LMA Sub Saharan Africa events – key themes

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On 4 July 2018 the Loan Market Association (LMA) held its fifth annual Sub Saharan Africa (SSA) Syndicated Loans Conference at the Hilton Hotel in Sandton, Johannesburg. The LMA was delighted to see over 150 market participants in attendance. Later the same month, it held two inaugural afternoon seminars in Kampala and Kigali, at which over 80 and 50 delegates participated respectively. All three programmes presented attendees with an impressive array of speakers, all of whom shared their views on the key issues and challenges currently affecting the SSA loan markets.

Some of the key themes discussed include:

The Economic outlook

The economic situation in SSA is now much more nuanced since the "Africa rising" era of previous years. In fact, 2016 witnessed the lowest growth rate in SSA since 1994. This was caused primarily by the problems experienced by SSA's two largest economies: South Africa and Nigeria, which between them account for 50% of its GDP. In addition, the eight oil exporting economies have suffered in recent years following the drop in oil price, although this has been offset by the oil importing countries, which have benefitted. More generally, global investors are turning away from emerging markets, resulting in a reduction in portfolio inflows across the continent.

Some of the key economic trends across the continent include:

1. Inflationary pressures.
Inflation has generally been on an upward trend since 2015. However, the inflation outlook is complex - whilst in the CFA Franc Zone, inflation remains low and stable, elsewhere inflation has risen, sometimes significantly. Potential explanations for this may be: 1) harvests in a number of countries have been negatively impacted, causing disruption for the agricultural sector and export levels; 2) weaker currencies or foreign currency shortages have meant higher import costs; and 3) significant fiscal deficits are evident across the continent, which have not been offset by tighter monetary policies.

2. Rising debt levels.
Looking at aggregate government debt data, SSA does not seem to have a huge debt burden at present, despite deterioration in fiscal and current account deficits. However, the averages conceal important messages – the median government gross debt level has risen to 53.4% of GDP in 2016. In addition, of the 45 countries in SSA on which the IMF provides data, 16 now have government debt to GDP levels of over 60%, and for five of these countries, it is over 100%. Four of these are currently in debt restructuring/ rescheduling negotiations.

3. Uncertain political environment.
Politics in SSA is changing, however, perhaps not as might be expected. The election process in SSA continues to evolve and the key theme is perhaps that demographics and technology are going to potentially change election outcomes, with social media campaigns becoming as important as formal ones. In addition, overall demographics of a growing youth population are likely to necessitate pressures on the need for income growth and political change. However, it is worth noting that if elections generate a disputed outcome, the likelihood of the international community intervening in a decisive way seems increasingly unlikely.

Overall, the economic outlook for SSA is more complicated than is commonly perceived. 2015 to 2017 were difficult years for SSA in macroeconomic terms, but 2017 seemed to signal the bottom of that slowdown. In addition, 2018/2019 are expected to see a return in overall growth. More generally however, in order to break through the 5% "growth ceiling", governments need to push ahead with more fundamental structural and fiscal reforms.

Looking to individual countries and regions:

1. Nigeria
Nigeria is beginning to experience signs of recovery as oil prices strengthen, but any growth is likely to be modest and constrained, both as a result of the approaching elections in February 2019 and the contradictory nature of some key areas of economic policy. For the naira, looking forward, there should be stability for some time to come, but the question remains as to whether the Central Bank of Nigeria can move to a more flexible exchange rate regime. Overall, the view on Nigeria is positive in the medium term, especially given that the country has been on a declining growth trend since 2010.

2. South Africa
South Africa has begun to recover as a result of the unexpected political turnaround, although this had been tempered by less positive economic data in the second quarter of 2018. Overall, political headlines are expected to remain at the forefront of any discussions pertaining to South Africa. Fortunately, its sovereign ratings outlook remains stable across all three agencies, however, state-owned enterprises and GDP growth results will determine how long this remains the case.

3. East Africa
The macro data for the region is broadly positive (with growth at around 5-6%), but

the sentiment of investors and businesses is less so. Ethiopia and Tanzania have been the standout growth stories in recent times, despite signs of strain in both countries. This includes questions over Tanzania's official growth data, with other macroeconomic factors suggesting that official figures are not necessarily correct. In Ethiopia, meanwhile, although growth remains robust by SSA standards, it has begun to slow. This is likely to be due to problems within its agricultural sector, as well as general political unrest across the country. Furthermore, whilst the new Prime Minister seems to have bought about a new positive reform effort, Ethiopia's large current account deficit remains a concern, as does its low foreign exchange reserves. The Ugandan economy, meanwhile, continues to make an uneven recovery after the growth slowdown which occurred in 2009/2010 resulting from a post election expenditure overrun, a surge in inflation and a collapse in the shilling. Growth slowed again in 2016, but there has been a recovery in 2017 which is predicted to continue into 2018/2019. However, business confidence remains under pressure as a result of the election cycle and fluctuations in the Ugandan shilling resulting from monetary and fiscal mistakes. Uganda has also dropped off the investor agenda as a result of the recent raft of Eurobond issuances by other African governments, which have diverted investor attention elsewhere. Furthermore, whilst government budgets have pushed the theme of increased public sector spending, this has not yet materialised to any noticeable extent, and this has also meant that private sector spending has not gone up in response. Burundi remains blighted by political problems which are not yet behind it, and while donor support continues to limit some of the potentially worse economic damage, the question remains as to how long this situation can continue. In Rwanda, growth slowed in 2016 to 2017 due to the impact of poor rains and the completion of a large number of infrastructure projects. There is also a further question as to whether the Rwandan economy has reached the end of its recovery phase, as was the case in Uganda around 2009/2010. However, there is an argument that Rwanda remains a better managed economy than Uganda and the slowdown may prove less problematic given it has one of the most development focused governments in SSA. Finally, in Kenya, growth has slowed as a result of the election, but is now on a positive turn (notwithstanding its agricultural and manufacturing sectors remaining drags on growth).

4. West Africa
In West Africa, the West Africa Economic and Monetary Union (WAMEU) is a bright spot on the continent, despite political uncertainty and potential terrorist incidents in some of the smaller member states. However, the divergence in growth in the two parts of the Franc Zone – the Central Africa Economic and Monetary Community (CEMAC) and WAEMU – is clear: WAEMU growth is now very robust and significantly driven by the two largest economies in the sub-region, Cote d'Ivoire and Senegal, both of which are set to grow around 7%

and 6% in 2018-2019 respectively. The other factor enabling WAEMU growth is that, although some of the smaller countries in the group have seen considerable political instability in recent years, this does not seem to have had a prolonged impact on the economy. Cote d'Ivoire has been the star performer of SSA, and investor interest in the country is high. However, there are some cracks in the success story. Despite strong GDP growth, there have been some long-standing concerns that this has not resulted in a noticeable improvement in incomes. Finally, Ghana is struggling under the weight of its $6bn debt burden with an average interest rate of 20%. Given that the country is only a $35bn economy, any volatility in the FX situation going forward could result in an inability to make scheduled debt repayments.

5. Southern Africa

Turning to the South African Development Community (SADC), growth has picked up across the region in most countries in 2018 (excluding Mozambique, whose debt situation remains unresolved at the present time). With regards to Zimbabwe, all eyes are focused on election results. After that time, given the lack of capital flows into the country, it remains difficult to see how it will finance itself or relieve its debt burden. It is hoped that Zimbabwe will agree to participate in the IMF programme, as part of which a route map forward could be created. As part of this programme, it would need to agree to both a comprehensive review of land reform issues, and resolve its currency situation. Of the remaining larger SADC economies, Botswana, Mauritius, Namibia and Seychelles are well primed, with sound government policies combining with an improving external environment.

Syndicated lending in SA and SSA

The majority of syndicated loan transactions taking place in the market are refinancings, with very few new money deals. The South African market is particularly flat, with no acquisition finance and very little corporate activity. This is partly down to the rating downgrade, which has meant that leveraged transactions are no longer attractive. Prior to the downgrade, multinationals had been actively seeking opportunities to acquire unlisted South African corporates. In addition, the leveraged market in South Africa is not particularly liquid, and leverage is on average only 3-3.5 - a stark contrast to the US and Western Europe. In addition, the rand market is only so deep, meaning that corporates struggle to service the higher interest rates required for leveraged deals. In terms of other countries, Nigeria is making some progress, and Cote d'Ivoire has also become a key market.

Across the continent, a preference remains for US dollar denominated transactions, although local currency tranches do exist, particularly when borrower revenue streams are in local currency. Local currency requirements are also undoubtedly increasing, and this is leading to more creative structuring solutions to address borrower needs in this respect.

For transactions at the higher end of the credit spectrum, lender liquidity and diversity is evident. This has meant that pricing for those deals has contracted significantly, increasing competition. Institutional investors continue to sit on large pools of liquidity. There is also interest from Far Eastern, Russian and Middle Eastern banks, however for the latter, the Africa strategy remains in its infancy and the continent is still seen as higher risk. However, there is demand from Middle Eastern banks for shorter tenor, US dollar denominated transactions, particularly in the trade finance sector. Interest is also being seen from private equity investors and debt funds, whilst European banks continue to follow their clients.

Overall, there remains a shortage of bankable assets in the market - a trend that remains unchanged in recent years. For less bankable assets, credit enhancement remains key, especially when trying to attract new investors to the market. In addition, careful structuring, fund transferability and availability of insurance (and re-insurance) are also paramount. In the project finance space, the energy and transport sectors are seeing the highest investment, but there is still a huge shortfall. Total infrastructure funding in Africa has been steadily declining in recent years, dropping from a peak of US£83bn in 2013, to US$62.5bn in 2016. The gap between project identification and disbursements is now, on average, eight to nine years, with one of the big drivers being limited access to early stage project preparation funding and only US$800mn available as uncommitted capital on funding requirements of US$10.6bn. Key to development of the project finance market is therefore increasing the number of project preparation facilities, of which there are currently 17.

One of the key challenges with project finance is the lack of skill set to make projects attractive to investors, particularly given the tenors required. There is therefore a real need to catalyse infrastructure investment within core sectors and both DFIs and ECAs have become key to this process. For example, ECAs are supporting not just trade finance, but trade-related projects. The involvement of ECAs is also increasing commercial bank appetite in those countries where political risk is rife. Finally, technology improvements are also improving the outlook, as is the entrance of strategic project finance investors willing to combine equity, debt and advisory expertise, and this is leading to the creation of a cautiously more optimistic environment for the sector.

Looking specifically to the East African markets, there is increased business confidence, especially when compared to the previous 12-18 months. This is leading to improved outlook and pipeline for banks active in those markets. Corporate productivity also seems to be increasing and pricing is becoming more stable. Whilst the syndicated loan market in countries such as Uganda and Rwanda is not highly developed, it is anticipated that greater standardisation and understanding of the product will help this market to develop. Key to this process is helping borrowers to understand the process and the documentation, as is greater coordination amongst established bilateral lenders. ■