measures, some commentators argue, have impoverished many Egyptians, despite the stable macroeconomic indicators—for instance, inflation is under control, interest rates have been reduced, and the exchange rate has been steady.

But the trend in the poverty data long precedes the recent IMF program. Official statistics show that poverty rates have increased steadily since the early 1990s; the rate has almost doubled since 2000. The recent hike is a continuation of an older and consistent trend that either went untouched by rounds of fiscal and monetary reforms under the auspices of the IMF and the World Bank or was exacerbated by them.

Those who focus on the role of the IMF austerity program to explain growing poverty are missing some other contributing factors.

The first is the sectoral composition of economic growth. In Egypt, the sectors that have generated the most growth and created economic value are traditionally capital- and energy-intensive and create relatively little employment—such as oil and gas, banking, and telecommunications. Some growing sectors like construction have generated jobs, but these were of low quality, requiring low skill and paying low wages. The same can also be said of tourism.

Sectors that might create jobs characterized by high productivity and wages—such as skill-intensive services and high value-added manufactured exports that require skill and technology inputs—have not grown, certainly not at a rate to influence the overall poverty data. These sectors require large public investments in education and vocational training, and in research and development, as well as an institutional infrastructure friendly for innovation and entrepreneurship. None of this has been prioritized by Egyptian governments.

Much of Egypt's employment, at least since the 1980s, has been in the informal sector, either through self-employment or in microbusinesses that produce jobs that pay subsistence income. An International Labour Organization study in 2009 showed that 91% of the employed young people in Egypt worked informally, in jobs characterized by low productivity, low wages and no social protection. According to the World Bank's vulnerable employment indicator, the average proportion of vulnerable employment in Egypt between 1997 and 2007, as a percentage of total employment, was as high as 24.09%.

The second factor contributing to the spike in poverty numbers has to do with redistribution. With a rudimentary capacity to collect wealth and income taxes and historically low—and declining—tax to GDP ratios, the Egyptian state has been in chronic fiscal crisis since the 1980s. This malaise has often been treated by episodic austerity measures, often under the auspices of the IMF, cutting public expenditure and raising indirect taxes on consumption. Both measures have usually resulted in throwing the brunt of fiscal-crisis management unevenly on the shoulders of the poorer and more vulnerable populations.

Instead of focusing primarily on economic growth, the IMF and other international lenders—as well as the managers of Egypt's economy—should care more about where growth occurs, and how growth is redistributed through state expenditure and revenues.

INVESTING IN AFRICA: MITIGATING FRAUD AND CORRUPTION RISKS

By **Alexandre Rene,** Partner, Ropes & Gray, Washington, D.C USA
Patrick Welsh, Counsel, Ropes & Gray, Boston USA
Scott Grannemann, Associate, Ropes & Gray, Boston USA

Continuing recent trends, a number of African economies have experienced strong growth in recent years and Sub-Saharan Africa now includes some of the fastest growing economies in the world. In both the short and long term, African economies remain attractive targets for investment. However, looming over this growth story remains the longstanding specter of corruption and impunity.

Governments, both on and off the continent, have recognized the harm caused by corruption and have developed regulatory schemes that reach across borders to hold individuals and investors financially and criminally liable.

Regulatory bodies have demanded robust compliance and corruption prevention programs. Investors can reap the rewards of investing in this high-growth continent; however, it is now essential that they enact robust compliance programs commensurate with the risks involved.

Africa Remains an Investment Opportunity

Overall, economic growth across Africa remains strong. The UN estimates that African GDP grew by 3.2% in 2018. That same year, 14 of the 30 fastest growing economies in the world were in Africa. The services sector in Sub-Saharan Africa grew at an annual rate of 6.3 percent from 2005-2014, outpacing global services growth of 2.6 percent. Foreign direct investment rose 11% in 2018 bucking the global trend, which saw a 13% decrease.

Recent political and economic changes underpin the continent's continued growth and maturation. For example, since taking office in 2018, Ethiopian Prime Minister Abiy Ahmend has started the process of privatizing the state-owned telecom operator and has discussed privatizing several other industries.

The Persistent Problem of Corruption and Impunity

Despite some successes over the last decade, corruption remains a significant inhibitor of sustained growth and investment. Sub-Saharan Africa was the lowest scoring global region in Transparency International's 2018 Corruption Perceptions Index. Low-scoring African countries commonly feature few political rights, low press freedoms, and a weak rule of law. Laws are often unenforced and a lack of resources leaves little ability to handle corruption, which is further exacerbated by internal conflicts and unstable governments. According to one survey, 22% of Sub-Saharan Africans who used a public service reported paying a bribe. For several countries, the figure was over 40%. In many countries, impunity also remains a fundamental issue. Government officials continue to solicit bribes and kickbacks, embezzle funds, and shelter money with little consequence, as enforcement authorities remain unable, or unwilling, to effectively halt this corrupt behavior.

There are however, positive signs of improvement. The African Union declared the theme of 2018, "Winning the Fight Against Corruption: A Sustainable Path to Africa's Transformation." In recent years, Nigeria, South Africa, and Egypt have all engaged in increased anti-corruption efforts creating new policy frameworks and anti-corruption committees and strategies. In South Africa, citizen engagement via social media discussions has been a driver of citizen engagement and has even been used as an avenue for reporting corruption. Additionally, some countries ranked relatively well in the corruption index compared to global peers including Botswana (34th), Rwanda (48th) and Namibia (52nd).

Anticorruption Enforcement

Investors in Africa need to be aware of these risks and must take affirmative steps to mitigate the risk of adverse enforcement decisions under the UK Bribery Act and the United States Foreign Corrupt Practices Act, which both cover activity conducted in foreign countries. They must also be aware of the laws of the country in which they are doing business as many African countries have recently expanded anti-corruption regulation.

Corruption laws such as the UK Bribery Act and the US Foreign Corrupt Practices Act (FCPA) hold investors liable for bribery conducted not just by employees and subsidiaries, but also third parties operating on their behalf. The reach of both the Bribery Act and the FCPA is far; liability can be imposed on businesses with only limited connections to the UK or US, no matter where the corrupt act takes place.

Recent enforcement matters demonstrate the risk faced by investors in Africa. In 2017, Rolls-Royce paid a $170 million criminal penalty related to $35 million in bribes paid around the world including $2.4 million paid to officials at Angola's state-owned and controlled oil company. Rolls Royce additionally settled with the UK Serious Fraud Office paying a fine of nearly £500 million. Similarly, in 2018, Canadian gold mining company Kinross paid $950,000 to settle allegations from the US SEC. The SEC alleged that Kinross's subsidiaries awarded a lucrative logistics contract to a vendor preferred by Mauritanian government officials and contracted with a politically connected consultant in contravention of Kinross's policies and procedures and without conducting required due diligence.

A number of African countries have taken steps to enhance anti-corruption laws and to enforce those laws more rigorously. For example, in 2016, Kenya implemented the Kenya Bribery Act of 2016 which criminalized the offering or acceptance of bribes. Similar to the UK Bribery Act and the FCPA, the act reaches beyond Kenya's national borders so long as the entity "carries on business, or part of business, in Kenya." In 2017, Nigeria's Economic and Financial Crimes Commission filed criminal corruption charges against Royal Dutch Shell and its subsidiary related to a $1.3 billion oilfield purchase in 2011. In addition to the Nigerian criminal charges, two middlemen were convicted in Italian court of corruption charges and the Nigerian government filed commercial lawsuits in England against Shell, its subsidiary, and against JPMorgan for its role in the transfer of funds. Dutch prosecutors are also purportedly preparing criminal charges against Shell.

Mitigating Corruption Risk

Despite the corruption risks, investors can mitigate corruption risks. Appropriate, risk-based compliance efforts can reduce incidents of corruption and, in the event a corrupt act takes place, can limit liability.

Conduct Appropriate Due Diligence

Robust due diligence is the foundation for any anti-corruption compliance program. Globally, regulators expect that investors will conduct due diligence into potential joint venture partners, acquisitions, vendors and consultants. The level of diligence should be tailored to the risk presented by the potential business opportunity. While a light approach may be appropriate for a low risk partner, investors should undertake comprehensive diligence into joint venture partners in higher risk contexts, such as in the oil industry. The more significant the transaction or engagement, the more willingness a third party should have to provide relevant and substantive information, and the more an investor should demand. Additionally, as part of the diligence process, it is important to understand local customs and business processes.

Undertake a Risk Assessment

A comprehensive risk assessment, tailored to the investment activity, is essential to developing an effective compliance program and mitigating corruption risk. A risk assessment begins by identifying corruption risk factors and potential schemes then identifying their probability and potential impact. Once these risks are identified, the investor can develop mitigating controls and processes tailored to those risks and their likelihood. The assessment can then evaluate the controls and processes in order to quantify any residual risk facing the organization. Response plans can be developed to effectively limit the harm of any residual risk that comes to fruition.

Develop and Enforce Effective Compliance Programs Tailored for the Risks Undertaken

The benefits of investment in a strong compliance program are twofold, preventing corrupt acts from taking place and, in the event they occur, potentially limiting an investor's liability.

Robust compliance programs have been shown to reduce exposure when operating in higher-risk parts of the world. The compliance program should be comprehensive in both its content and breadth. The program should discuss the various regulatory schemes and the specific risks that arise in the company's sector. It should include systems for maintaining compliance, particularly in areas of high risk such as dealing with foreign suppliers or government officials.

Conduct Periodic Training Tailored for the Risks Employees and Third Parties Will Face
Training on the program should occur regularly and cover key points of relevant anti-corruption laws. The program should cover both employees as well as any third party agents that work on the company's behalf; essentially, anyone that can expose the company to liability. The training should be tailored to the specific risks faced by the organization and to the activities performed by the specific business units, employees, or third party agents. Training should be updated as appropriate to deal with new risks and ensure compliance with the latest policies or procedures.

Conclusion

The rewards of African investment come with some risks. However, appropriate diligence and continued adherence to a compliance program can mitigate these risks by reducing incidents of corruption and decreasing a businesses exposure to regulatory enforcement actions.

"African economies remain attractive targets for investment. However, looming over this growth story remains the longstanding specter of corruption and impunity."

Contributors' Profile

Alexandre Rene is co-chair of the global Litigation and Enforcement practice group, based in Ropes & Gray's Washington, D.C. office. Alex has extensive experience representing corporate entities and their executives in connection with litigation and investigations arising out of white collar criminal prosecutions, grand jury investigations, criminal antitrust investigations, and corporate compliance matters. A seasoned litigator who has successfully handled numerous cases in federal and state courts, Alex has also represented his clients in civil matters such as breach of contract, tortious interference, business conspiracy, fraud, criminal conversion, and forum non conveniens. Alex also spent two years on secondment in London advising primarily on anti-bribery issues.

Prior to entering private practice, Alex was an Assistant United States Attorney for the District of Columbia and a Trial Attorney in the Department of Justice's (DOJ) Criminal Division, Fraud Section. While in the Fraud Section, Alex served as a member of the DOJ's Corporate Fraud Task Force and prosecuted matters involving mail, wire and procurement fraud, campaign finance and securities fraud, obstruction of justice, money laundering, and violations of the Travel Act and Foreign Corrupt Practices Act (FCPA), among other offenses.

Patrick Welsh focuses on white-collar criminal defense and governmental investigations. He has represented companies under investigation by the Department of Justice, the Securities and Exchange Commission, Congress, and other federal and state authorities. He has extensive experience advising clients in the pharmaceutical, medical device, and energy sectors on compliance with the False Claims Act, the Food, Drug, and Cosmetic Act, the Anti-Kickback Statute, the False Claims Act, state consumer protection laws.

Patrick's pro bono practice has included the representation of individuals in federal immigration court, a non-profit organization in a challenge to a state agency's interpretation of an environmental statute, and an individual in a civil rights action against a municipal agency.

Scott Grannemann joined Ropes & Gray's litigation department in 2018. Prior to joining the firm, Scott worked for seven years as an investigator in the Medicaid Fraud Division of the Massachusetts Attorney General's Office where he conducted civil and criminal investigations into fraud against the state's Medicaid program. His work covered violations of state criminal laws, Medicaid regulations, and the state and Federal False Claims Acts (including qui tam actions) via schemes of billing for services not rendered, upcoding, and kickbacks. He additionally investigated cases of physical and sexual abuse and neglect in nursing homes. During law school Scott was the Vice President of Suffolk University's Moot Court Honor Board and Journal of Trial and Appellate Advocacy.