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CAPITAL MANAGEMENT LIMITED

Off the Cliff

Sub-Saharan Africa Update

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Executive Summary

The COVID-19 pandemic remains a key threat to the growth of several economies in 2020. With advanced economies recording double digit contractions in Q2'20 despite the presence of automatic stabilizers, many developing economies had pressing pre-pandemic issues that restrained their capacity to respond adequately to the pandemic ranging from constrained resource flows, weak fiscal buffers, high debt burdens to balance of payment imbalances.

Most Sub-Saharan African economies fell off the cliff recording negative or sub-optimal growth outcomes in Q2'20. Led by South Africa, the lockdown induced broad-based contractions in key sectors. Due to the time lag involved in production, agriculture was spared the onslaught. Nigeria and Ghana experienced their worst quarterly contraction in nearly three decades, as both services and industry sectors felt the impact. Angola is expected to contract for the fifth consecutive year while Kenya and Ghana are the outliers that are expected to grow in 2020 due to strong external demand and diversified export base.

Lower receipts from commodity exports and tourism will drag fiscal balances of many SSA nations into the negative territory and raise already high debt levels. Most budget and balance of payment deficits will be majorly funded by facilities from International Financial Institutions (IFIs) except Ghana, which raised Eurobonds earlier in the year. More Sub Saharan African nations were beneficiaries of IMF's emergency financing than any other region in the world as 33 countries applied for funds to meet their respective balance of payment needs. While Angola's credit rating was downgraded further the junk zone, debt relief moves made by Zambia and Chad could raise risks of further credit rating downgrades later in the year despite improved credit outlook on Nigeria.

Inflation continues to diverge from the target expectations of Nigeria and Angola. With the exception of Ghana and Kenya, inflation remained on the uptrend in our coverage areas. Angola and Nigeria continued to reel from currency depreciations and reforms. In South Africa, inflation has risen above the lower target of the SARB due to higher fuel prices and electricity tariffs.

SSA Currencies exhibited a mixed performance in Q3'20; none is yet to recover from the risk-off induced currency depreciations borne in H1'20. In Q3, the South African Rand (+3.47%) has been strengthened by the surge in the demand for gold and gradual return of economic activity. The Angolan Kwanza (-8.47%) remains weak due to lower crude prices. The Nigerian Naira (+1.56%) recorded marginal gains due to resumption of FX sales to Bureau De Change Operators and interventions by the Central Bank of Nigeria. The Ghanaian Cedi (-0.1%) has been relatively stable due to its diversified export base, IMF inflow and interventions by the Bank of Ghana.

Most central banks adopted a wait-and-see approach in Q3'20 following a dovish H1'20. However, Nigeria reduced its Monetary Policy Rate for the second time by 100bps to 11.5% and adjusted corridor rates to +1%/-7% around the MPR to drive credit growth and reflate the economy.

Lockdowns initiate broad-based contractions in SSA Economies

The response of advanced economies to the global pandemic disrupted international supply chains because cities and countries were locked down as cases of COVID-19 were on the rise. In Africa, the Southern African region currently leads with over 700,000 cases, followed by the Northern and Western regions. South Africa leads the continent with over 600,000 cases. Morocco, Ethiopia and Nigeria lead cases in North, East and West Africa with approximately 105,300, 70,400 and 57,600 coronavirus cases respectively. The lockdown culture has had significant implications for growth outcomes in Sub-Saharan Africa economies.

Several economies bled in Q2'20 as reactive lockdown measures dragged output in Q2'20 South Africa (- 51.0%) contracted for the fourth consecutive quarter in Q2'20 as mining, manufacturing and construction sectors felt the impact of the country's stringent lockdown measures. Nigeria (-6.10%) followed suit with its worst contraction in over 30 years. Ghana (-3.2%) was affected by the slump in both industry and services sectors. Angola is expected to enter its fifth year of economic downturn as the country is yet to recover from the 2014 oil price crash. Kenya and Ghana are the only countries under our coverage that are expected to deliver positive growth outcome in 2020.

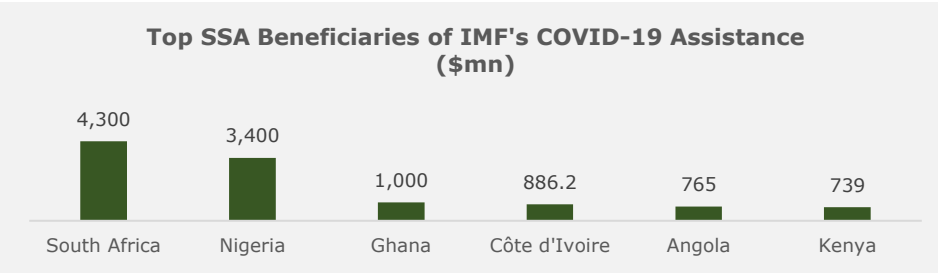
SSA FY'20 Macroeconomic Forecast

	GDP Growth	Inflation (FY'20)	Reserves (Imports Coverage)	Current account (% of GDP)	External Debt (% of GDP)
SSA	-3.20%	9.30%	3.1	-4.70%	28.70%
Angola	-4.00%	21.00%	9.3	-1.30%	94.00%
Ghana	1.50%	9.70%	3.5	-4.50%	36.00%
Kenya	-0.30%*	5.10%	2.4	-4.60%	31.30%
Nigeria	-5.40%	13.40%	3.7	-3.30%	17.40%
South Africa	-7.20%	3.00%	6.8	-1.80%	55.30%

Note: Red highlights indicate a deterioration while Green highlights indicate an improvement from FY'19.
**Yet to be reviewed*

Source: IMF, Vetiva Research

As at the drafting of this report, Sub-Saharan Africa has the highest number of beneficiaries under IMF's emergency financing initiatives with 33 beneficiaries, compared to 20 in the Western Hemisphere and 13 in the Middle East and Central Asia. The IMF has approved $15.7bn in disbursements to the region year-to-date, with Angola being the most recent recipient of $765mn as part of a three-year aid program. South Africa ($4bn), Nigeria ($3.4bn) and Ghana ($1.0bn) are the leading beneficiaries of the inflows, jointly responsible for more than half of total inflows to the region.



Source: IMF, Vetiva Research

South Africa leads with a record 51% contraction

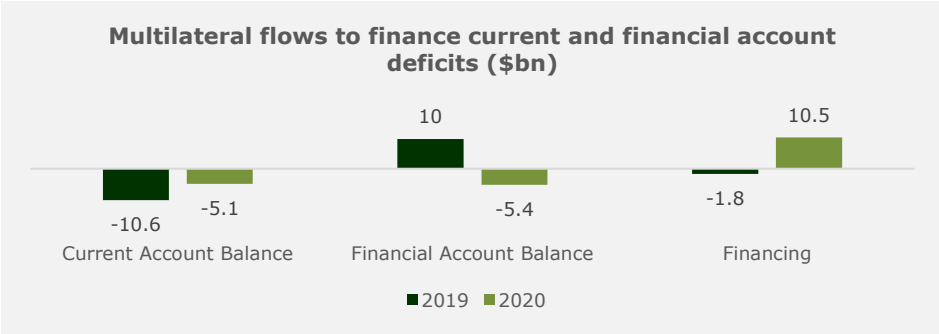
South Africa plunged by over 51%, according to the seasonally adjusted annualised rate, as manufacturing, trade and transport sectors were handicapped by the stringent lockdown measures imposed by the country. The COVID-19 crisis led to net capital outflows greater than 2% of the GDP as exit of foreign portfolio investment had adverse implications on the capital account balance of the country.

South Africa was able to access $4.3bn in an emergency financial assistance from the IMF under the Rapid Financing Instrument Initiative. The initiative was put in place to provide urgent balance of payment (BoP) needs to countries, who were affected by the outbreak of COVID-19. Thus, a supplementary Budget review was presented before the legislature to provide safety nets for vulnerable citizens and increase health expenditure. The country reeled out a fiscal stimulus of 500bn rand ($29.9bn) which amounts to 10.3% of GDP.

The Reserve Bank responded to the pandemic by reducing the repo rate by a total of 300 basis points, thus far, in 2020 to reduce short term borrowing costs. The bank also bought government bonds to normalise liquidity. In August, bond purchases had reduced as yields that were raised due to sell-offs by foreign investors fell below 10%. The Bank has also adjusted capital requirements, liquidity coverage ratio of banks to induce lending. As inflation had fallen below the lower target of the Central Bank, its expansionary moves were crucial in reflating the economy. In Q3, inflation rose beyond 3% due to the pick-up in the price of crude oil.

According to a recent IMF country report, the South African economy is expected to contract by 7.2% in 2020, which is lesser than the June forecast (-8.0%) due to fiscal stimuli. Also, the rise in public expenditure is expected to drag the fiscal balance of the country to 16.1% of the GDP in 2020 (2019: 6.7%) while public debt will rise to 81.8% of the GDP in 2020 (2019: 63.7%) as a result of COVID-19 related emergency expenditures and the plunge in fiscal revenue. Inflation in South Africa is expected to average 3.0% in 2020 (2019: 4.1%) despite depreciation of the rand due to sticky oil prices

In addition, the surge in the demand for gold is expected to limit the country's current account deficit to $5.1bn in 2020, from the $10.6bn deficit in 2019 as higher gold prices and weaker rand improves terms of trade. In 2019, the country was able to finance its balance of payment needs with reserve drawdowns. In 2020, an expected outflow of $4.8bn in foreign portfolio investment is expected to worsen external balance to a $10.5bn deficit (2019: $1.8bn surplus). Multilateral flows from the World Bank, IMF, AFDB, amidst others, is expected to support the BoP needs of the South African economy.

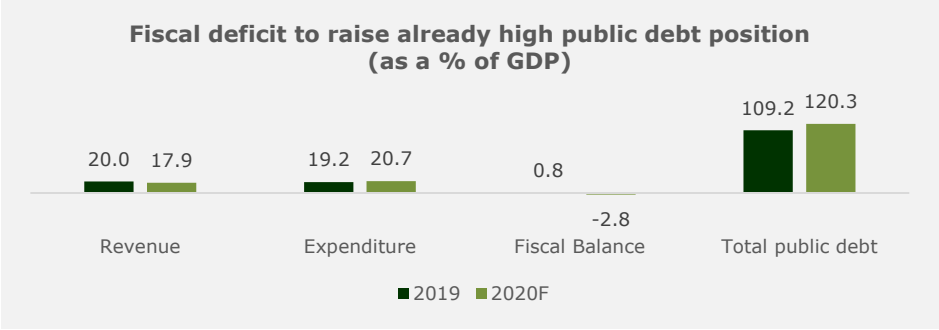


Source: IMF, Vetiva Research

Angolan economy reels from five years of economic downturn

Prior to COVID-19, the Angolan economy has been struggling from the effects of the 2014 oil price crash. Like Nigeria, oil constitutes two-thirds of government revenue and 95% of exports, making the economy susceptible to volatilities in the oil market. The country's economy shrank by -1.8% y/y in Q1'20 (Q4'19: -0.6%) before the COVID-19 pandemic. The oil sector remains in a 4-year long recession after slipping -1.7% in Q1'20.

In response to the pandemic, fiscal authorities have implemented several measures including a 12-month VAT credit for imported goods, reduction in the number of ministries, reduction in capital expenditure, deferral of social security contributions and hiring freeze in the civil service. Angola also witnessed a downgrade by Fitch Ratings to CCC due to low oil receipts, depreciating Kwanza, high debt servicing costs and downward pressure on fiscal and external buffers. Falling nominal output and a weaker currency continues to elevate public debt beyond GDP.



Source: IMF, Vetiva Research

The Banco Nacional de Angola (BNA) has been largely accommodative in its monetary stance following the establishment of a Kz100bn ($170mn) credit line to support the purchase of government securities and provided liquidity support to banks. The BNA also adopted an electronic foreign currency trading platform as part of its foreign exchange reforms, which will replace currency auctions once main players are registered and licensed. Since the floating of the Kwanza in October 2019, the Angolan Kwanza has been largely volatile propelling inflation beyond 20%.

The country is set to contract for the fifth consecutive year amplified by the COVID-19 health crises, slump in oil prices and OPEC-induced cuts in oil exports. The pandemic is expected to drag the economy by 4% in 2020 while government revenue is projected to fall to Kz6.37tn ($10.1bn) in 2020 (2019: Kz6.52trn, $10.4bn) due to lower oil prices and production quotas. Government expenditure is expected to rise to Kz7.36trn ($11.7bn) in 2020 (2019: Kz6.27trn, $9.9bn) resulting in an overall fiscal deficit of -2.8% of GDP.

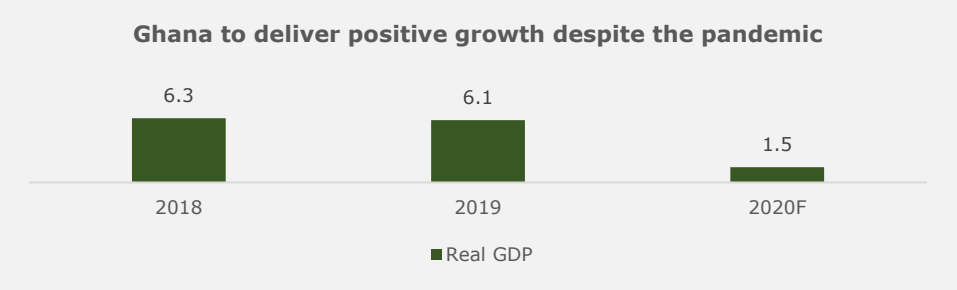
The country is expected to record a -1.3% current account deficit in 2020, down from a 5.7% surplus due to lower oil exports and service imports. Low oil prices could also dent terms of trade in 2020 by 37.8%. A capital and financial account deficit of -2.5% is expected due to plunge in foreign loans and direct investments. Overall balance is also expected to plunge to -9.0% in 2020 (2019: -0.4%). The deficit is likely to be funded by flows from international financing institutions (IFIs).

Ghana records first quarterly contraction in 3 decades

One of the most rapidly expanding economies in the world, Ghana has a diversified foothold in three export commodities – gold, cocoa and oil. However, this could not insulate the Ghanaian economy from the adverse economic consequences of the COVID-19 pandemic. Like most economies around the world, the Ghanaian economy contracted by 3.2% in Q2'20. The economic contraction was driven by a plunge in both Industry (-5.7%) and Services (-2.6%) sectors. Like Nigeria and South Africa, Agriculture (+0.7%) was able to grow slightly, possibly supported by the time lag involved in production.

In response to the pandemic, the government released GH¢1bn ($166mn) in Coronavirus Alleviation Programme (CAP) loans to medium and small-scale enterprises. The fiscal stimulus coupled with other health and social expenditure amounts to 0.4% of the country's GDP. The Bank of Ghana (BoG) has left its policy rate at 14.5% - following the 150 basis points cut in Mar'20 - due to the impact of earlier fiscal and monetary stimuli on budget deficit and inflation.

We recall that Ghana was one of the first economies to ease lockdown restrictions, after proactively closing its borders early enough. Consequently, the country is one of the very few economies that is expected to grow in 2020. Recovery in cocoa prices and gold could steer the economy on a path of recovery while credit growth is expected to slow to 4.7% (2019: 18.3%).



Source: IMF, Vetiva Research

According to the IMF, revenues to the government could plunge to 13.5% of the GDP (2019: 14.3%), due to lower oil and tax receipts. In contrast, government expenditure is expected to rise to 23% of GDP in 2020 (2019: 21.8%) - bringing the fiscal deficit to -9.5% of GDP (2019: -7.5%). The Central Government debt is expected to rise to 68% of GDP due to higher external financing from Eurobond issuance and IFIs. In consequence, Ghana is projected to have a wider deficit in 2020, -4.5% of GDP (2019: -2.7%) due to lower oil prices, tourism revenues and remittances. A much stronger recovery in gold and cocoa prices, as well as lower repatriations, could narrow this anticipated deficit.

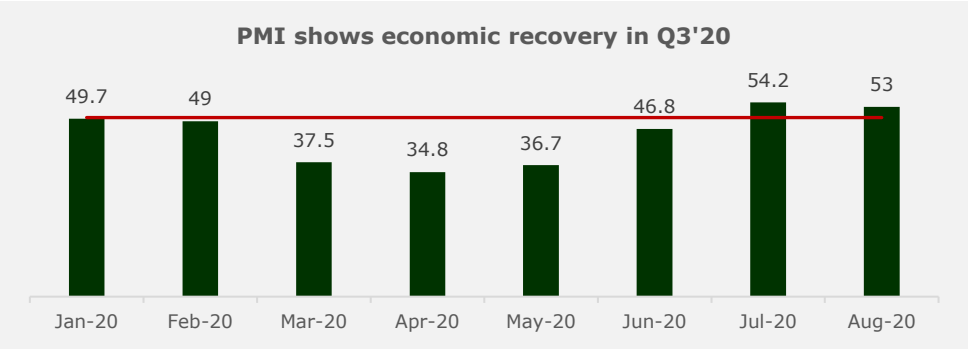
Ghana's capital and financial accounts could post a thin surplus on the back of influx of capital and portfolio investment, despite the risk-off sentiments towards emerging markets and forthcoming election. The country is planning to list up to $500mn of its gold royalty fund in October in London, taking advantage of the bullish run in gold.

Kenya rides on strong external demand

The Kenyan economy felt the impact of the COVID-19 pandemic in Q1'20, albeit growth was still in the positive territory. Growth slowed to 4.9% y/y (Q4 '19 – 5.5% y/y) due to slower growth in 12 sectors. However, a -9.0% slump was recorded in the accommodation and restaurant sector, which contributes less than 2% to GDP. The agricultural sector expanded by 4.9%, despite locust and flooding challenges while manufacturing and trade sectors grew by 2.9% and 6.4% respectively.

In response to the pandemic, Kenyan fiscal authorities passed a supplementary budget that provided tax cuts, refunds, increased health expenditure and cash transfers to vulnerable groups. The Finance Minister had also hinted at removing a couple of tax exemptions to make up for revenue shortfalls. Monetary authorities have also complemented the fiscal expansionary posture, as the Central Bank of Kenya (CBK) has reduced the policy rate by 100bps this year to 7.25%. The reserve requirement has also been lowered to 4.25% from 5.25%. The CBK extended tenor on repo agreements and granted flexibility to banks on loan provisioning. In Q3, inflation fell to 4.2% in the East-African nation.

According to Purchasing Managers Index surveys, Kenyan economy may slow further in Q2'20 before recovering in Q3'20 as PMI numbers crossed to the expansionary region in July. Strong external demand following the opening of air borders buoyed export sales growth in the East African country. Kenya is expected to deliver positive growth in 2020.



Source: Standard Bank, Vetiva Research

Going by IMF forecasts, both revenue and expenditure could fall in 2020 due to lower tax and non-tax revenues as well as lower recurrent expenditure. However, fiscal deficit is expected to expand to -7.8% of GDP (2019: -6.3%). Commercial borrowing and project loans are financing the government's deficit. The country's current account deficit is expected to narrow to -4.4% of the GDP in 2020 (2019: -4.5%) due to a strong contraction in imports, as a result of softer energy prices than the expected decline in tourism receipts. The deficit in Kenya's financial account is expected to narrow to -2.3% of GDP due to slower exit of capital investment and a gradual pick up in portfolio investment. The country's overall BoP is expected to turn swing to a deficit of 1.8% of GDP in 2020 (2019: +1.2% of GDP).

Recession fears resurface in Nigeria

The Nigerian economy was affected adversely by the 5-week lockdown which crippled economic activity in Q2'20. Economic activities plunged by -6.10% y/y, as both the oil and non-oil sectors shed weight. Major sectors, including Trade, Manufacturing, Mining, Construction and Real Estate sectors, recorded negative growth outcomes in the review period. The sharp drop in oil receipts necessitated the devaluation of the Naira, which further constrains growth in the real sector.

The country's fiscal capacity was highly constrained due to low oil prices and high debt servicing costs. As a result, the government was only able to set up a ₦500bn ($1.3bn) COVID-19 crisis intervention fund - which amounted to 0.39% of GDP - to cover health-related expenditures. Budgetary assumptions were reviewed in line with current realities while the energy sector has seen some reforms. The reforms have been driven by the government's efforts to expunge expensive subsidies from its books.

Inflation has remained stubbornly high due to continuous border closure policies, exchange rate devaluations and removal of price ceilings from Premium Motor Spirit (PMS). Despite inflationary pressures, the Central Bank of Nigeria (CBN) has sustained expansionary monetary stance to reflate the economy. The CBN has slashed the monetary policy rate (MPR) by a total of 200bps so far in 2020, including a recent 100bps cut at its Sept'20 meeting and the adjustment of corridor rates to +1%/-7% around the MPR.

The bias for growth at the Sept'20 meeting was driven by the desire to boost credit growth to the economy. The Bank has also introduced a credit recovery system that could enable banks recover loans from defaulters that are warehousing cash in other local banks. Coupled with a cut in local savings deposit rates, the Bank has induced local banks to lend to the real sector.

The economy is expected to enter a recession barely 4 years after the 2016 recessionary episode. The IMF expects a revised 5.4% contraction in its latest GDP forecast; however, we see a 2.2% slip in the economy as Agriculture and ICT continue to trail the path of growth. The Federal Government is also working on a short-term plan to succeed the Economic Recovery and Growth Plan (ERGP), which is the Economic Sustainability Plan (ESP). The ESP is a ₦2.3trn ($6.03bn) plan expected to reflate the Nigerian Economy via real, fiscal, and monetary plans.

Source: NBS, Vetiva Research

According to the IMF, government revenue is expected to plunge to 4.9% of the GDP (2019: 7.9%) due to lower oil receipts. Government expenditure is expected to fall to 11.7% of the GDP (2019: 12.9%) due to slash in non-essential capital expenditures and subsidies. Fiscal deficit is expected to widen to 6.8% of the GDP in 2020 (2019: 5.0%). Fitch recently upgraded its outlook on Nigeria's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'Stable' from 'Negative' due to stable oil prices, easing of global funding conditions and relaxation of movement restrictions.

Nigeria's current account deficit is expected to expand to 3.3% of GDP due to lower oil exports and unfavourable terms of trade. Exit of portfolio investors could also drag the capital account balance to negative terrain, resulting in a $16.2bn wide BoP gap which is likely to be funded by flows from IFIs.

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