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African Markets Revealed

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Ferishka Bharuth
Mulalo Madula
Phumelele Mbiyo
Fausio Mussa
Jibran Qureishi
Dmitry Shishkin
Gbolahan Taiwo

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Geese Flying Against Sun

A group of Egyptian Geese, Scientific name: Alopochen aegytiacus, flying against sun disk in a spectacular sunset over Amboseli National Park, Kenya.

Source: Buena Vista Images

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Tailwinds coming up

- Over the past 12-15 months, the global backdrop increasingly posed a headwind to the economic growth outlook for Africa. Uncertainty triggered by the US-China trade war, the removal of monetary policy support in some developed countries, together with outright tightening of monetary policy in others, prompted downward revisions to consensus forecasts for global growth in 2020 and 2021. However, we believe that global growth forecasts for 2020 and perhaps 2021, which already indicate acceleration from 2019, will be revised upwards. We expect elevated global financial markets and growth in developed economies to boost economic growth in Africa.
- There has been much hype about the proposed changes to the XOF. We now propose some questions and answers: Is the chance of devaluation for the reformed XOF greater or less than the previous arrangement? Greater. Are there hedging instruments that one could use to manage this risk? Yes. How can one know if there is anything that will change operationally for businesses operating in the region because of the reform? From regulatory pronouncements made by the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO).
- In formulating views about the evolution of the commodity producing economies in our coverage, it seems reasonable to assume that oil prices will range mostly around USD60/bbl – USD65/bbl in 2020. For copper prices, a range of USD6,200/MT – USD6,500/MT seems reasonable. Sure, over the course of the year there might be a fair bit of volatility, perhaps occasioned by trade anxiety or a flare-up of geopolitical noise. But it seems unlikely that prices will deviate much from their recent ranges.

- Risk assets have rallied tremendously since 2009, with some commentators now observing market frothiness. Yet others suggest that the US equity market rally specifically is the 'most unloved' in history. Evidently, the rally has benefited only a small section of the investing public, with large amounts of cash sitting on the side-lines. While a correction might be underway, with the scare due to the coronavirus outbreak weighing on market sentiment, it is hard to say that the rally is ending.
- We still see the Eurobond market continuing to rally in the next 2 – 3 months. We like Egypt and Senegal and we retain our tactical overweight exposure to Angola and Nigeria.
- In local rates markets, the Ugandan duration trade probably needs re-evaluation. We still like the trade but expect some transitory pressure against the trade between Q2:20 and Q3:20. Given how much the other positions in our shadow portfolio have rallied, such as the KES, NGN and EGP, we are more inclined to take profits in coming months. Implied NDF yields are too low across the board, except on the USD/ZMW, but the pressure on the ZMW seems set to persist.

Global growth – turning into a tailwind for Africa

Developed countries' GDP growth is widely expected to slow in 2020. But, that has been the case for at least a year already. Moreover, forecast revisions have tended to the downside.

The slowdown among developed countries was not the only reason economic growth in Africa failed to meet our expectations but it admittedly was a significant factor. There was drought that affected agricultural production in some countries in Southern Africa. In Zambia and Zimbabwe, the severity of the drought also constrained hydro-electricity generation.

Clearly, the US-China trade war had an impact on the trajectory of copper prices, thereby affecting Zambian economic activity. Now that there is a US/China truce of sorts, an uptick in commodity prices that might turn out positively for copper production seems possible.

USD performance, 2019

Asset class	Return, %
FX	
Africa 8, spot (with carry)	-3.1 (7.3)
Africa 10, spot (with carry)	-2.2 (7.1)
EM 10, spot (with carry)	1.5 (7.6)
Bloomberg USD index, spot	-0.9
Local bonds	
Africa 8	18.7
Africa 10	16.4
EM 10	19.2
Bloomberg DM Sovereign	5.6
Credit	
Africa (ex SA)	21.8
Africa	20.6
EMBI Global	14.4
Bloomberg HY Global Corporate	13.4
Equity	
MSCI Frontier Africa	5.3
MSCI Africa	7.9
MSCI EM	15.4
MSCI DM	25.2

Source: Bloomberg; Standard Bank Research

Significant policy missteps in some countries may explain their persistent economic underperformance. Policymakers in these countries probably need to redouble their efforts to boost investment spending and address infrastructural bottlenecks. To attract capital for such investment spending, these governments would find the going easier if global financial market sentiment remained elevated.

Even though most forecasters have been downwardly revising their forecasts for global GDP growth in both 2019 and 2020, these forecasts still point to acceleration in both years. Moreover, we are now probably close to the bottom of these revisions. From now on, we'd foresee 2020 revisions as upwards. This is true of both African economies and developed market economies. Ebullient global financial markets and faster growth in developed economies should therefore support economic growth in Africa.

African currency unions – much hype, little impact

It would seem every time that some regional trading block on the continent makes a pronouncement about possibly adopting a common currency, new fresh insights on the topic of regional currencies arise.

It is worth pointing out that the East African Community (EAC), the Southern African Development Community (SADC) and the Economic Community of West African States (ECOWAS) have all, at some point or other, made a commitment to adopting a single currency by some stipulated deadline. Since 2000, all these trading blocks have made such commitments, then changed them, and recommitted to new dates.

Besides these postponements is the flurry of speculation and conjecture that such pronouncements provoke each time. But, when nothing changes, ordinary lives resume, only for the flurry of speculation to be revived when another block makes a pronouncement.

This is not to say that these regional trading blocks won't ever promulgate common currencies. But one should separate regulatory pronouncements from political bluster. If a common currency is to be adopted in a region, then the central banks in that region would develop regulations and guidelines to effect the creation of such a common currency. Similarly, regulators for other business sectors, like pension funds, would also issue regulations affecting those industries. Once those have been communicated, compliance with them would be mandatory for all citizens of the countries in that trading block. Everything else would amount to speculation based on what may turn out mere political bluster.

So, for citizens in a trading block that is purportedly going to introduce a common currency, it is far more instructive to keep track and comply with the applicable regulations in that trading block.

One doesn't need to know the date that the SADC or the EAC has committed to adopting a common currency. When that date approaches, there will be increased hype about it. But, considering that various pronouncements have been made over the last 20-y, is there any reasonable basis for one to determine if the current currency arrangements will be any different in another 5-y? Probably not. But it is perhaps a reasonable starting point to say that the probability of the status quo being maintained is closer to 100% than to 0%. Is there a way of telling if such a change, were it to happen, would be deleterious, and if so, an acceptable way of mitigating the risks now? Also probably not.

It is always worth keeping in mind that the establishment of a common currency would be the result of a political process, a potentially long and tortuous process.

Specifically, for investors in the XOF region, the question boils down to whether a new regime there would imply a greater chance of depreciation than has transpired since

1994 when the CFA franc was last devalued. If one follows our logic from above, then the probability that the GHS and NGN will still be around in 5-y is close to 100%.

But members of the Union Economique et Monétaire Ouest-Africaine (UEMOA) that use the XOF have taken decisions that will reform that arrangement. There will no longer be French representatives in the governance structures for the XOF. The region's FX reserves will be managed by the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) rather than having half of them pledged to the French Treasury. However, the latter would still guarantee convertibility of the XOF.

Notably, these changes are meant as preparation for the adoption of the ECO as a single currency for ECOWAS, which is made up of UEMOA and the West African Monetary Zone (WAMZ). Crucially, members of the WAMZ have their own currencies. Nigeria has a GDP that is about 40% of ECOWAS. Presumably, adoption of a single currency would not be a replication of the XOF mechanism for the entire ECOWAS.

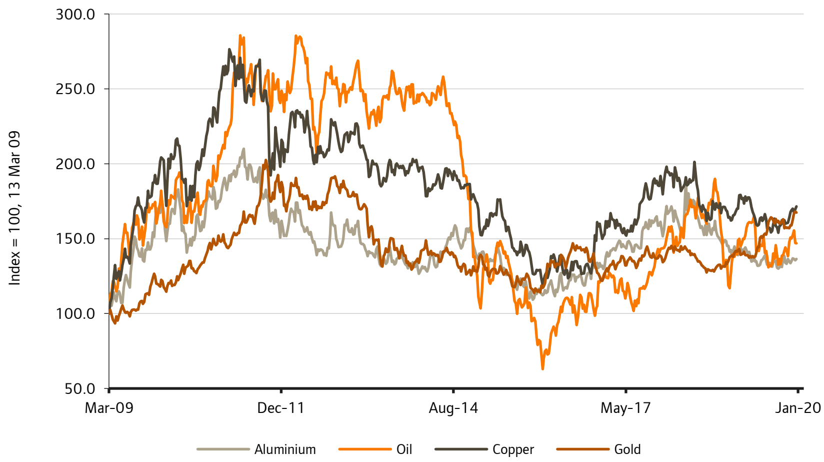
After all, it is worth pointing out that the CFA franc mechanism is a combination of a monetary union and a currency peg. This removes policy flexibility for individual members in a monetary union. For example, they lose the ability to manage monetary policy, as such authority would be housed in a regional central bank, as is the case for UEMOA. There would be restrictions on fiscal policy conduct. Lastly, policymakers must commit to entrenching a policy framework that relies on gaining external competitiveness via productivity improvements rather than currency devaluation.

There is a lot that is uncertain at present, not least of which is for which currency regime ECOWAS will ultimately settle. Is the ECO going to be pegged, a managed float, or free-floating? Perhaps members of the WAMZ value policy flexibility more than those in UEMOA. In that case, the ECO arrangement would be less restrictive than the XOF arrangement.

It seems reasonable to believe that if ECOWAS will ultimately adopt the ECO as a common currency, it would have a greater chance of depreciating than the XOF. But, right now, there is probably nothing worth doing to prepare for such a change. Of course, there is no way of knowing when the ECO will start being used in actual transactions. The bottom line is that despite all the hype about the ECO in West Africa, as a practical matter, there is probably no cost to operating as if the status quo will prevail for the next 5-y.

Commodity prices: inching higher

Figure 1: Commodity prices have an upside bias



Source: Bloomberg

It seems likely that commodity prices will rise in the next 4-m. For much of H2:19, commodity prices were bottoming out, especially base metals prices. Copper prices hovered around the USD6,000/MT level in late-2018. The recovery in early 2019 was cut short once prices got around USD6,500/MT in early 2019, and reverted to just below USD6,000/MT for much of H2:19.

Such downward pressure was understandable given the mounting anxiety about the global growth outlook precipitated by the US-China trade conflict. Consensus forecasts for copper prices were consistently revised lower in 2019. Yet, these have been revised higher since Dec, with consensus forecasts putting copper prices at USD6,200/MT at the end of this year, up USD450/MT from the forecast at the end of Dec.

We wouldn’t be surprised to see these forecasts nudged higher this year. The theme of supply constraints keeps coming up among copper analysts. There has been occasional, isolated speculation that copper prices could rise above USD7,000/MT, although, clearly, that is not the consensus view. Be that as it may, it seems as if the risks are biased to the upside despite any volatility occasioned by geopolitical or trade shocks.

This was not limited to copper prices. The London Metals Exchange’s LMEX index bobbled around the 2,800 level for much of H2:19, with the upside capped at about 2,860. It has been nudging this level since end 2019.

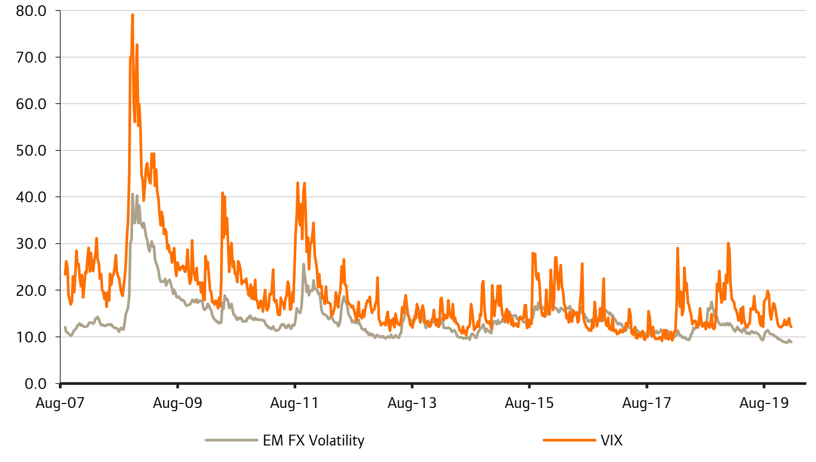
There is still plenty to suggest that oil prices will remain mostly above USD60.0/bbl over the next 4 – 6 months. Geopolitical strains, especially surrounding Iran, could keep prices elevated. Additionally, OPEC seems prepared to stick with production quotas to keep prices elevated.

Consensus forecasts for oil prices drifted marginally lower in Q4:19, with forecasts for the Brent crude oil price at the end of 2020 approaching USD60/bbl. But these are inching higher. For our macroeconomic forecasting purposes, we have assumed prices will be around USD60/bbl – USD65/bbl this year.

Global risk appetite: further rally in risk assets still likely

Since publication of the Sep edition of this report, the S&P 500 Volatility index has been mostly below 15, falling closer to the 12 level at the time of writing. It jumped to just over 20 temporarily in early Oct, but the trend has been to the downside.

Figure 2: Volatility subdued



Source: Bloomberg; Standard Bank Research

Perhaps this is to be expected given that the US equity markets have been consistently rallying, making record highs over the past 3-m.

By some accounts, the performance of the US equity markets seems the embodiment of market frothiness inspired by loose monetary policy. This characterisation could apply to all risk assets, since most returned around 20% in 2019, as the table on page 2 shows. Indeed, the strong US equity market performance was replicated by other developed market equities, romping ahead of their emerging market counterparts.

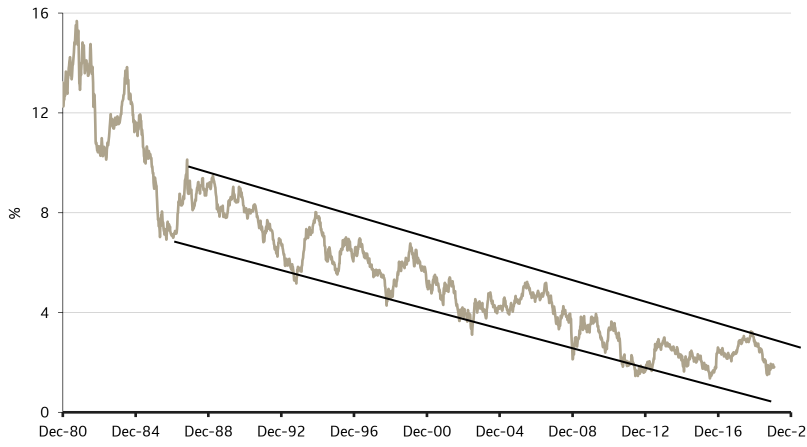
Yet other accounts characterise this rally as being the most unloved, with considerable amounts of cash sitting on the side-lines as some investors fret over risks that might derail this rally that has now broken all kinds of records. There are other indicators that point to plenty of anxiety in the market despite the low levels of the VIX index. Lately, the outbreak of the coronavirus is causing jitters in the markets. Bellicose trade rhetoric from the US administration may agitate markets over the next 4 – 6 months. However, electoral aspirations may influence the US president's approach to trade. Arguably, there is little to be gained by the US president in starting another skirmish that might undermine sentiment and slow the real economy. With the re-negotiated NAFTA and the phase 1 of the China trade pact under his belt, he has plenty to bask in.

Global rates: sustained monetary stimulus

Even though the US Federal Reserve's Federal Open Market Committee has been hinting at keeping the Fed Funds rate steady for a prolonged period, the market is still expecting another rate cut. Still, these expectations are for H2:20 rather than H1:20. Consensus forecasts for the Fed Funds rate at the end of Q4:20 have now drifted marginally higher in the past 2 – 3 weeks. Even market pricing for the Fed Funds rate suggests that conviction in the rate cut view has been waning. Perhaps if economic data keeps up a strong showing, the consensus forecasts will gravitate towards a no rate cut view over the coming 3 – 4 months.

Of course, all this would depend on the trajectory of economic activity in this period. Certainly, market sentiment has been buoyed by the seeming truce between the US and China on trade. But, recall that during 2019, there was clear evidence that US economic activity was slowing down. Indeed, the reason for the market's pricing to swing from hikes to cuts was due to concerns that the Fed was slow in cutting the policy rate in response to the economic slowdown occasioned by escalating trade tariffs.

Figure 3: US Treasury 10-y yields below Fed Funds rate

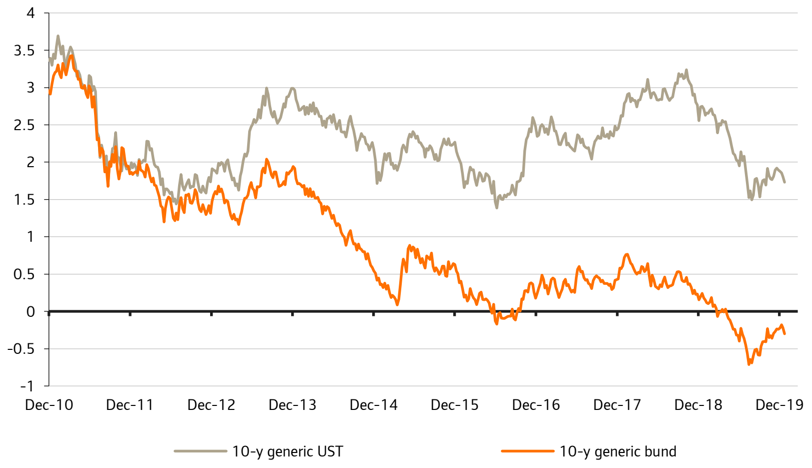


Source: Bloomberg

So, the market will need a body of evidence that growth in US economic activity is gathering momentum before unwinding expectations for further rate cuts. As things stand, most economists anticipate a slower pace of growth of the US economy in 2020 than in 2019. Our G10 strategist Steve Barrow expects growth of 1.5% y/y in 2020, from what he estimates was 2.0% y/y growth in 2019. Evidently, the market believes that such a deceleration would require further stimulus from the Fed.

In line with the market's view on the Fed Funds rate, the consensus expectation is for US 10-y Treasury yields to be around 1.9% this year, marginally higher than the current levels. Barrow expects the 10-y yield to end the year at 2.0%, rising further to 2.15% by end Q2:21 but only after the rate first dips to 1.5% in Q2:20.

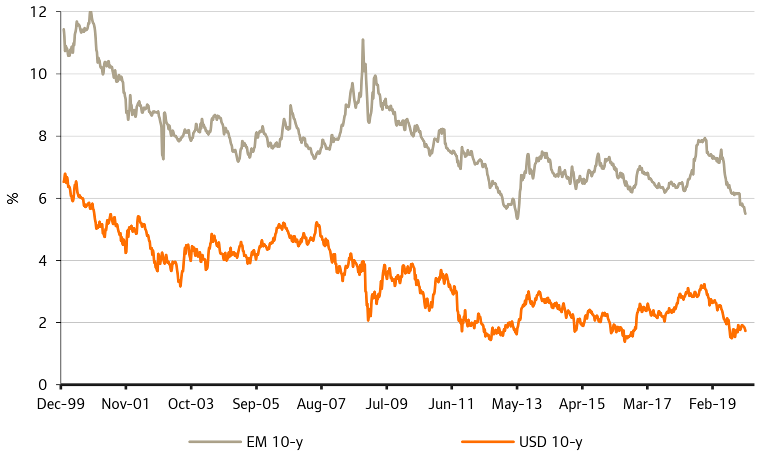
Figure 4: 10-y generic US Treasury and German bund yields



Source: Bloomberg

What about Eurozone yields? Steve Barrow expects Eurozone yields to initially fall further, becoming more negative, before reversing course from Q4:20 onwards. He expects the 10-y Bund yield to drop to -0.6% at end Q3:20, before rising to -0.5% by end 202, and rising to -0.3 by end Q2:21. Other developed country central banks are likely to ease monetary policy. The BOE, Bank of Canada, Reserve Bank of Australia, Reserve Bank of New Zealand are the central banks expected to ease monetary policy.

Figure 5: EM 10-y average bond yields versus US Treasury 10-y yields



Source: Bloomberg; Standard Bank Research

Political risks: light electoral calendar in the next 4-m

None of the countries in our coverage will hold elections over the coming 4-m. But, a handful will hold general elections in H2:20.

The Tanzanian general elections will probably generate a fair amount of noise. In the past, the ruling party tended to win rather comfortably, amid the opposition's allegations of vote-rigging.

It remains to be seen if the ruling party will put forward policy proposals that are a significant departure from current policies. Of course, a number of policy issues could turn out to be pivotal for medium-term economic performance. Perhaps chief among these is the development of the natural gas sector. But the general regulatory backdrop, that has made it difficult for foreign companies to operate in the country, is crucial too.

The Ethiopian elections will also be crucial ones to watch. If anything, they could be a clear sign of whether the Prime Minister's reform agenda has any grassroots support. He has been widely lauded outside the country for the bold reform moves he has made and for advancing peace. With respect to the latter, he went on to win the Nobel Peace Prize.

The reform agenda is probably going to be what matters the most to the electorate. Of course, given the strong federal nature of the government in Ethiopia, the existence of strong regions and tribes, it is hard to say how these elections will play out. But the ruling party probably has the upper hand. Additionally, there would probably be more attention paid to governance issues, and issues of regional representation in government than opposition to the economic reforms per se.

At face value, the Egyptian parliamentary elections are a risk event. But that is a hard characterisation to justify. Sure, the introduction of a Senate will likely complicate things. But in the National Assembly the representation and power of political parties is heavily diluted. Of the 596 deputies in the current parliamentary term, only 120 represent political parties, with 448 being independents and the remainder appointed by the president.

Only Côte d'Ivoire's and Ghana's elections could be regarded as presenting significant uncertainty. An argument can be made that Ghana's elections do not really represent such a huge risk. After all, the electorate has switched between the NPP, currently in power, and the NDC since multi-party democracy was introduced in 1992, giving each party 2 terms in power. So, if the NPP were to be voted out of power, then this would be a significant departure from history.

The key concern for the market is that the NPP will essentially try to buy the elections by boosting government spending, whether it be recurrent or capital expenditure. Yet the government observed the Fiscal Responsibility Act in budgeting for a 4.7% of GDP fiscal deficit this year. Admittedly, the revenue assumptions may have been somewhat optimistic, requiring that the government restrain spending. Therein lies doubts for the market: expenditure restraint, and, in an election year? Regardless, preliminary data shows that there was spending restraint in 2019, with the government achieving the originally budgeted 4.2% of GDP fiscal deficit.

Côte d'Ivoire's elections are highly unpredictable, something that is likely to keep the market apprehensive. As is the norm, coalitions will be formed in the run-up to the elections. Yet, at this stage it is not clear how these will be composed. President Ouattara, who is serving his second term, and should thus be ineligible to be president, has not announced whether he will run or not. He has previously pointed to what he considers to be grounds to allow him to run again due to the new constitution introduced in 2016. Apparently he will announce his intentions in Jul.

Furthermore, Guillaume Soro, the former President of the National Assembly who fell out with President Ouattarra and has been positioning himself for a presidential run, faces an arrest warrant. The public prosecutor alleges that he was involved in a coup plot last year. Recall, it was Soro and his fighters that turned the tide against Laurent Gbagbo during the civil war in 2010, allowing Ouattara to capture the presidency.

Fracture within the ruling SWAPO in Namibia led to the party losing significant support in last year's elections. A SWAPO member decided to run in the elections as an independent, garnering nearly 30% of the vote, an unprecedented feat. SWAPO also lost some 14 seats in parliament. It remains to be seen if these election results will have reverberations for government policy.

FX strategy: slim pickings

Despite some notable depreciations, there are not a lot of carry opportunities. In the past 4-m, the currencies that depreciated the most were the AOA that depreciated by 25%, the ZMW that depreciated by 10.1%, and the ETB that depreciated by 7.9%.

The USD/AOA move is still mostly policy-determined. Even though the directional bias to the pair is still to the upside, policymakers are looking to provide enduring support to the economy. As part of a package of economic reforms, the government will be privatising some state-owned enterprises over the next 5-y. To help that process along, they have relaxed capital account controls, making it easy for foreign capital to take advantage of any opportunities that this privatisation process may present. They have relaxed requirements for foreign investors to seek approval of the central bank to bring in equity capital into a listed entity.

The central bank has not removed licencing requirements for foreign fixed income investors. To buy government debt securities foreigners still need to obtain a licence from the central bank.

Since trading mostly in a 9.50 – 10.30 range between Mar 16 and Sep 18, USD/ZMW has risen in a stepwise fashion. It stuck around 12.00 for about 7-m, before rising to 13.00, after initially touching 14.00. It stuck around 13.00, then resumed the uptrend to a peak near 15.25. After retracing below 14.00 temporarily, it has been in a range of 14.00 – 15.00 since the beginning of the year. All told, the pair has risen at about a 29% annualised pace since Sep 18.

It is still hard to justify making an allocation to ZMW T-bills. In large part such reluctance is provoked by the seeming unwillingness of policymakers to address persistent fiscal and BOP pressures. To be sure, copper prices have recovered somewhat. It seems highly probable that the volume of water flowing down the Zambezi River will recover sufficiently to revive hydro electricity generation over the next 2-y. This revival might be sufficient to bolster copper production as well, in addition to agricultural production, thereby supporting the BOP. Copper export volumes fell by just over 20% y/y in the 11-m to Nov 19, with electricity supply constraints probably a factor behind this decline.

There is no end in sight to the strong demand for FX to fulfil the government's external debt service obligations. The Bank of Zambia made some USD1.17bn in external debt service payments in the first 11-m of 2019. Budgeted external debt service payments are budgeted to be in excess of USD1.5bn in 2020. Data from the BOZ indicates that demand from the public sector is some 3 times the amount demanded by FX bureaus.

On one hand, clearly this demand is unlikely to shrink in coming years. FX demand by the government is inelastic. But on the other hand, given that it is the government, it can exert moral suasion, or let the BOZ do that on its behalf, to keep USD/ZMW from spiralling upwards in a disorderly fashion. So, for now, we prefer opportunistic exposure via the short-dated NDFs, especially after a sharp depreciation of the ZMW.

The ETB is not typically among the currencies that depreciate the most on the continent. But the pace of depreciation has picked up in recent months. Usually, the central bank devalues the ETB by a large amount once every few years, then keep the pace of depreciation fairly low, about 5% on an annualised basis.

The movement of the exchange rate in recent months seems like quite a departure from this. Perhaps this departure is understandable given the economic reform program of the government. This program is being supported by a 3-y Extended Credit Facility and an Extended Fund Facility from the IMF. Among the aims of the program are exchange rate reforms to address FX shortages and increase FX flexibility.

These exchange rate reforms were always inevitable. Over time it is likely that the private sector will come to dominate in investment spending in the economy. In combination with other reforms, addressing FX shortages and allowing the exchange rate to reflect the supply-demand balance for FX in the economy looked inevitable. Nevertheless, we are not anticipating that there will be any opportunities for fixed income investors in the near term.

The 13.1% depreciation of the GHS in 2019 is the first double-digit pace of depreciation since the 13.9% depreciation in 2015. Of course, 2015 was a pre-election year. The GHS depreciated by 9.2% in 2016. Arguably, the market may have been somewhat mollified by the existence of an IMF-funded program at that time. The government was on a fiscal consolidation path.

Could the upcoming elections in 2020 be a factor pushing USD/GHS materially higher? Certainly, many investors have expressed trepidation at the prospect of an election while the government is without an IMF-funded program. The fear is that there could be fiscal overruns that would keep import demand strong, thus leading to the FX pressures. Of course, such overruns would worsen the debt picture.

We continue to highlight the fact that such trepidation has not translated into a notable reduction in exposure to GHS bonds. The Central Securities Depository indicates that foreigners were holders of GHS29.07bn in GHS bonds in Dec, compared with GHS27.26bn in Nov. Throughout 2019 the average was close to GHS27.5bn. The peak was GHS29.22bn in Apr 18.

Of course, the BOG was steadfast in its determination to intervene to keep USD/GHS from rising in a disorderly fashion. Arguably, the BOP is in a sufficiently strong position that the BOG can provide FX supply to the market, thereby helping to stabilise the exchange rate for an extended period. It has helped that the government has been willing to issue Eurobonds quite early in the year, granting the BOG the ability to boost FX reserves and use those to intervene in the FX market. The government aims to issue Eurobonds early this year, as it did last year. Perhaps this will help to restrain the depreciation pressures in the FX market.

The East African Shillings continue to exhibit broad stability. We see little impetus to change this over the next 4 – 6 months. The KES might enjoy some support in early Q1:20 due to flower export sales. That might reverse somewhat in Q2:20 due to dividend payments.

There will be elections in early 2021 in Uganda. Pre-election noise has typically exerted some pressure on the UGX. But this typically fizzles out closer to elections.

We have maintained exposure to the EGP in our shadow portfolio since May 17 without interruption. We see no reason to relinquish our exposure. But, the EGP has appreciated by about 13.0% over the past 12-m. Strong portfolio inflows have been in evidence, part of the broader improvement in the BOP.

In a low interest rate environment in much of the developed world, it is perhaps not surprising that there has been such strong interest in the EGP market. But we see T-bill yields falling over the next 4 – 6 months. In part, this will be instigated by the central bank that has every reason to lower policy rates given a favourable inflation outlook. So, as yields decline, so will the attraction of this carry trade.

For now, we have no reason to relinquish our exposure to the NGN either. The desire of policymakers to maintain USD/NGN in a narrow 360 – 365 range is undiminished. With oil prices holding above USD60/bbl, there shouldn't be much trepidation on their part.

That notwithstanding, FX reserves have fallen rather sharply in recent months. The 30-d moving average of gross FX reserves fell to just under USD38.3bn in early Jan from over USD45.0bn in Jul. Import demand has picked up notably, fuelled by capital imports as some capital expenditure projects advance. Of course, the decision by the CBN to prohibit non-bank domestic investors from partaking in the OMO bill market triggered some foreign portfolio outflows.

Still, it seems as if FX reserves are stabilising. Furthermore, with OMO bill yields so much higher than T-bill yields, it seems likely that foreign portfolio interest in that market might be revived. The only hindrance is likely to be lack of issuance to allow investors to re-enter the trade.

Fixed income strategy: contemplating profit-taking

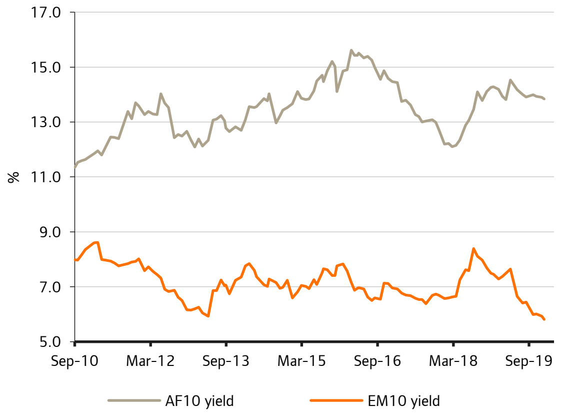
Our shadow portfolio is nearly composed of local currency bonds. The performance of the EGP and NGN bonds has been stellar in recent months. It has led us to start contemplating taking profits on our positions.

African local currency bonds slightly underperformed emerging market bonds in 2019 as African bond yields did not decline as much as those of emerging markets (Figure 6).

That is not true of Egyptian and Nigerian bond yields. The combination of incessant buying by foreign portfolio investors, declining inflation and monetary policy easing underpinned the reduction in Egyptian bond yields. Of course, the appreciation of the EGP added further to the outperformance of these bonds.

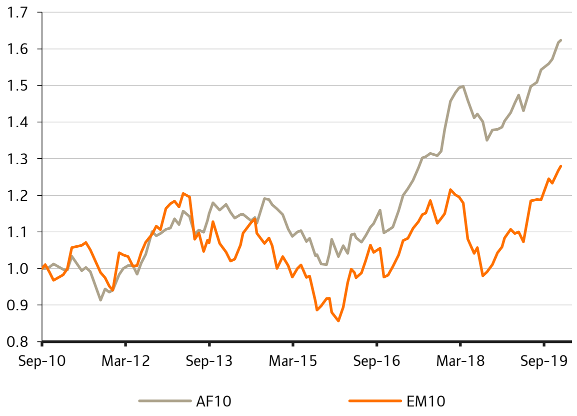
We have been anticipating that the Egyptian yield curve would dis-invert. But this is yet to materialise. Bond yields are now in the low teens, while T-bill yields are in the mid-teens. There seems to be a stronger bias for T-bills to fall faster than bond yields in the coming 4 – 6 months, something that would lead to that dis-inversion. Given that the bias if to the downside for yields across the curve, we will retain our position.

Figure 6: EM10 versus AF10 average 10-y bond yield



Source: Bloomberg; Standard Bank Research

Figure 7: EM10 versus AF10 average 10-y bond return



Source: Bloomberg; Standard Bank Research

Given that Nigerian inflation has been elevated, we were doubtful if there would be a trigger for bond yields to fall meaningfully. Well, the surprise decision by the CBN to prohibit local non-bank investors from participating in the OMO bill market forced those investors into buying government paper. This has pushed bond yields into the low teens, and T-bill yields into low single digits. Additionally, it is not issuing as much OMO bills to mop up excess liquidity in the market.

Inflation is still elevated, something that has led the CBN to refrain from lowering the Monetary Policy Rate. We wouldn't rule out the possibility that the CBN would regularise things by lowering the MPR. After all, it has eased its policy stance by allowing excess liquidity to build up in the money market. However, we remain unconvinced of much room for bond yields to fall further.

The case for Ugandan duration requires re-evaluation. The trade has not worked thus far, with yields backing up somewhat since we put it on. However, the currency remains solid.

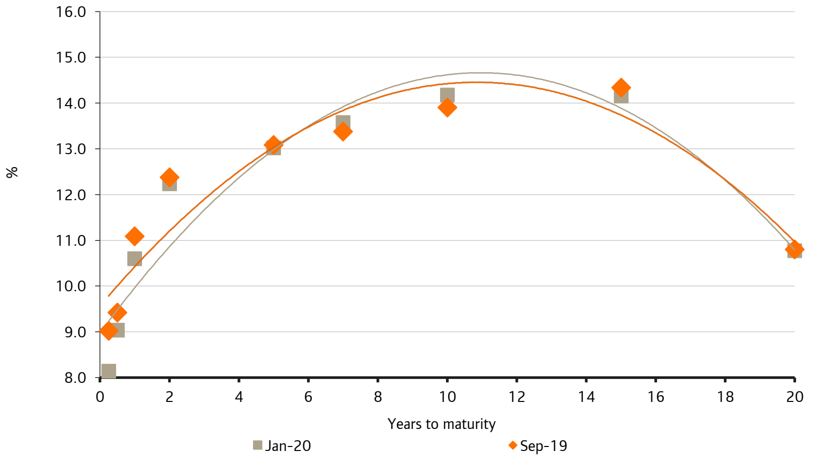
However, there is an election coming up next year. Local investors might start to anticipate that the government will ramp up spending in the lead-up to those elections. Furthermore, the government has been falling behind in its revenue collection targets. All this points to the possibility that yields might remain elevated, if not rise some more.

Truthfully, these dynamics would make the trade even more appealing. In addition to yields potentially rising, there is also a possibility that USD/UGX might also rise somewhat in coming months. Before previous elections we have witnessed plenty of conjecture about a potential boost to import demand that leads to a depreciation of the UGX. But such depreciation tends to peter out, sometimes as much as 6-m before the election. Therein lies our quandary. Do we get out now and re-enter the trade at potentially higher yields and exchange rate in Q3:20, or do we hold on through the possible turbulence in the intervening period?

Our KES duration trade worked out pretty much as we anticipated. The currency appreciated slightly, and yields fell. As Q1:20 progresses, it will be worth considering if this would be the right time to take profit on the trade.

To be clear, the CBK's MPC is more likely to cut than raise interest rates. Inflation is on its way down, and after the repeal of the rate cap, credit growth is continuing to accelerate modestly. Even though the trajectory for USD/KES might reverse in Q2:20, in large part due to a ramp-up in demand from multinational companies for dividend payments, the MPC is unlikely to be unduly concerned by this.

Figure 8: AF10 yield curve simple yield average



Source: Bloomberg; Standard Bank Research

Despite irksome fiscal policy management, we have retained our exposure to Zambian duration. Yields are quite elevated, having been in excess of 20% in the primary auction since the end of Dec 18. In fact, BOZ data indicates that the average bond yield rate in the 2-y to Dec 18 was about 19.3%.

Such high bond yields are bound to affect fiscal policy in a fundamental way. There is a strong likelihood that interest expenditure will absorb an ever-rising proportion of revenues, and account for a bigger share of total spending. Barring a fiscal adjustment this scenario could undermine overall macroeconomic stability.

This might be the year that the government finally delivers on the fiscal consolidation to which it has committed itself. We acknowledge, though, that the various shocks to have hit the economy, particularly the drought, could make fiscal consolidation hard to effect.

We have held a GHS bond position since late 2016. At the time, it seemed reasonable to believe that an improving BOP and ongoing disinflation would slow the pace of depreciation of the GHS while also leading to lower government bond yields.

The currency drag on this trade has been far too high. But, interestingly, it has not been consistent. The annual pace of depreciation was 13.1% in 2019, 8.4% and 8.8% in 2018 and 2017 respectively, 9.1% in 2016 and 13.9% in 2015. It still seems reasonable to expect that the GHS will settle into a single-digit pace of depreciation in the medium term. So, perhaps last year’s rather fast pace of depreciation, in a pre-election year, is similar to 2015, and will be followed by less depreciation in subsequent years. So, we will keep this position.

African Eurobonds: further yield compression, but with volatility

Since the Sep 19 edition of this report, African Eurobond spreads compressed. The spread over US Treasuries for our SBAFSOZ index – comprising all the USD Eurobonds issued by African governments, except South Africa – dropped to around 500 bps at the time of writing, from about 535 bps at the time of writing the Sep edition.

Even though African Eurobonds outperformed the broader EM in the past 4-m or so, as measured by the EMBI Global Index, EMBI spreads tightened by more. Such tightness of EM spreads, naturally, is a reason for some caution regarding African Eurobonds. EM spreads are lower than they were at the beginning of 2018, before the sell-off that ensued in the early part of that year. But, in the short term, the more subdued risk sentiment is, the more likely it is that the spread compression will continue.

Another reason for caution is impending issuance. Ghana has announced plans to issue up to USD3.0bn in Feb. We wouldn’t rule out other issuers over the course of this year. Perhaps Angola, Kenya, Egypt and Nigeria are candidates. Admittedly, the timing for some of these might be in H2:20 rather than H1:20.

We have not changed the composition of our portfolio much since deciding to increase our exposure to long duration bonds some 4-m ago. At that time the spread between longer duration bonds and shorter duration bonds was close to historical highs. For instance, the spread between the Egypt ‘47s and ‘23s was nearly 2 standard deviations away from the mean. Similarly, the spread between the Senegal ‘48s and ‘21s was nearly 1.9 standard deviations away from the mean. As we anticipated then, the spread is compressing.

Observing that the tensions between the US and China were thawing, we tactically increased our exposure to oil sovereigns, specifically Angola and Nigeria. We are happy to retain this exposure.

Egypt and Senegal are our core overweight positions. The Egyptian government's determination to arrest the debt will likely succeed given that it is targeting a primary surplus of 2% of GDP, perhaps sustaining that in the coming 3 – 5 years. Economic growth is solid, above 5.0% y/y on a multi-year basis, something that is likely to underpin revenue growth as well. Credit rating upgrades in the next 2-y are very likely.

Hedging CNY exposure

Trade consummated between Africa and China is still predominantly conducted in USD. Standard Bank offers forwards that allow African importers to hedge CNY exposure.

Indicative CNY forward prices

	Historical prices				Forward prices		
	-12m	-6m	-3m	spot	+3m	+6m	+12m
CNY/BWP	1.54	1.55	1.56	1.53	1.53	1.53	1.52
CNY/GHS	0.74	0.79	0.79	0.81	0.83	0.86	0.91
CNY/KES	15.01	15.14	14.68	14.52	14.61	14.72	14.92
CNY/MUR	5.11	5.30	5.19	5.23	5.21	5.19	5.14
CNY/ZAR	1.99	2.06	2.14	2.07	2.09	2.11	2.15
CNY/UGX	547.28	536.74	529.93	526.40	533.48	545.19	571.54

Source: Bloomberg Standard Bank Research

African Eurobonds

					Spread, bps		Spread change, bps			Total Return, %		
Name	**Moody's/Fitch**	**Mid Price**	**Mod Dur**	**Yield, %**	**Over UST**	**Z-Spread**	**1 wk**	**YTD**	**12mths**	**1 wk**	**YTD**	**12mths**
ANGOL 9.5% 12-NOV-2025	B3/B	117.830	4.5	5.83	430	427	16	-3	-44	-0.2	1.3	14.4
ANGOL 8.25% 09-MAY-2028	B3/	108.258	6.0	6.92	531	531	30	13	17	-1.1	0.9	13.3
ANGOL 8% 26-NOV-2029	B3/B	106.980	6.8	7.00	536	536	28	19		-1.1	0.6	
ANGOL 9.375% 08-MAY-2048	B3/	109.655	10.3	8.47	667	669	26	19	50	-1.6	0.7	14.2
ANGOL 9.125% 26-NOV-2049	B3/B	106.657	10.5	8.50	670	672	27	26		-1.7	0.1	
REPCAM 9.5% 19-NOV-2025	/B	114.601	3.9	5.95	444	441	4	-40	-99	0.3	2.6	16.3
REPCON 3% 30-JUN-2029	/CCC	88.035	4.0	9.06	755	747	9	7	-112	0.2	1.0	19.9
EGYPT 6.125% 31-JAN-2022	B2/B+	104.934	1.8	3.55	206	199	9	-25	-176	0.0	0.9	11.8
EGYPT 5.577% 21-FEB-2023	B2u/B+	105.079	2.8	3.81	233	227	8	1	-162	0.1	0.6	14.4
EGYPT 4.55% 20-NOV-2023	B2u/B+	102.806	3.5	3.75	225	223	4	0		0.2	0.8	
EGYPT 6.2004% 01-MAR-2024	B2u/B+	108.766	3.5	3.86	236	234	13	1		0.0	0.8	
EGYPT 5.875% 11-JUN-2025	B2/B+	107.631	4.6	4.27	274	272	9	-11	-184	0.1	1.6	21.6
EGYPT 7.5% 31-JAN-2027	B2/B+	114.201	5.4	5.06	348	348	1	-25	-151	0.5	2.7	22.3
EGYPT 6.588% 21-FEB-2028	B2u/B+	106.663	6.1	5.55	393	395	-7	-19	-106	1.1	2.8	21.4
EGYPT 7.6003% 01-MAR-2029	B2u/B+	112.138	6.5	5.86	422	423	2	-17		0.6	2.8	
EGYPT 7.0529% 15-JAN-2032	B2u/B+	106.821	8.1	6.23	453	454	2	-1		0.6	2.2	
EGYPT 6.875% 30-APR-2040	B2/B+	102.712	10.8	6.64	482	486	9	7	-74	0.0	1.9	28.0
EGYPT 8.5% 31-JAN-2047	B2/B+	114.432	11.0	7.27	544	548	12	-4	-76	-0.3	3.2	28.5
EGYPT 7.903% 21-FEB-2048	B2u/B+	107.705	11.4	7.25	540	546	18	1	-56	-0.9	2.7	26.4
EGYPT 8.7002% 01-MAR-2049	B2u/B+	114.784	11.2	7.45	561	566	16	0		-0.6	2.8	
EGYPT 8.15% 20-NOV-2059	B2u/B+	109.235	12.4	7.42	552	563	16	6		-0.8	2.3	
ETHOPI 6.625% 11-DEC-2024	B1/B	109.463	4.2	4.44	292	290	17	-13	-113	-0.2	1.5	16.3
GABON 6.375% 12-DEC-2024	/B	107.799	3.4	4.17	268	263	-19	-71	-256	1.1	3.3	21.2
GABON 6.95% 16-JUN-2025	Caa1/B	108.526	4.5	5.12	359	357	-7	-38	-185	0.8	2.8	22.1
GHANA 7.875% 07-AUG-2023	B3/B	111.595	3.0	4.30	282	277	6	-37	-156	0.2	1.9	15.2
GHANA 8.125% 18-JAN-2026	B3/B	110.643	4.1	5.63	412	409	7	-47	-134	0.2	2.9	18.5
GHANA 7.875% 26-MAR-2027	B3u/B	107.271	4.8	6.19	464	462	15	-23		-0.2	2.4	
GHANA 7.625% 16-MAY-2029	B3/B	103.056	6.0	7.13	552	552	27	4	-39	-0.9	1.4	17.7
GHANA 10.75% 14-OCT-2030	B1/BB-	130.233	6.4	6.50	486	486	18	-6	-87	-0.4	2.1	21.1
GHANA 8.125% 26-MAR-2032	B3u/B	102.962	7.2	7.59	592	591	21	6		-0.7	1.5	
GHANA 8.627% 16-JUN-2049	B3/B	101.264	10.5	8.51	670	673	19	8	2	-0.9	1.9	19.9
GHANA 8.95% 26-MAR-2051	B3u/B	103.255	10.3	8.64	685	686	24	12		-1.3	1.4	
IVYCST 5.375% 23-JUL-2024	Ba3/B+	105.817	4.0	3.95	243	242	14	2	-149	-0.1	0.8	17.4
IVYCST 2.5% 31-DEC-2032	/B+	100.065	5.6	5.74	414	410	21	21	-30	-0.5	0.3	14.4
IVYCST 6.375% 03-MAR-2028	Ba3/B+	108.225	5.6	4.98	339	340	9	-22	-113	0.1	2.7	20.2
IVYCST 6.125% 15-JUN-2033	Ba3/B+	103.198	8.6	5.76	405	405	13	-4	-70	-0.3	2.5	23.4
KENINT 6.875% 24-JUN-2024	/NR	108.983	3.8	4.60	309	307	14	0	-141	-0.1	0.9	17.0
KENINT 7% 22-MAY-2027	B2u/B+	107.210	5.0	5.62	407	405	15	3		-0.2	1.1	
KENINT 7.25% 28-FEB-2028	B2u/B+	108.920	6.0	5.85	424	424	19	18	-88	-0.5	0.4	20.0
KENINT 8% 22-MAY-2032	B2u/B+	109.764	7.5	6.75	507	507	14	13		-0.2	1.0	
KENINT 8.25% 28-FEB-2048	B2u/B+	108.786	11.1	7.50	566	570	11	9	-42	0.0	1.8	24.6
MOROC 4.25% 11-DEC-2022	/BBB-	105.325	2.7	2.32	84	79	16	20	-59	-0.1	0.0	8.6
MOROC 5.5% 11-DEC-2042	/BBB-	123.911	13.9	3.91	192	209	8	18	-36	0.3	1.1	23.6
MOZAM 5% 15-SEP-2031	Caa2u/	96.921	7.0	7.62	597	597	12	-21		0.0	3.5	
REPNAM 5.5% 03-NOV-2021	Ba2/BB	104.377	1.7	2.94	143	129	8	-17	-119	0.0	0.6	9.1
REPNAM 5.25% 29-OCT-2025	Ba2/BB	105.345	4.9	4.19	264	264	10	-4	-77	0.1	1.3	15.6

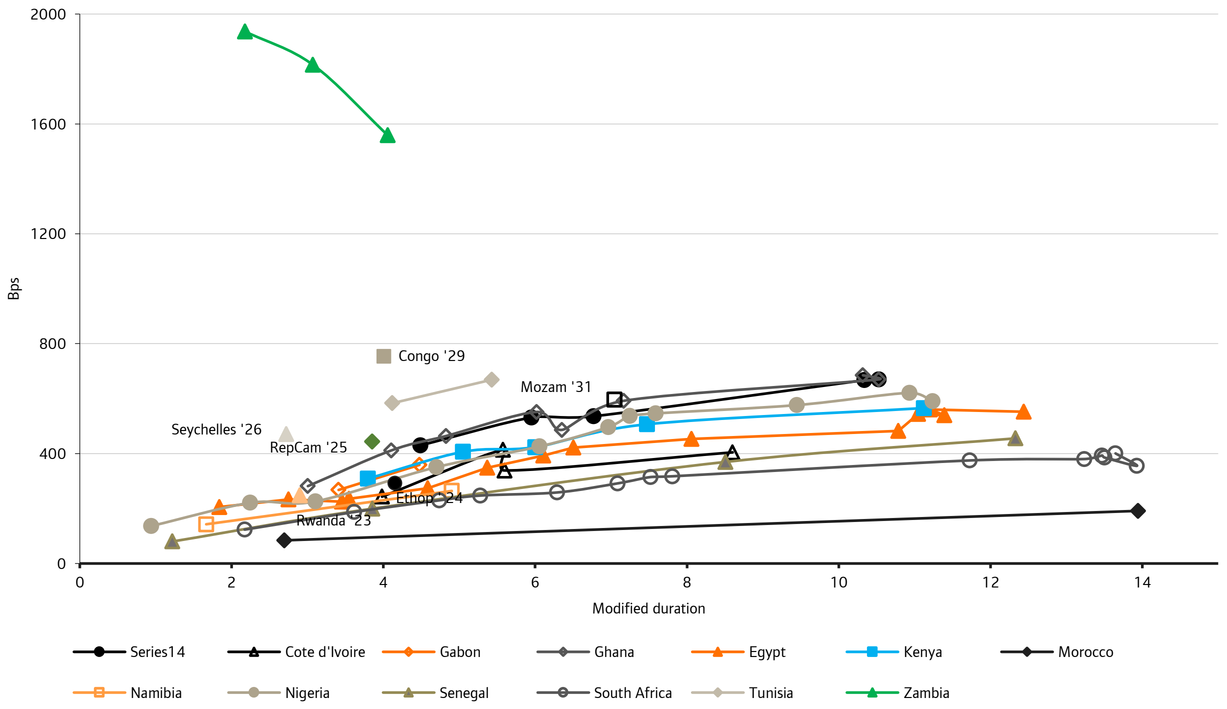
Continue on the next page

African Eurobonds (continued)

					Spread, bps		Spread change, bps			Total Return, %		
Name	Moody's/Fitch	Mid Price	Mod Dur	Yield, %	Over UST	Z-Spread	1 wk	YTD	12mths	1 wk	YTD	12mths
NGERIA 6.75% 28-JAN-2021	/B+	103.755	0.9	2.92	136	101	8	-22	-133	0.0	0.5	7.6
NGERIA 5.625% 27-JUN-2022	B2/B+	104.443	2.2	3.69	221	213	20	2	-95	-0.2	0.5	10.5
NGERIA 6.375% 12-JUL-2023	/B+	108.433	3.1	3.75	226	222	6	-37	-145	0.2	1.8	14.5
NGERIA 7.625% 21-NOV-2025	B2/B+	112.898	4.7	5.04	351	348	17	-30	-100	-0.3	2.6	17.3
NGERIA 6.5% 28-NOV-2027	B2/B+	103.855	6.1	5.88	426	428	28	-7	-44	-1.0	2.0	16.9
NGERIA 7.143% 23-FEB-2030	B2/B+	103.784	7.0	6.62	497	497	29	-3	-22	-1.2	2.1	17.2
NGERIA 8.747% 21-JAN-2031	B2/B+	112.870	7.2	7.04	537	538	25	-10	-13	-1.1	2.4	16.9
NGERIA 7.875% 16-FEB-2032	B2/B+	105.769	7.6	7.15	546	546	30	-2	3	-1.4	2.2	16.2
NGERIA 7.696% 23-FEB-2038	B2/B+	101.804	9.4	7.51	577	575	28	8	23	-1.6	1.6	16.1
NGERIA 9.248% 21-JAN-2049	B2/B+	113.519	10.9	8.04	621	625	24	6	14	-1.6	1.8	18.0
NGERIA 7.625% 28-NOV-2047	B2/B+	98.526	11.2	7.75	591	596	27	14	36	-1.8	1.3	15.3
RWANDA 6.625% 02-MAY-2023	/B+	108.079	2.9	3.96	247	243	10	-16	-132	0.0	1.1	13.7
SENEGL 8.75% 13-MAY-2021	Ba3/	108.132	1.2	2.33	80	52	17	8	-158	-0.1	0.1	8.2
SENEGL 6.25% 30-JUL-2024	Ba3/	111.342	3.9	3.51	200	198	15	4	-129	-0.1	0.7	15.3
SENEGL 6.25% 23-MAY-2033	Ba3/	107.381	8.5	5.41	370	371	14	-3	-76	-0.4	2.4	23.5
SENEGL 6.75% 13-MAR-2048	Ba3/	103.801	12.3	6.45	455	465	13	-3	-48	-0.5	3.4	25.7
SEYCHE 3% 01-JAN-2026	/BB	105.037	2.7	6.20	471	463	-6	-13	1	0.5	1.2	10.0
SOAF 5.875% 30-MAY-2022	Baa3/BB+	107.127	2.2	2.71	123	116	9	4	-61	0.0	0.3	8.2
SOAF 4.665% 17-JAN-2024	Baa3/BB+	104.780	3.6	3.37	187	184	14	9	-38	-0.1	0.5	10.3
SOAF 5.875% 16-SEP-2025	Baa3/BB+	110.234	4.7	3.84	230	229	15	17	-35	-0.2	0.2	12.3
SOAF 4.875% 14-APR-2026	Baa3/BB+	104.496	5.3	4.05	247	249	12	13	-21	-0.1	0.6	12.4
SOAF 4.85% 27-SEP-2027	Baa3/BB+	104.109	6.3	4.21	259	262	13	11	-29	-0.2	0.8	14.4
SOAF 4.3% 12-OCT-2028	Baa3/BB+	98.040	7.1	4.57	292	295	17	24	11	-0.4	0.0	12.6
SOAF 4.85% 30-SEP-2029	Baa3/BB+	100.203	7.5	4.83	315	318	15	22		-0.4	0.2	
SOAF 5.875% 22-JUN-2030	Baa3/BB+	108.105	7.8	4.87	317	321	13	24	4	-0.3	0.1	14.0
SOAF 6.25% 08-MAR-2041	Baa3/BB+	107.869	11.7	5.62	375	383	14	22	32	-0.5	0.4	13.9
SOAF 5.375% 24-JUL-2044	Baa3/BB+	95.256	13.2	5.74	380	393	15	23	50	-0.8	0.0	12.1
SOAF 6.3% 22-JUN-2048	Baa3/BB+	105.724	13.5	5.88	393	407	17	26	32	-0.8	0.0	14.7
SOAF 5.65% 27-SEP-2047	Baa3/BB+	97.743	13.5	5.81	386	400	16	22	44	-0.7	0.6	12.9
SOAF 5% 12-OCT-2046	Baa3/BB+	92.405	13.9	5.55	356	373	12	21	49	-0.3	0.8	12.2
SOAF 5.75% 30-SEP-2049	Baa3/BB+	97.039	13.6	5.97	401	416	18	29		-0.9	-0.3	
BTUN 5.75% 30-JAN-2025	B2/B+	93.395	4.1	7.35	583	581	13	25	-36	0.0	0.1	15.2
BTUN 8.25% 19-SEP-2027	B2/WD	99.853	5.4	8.27	669	668	27	34	44	-0.8	-0.3	12.5
ZAMBIN 5.375% 20-SEP-2022	/CCC	69.664	2.2	20.85	1,936	1,930	-65	-18	874	2.0	2.0	-3.0
ZAMBIN 8.5% 14-APR-2024	/CCC	69.007	3.1	19.63	1,815	1,809	-23	44	732	1.4	0.4	-4.5
ZAMBIN 8.97% 30-JUL-2027	/CCC	68.921	4.1	17.11	1,559	1,554	-14	31	537	1.3	0.5	-3.6
SB Africa Eurobond (incl. SA)	B+		7.1	6.51	486	481	17	6	-13	-0.4	1.4	16.4
SB Africa Eurobond (excl. SA)	B+		6.8	6.77	512	508	17	2	-21	-0.4	1.5	17.0

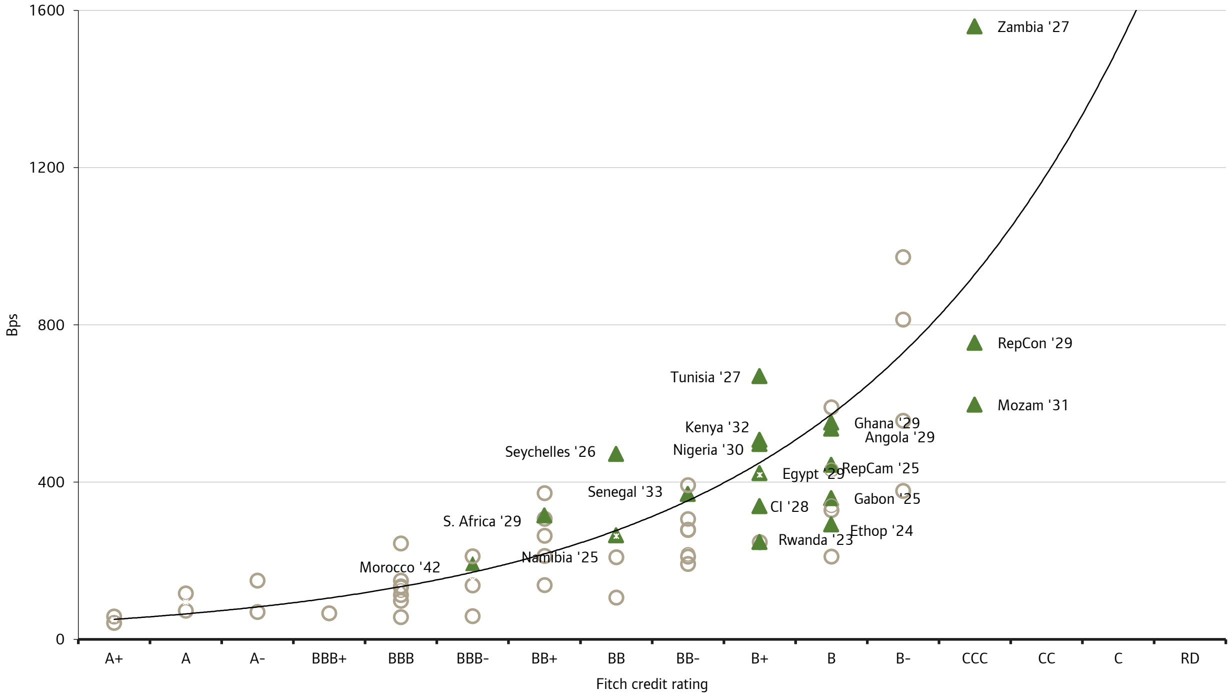
Source: Bloomberg; Standard Bank Research

Figure 9: African sovereign USD bonds (spread over US Treasuries versus modified duration)



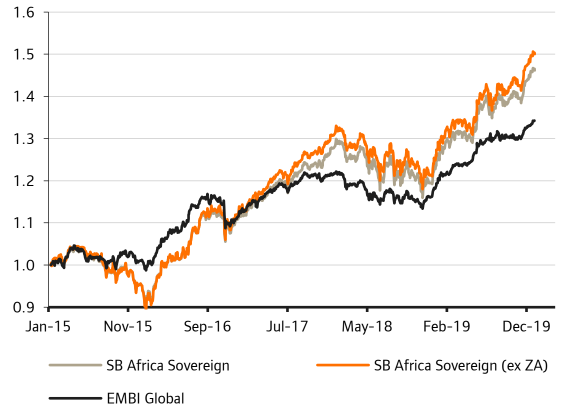
Source: Bloomberg; Standard Bank Research

Figure 10: African and broader EM bonds (spread over US Treasuries versus credit rating)



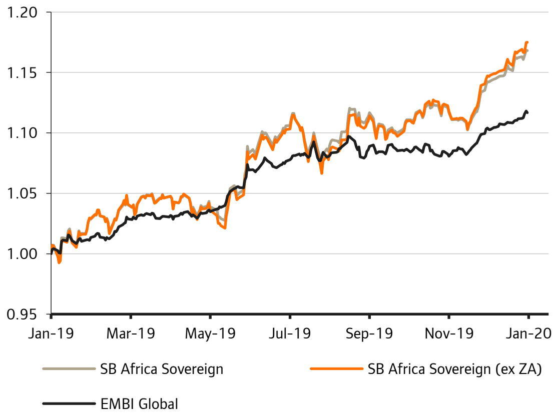
Source: Bloomberg; Standard Bank Research

Figure 11: African Eurobonds (5-y performance)



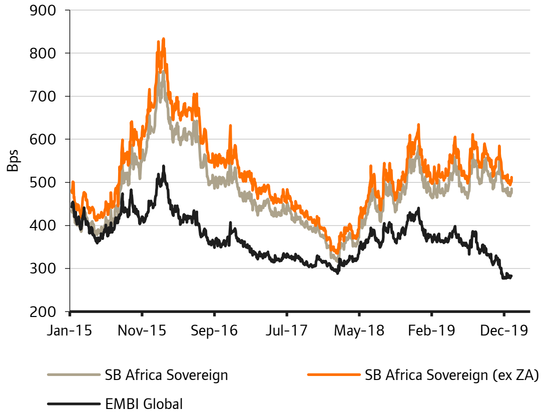
Source: Bloomberg; Standard Bank Research

Figure 12: African Eurobonds (1-y performance)



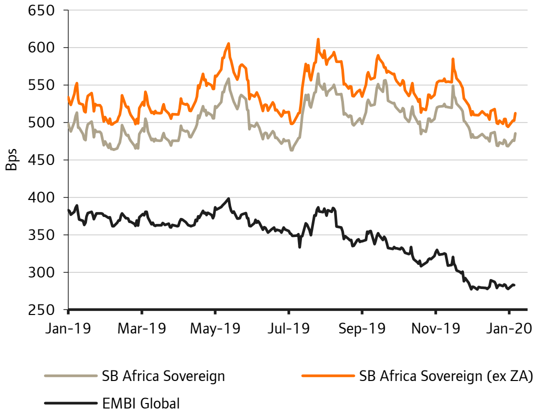
Source:

Figure 13: African Eurobonds spread over UST (5-y)



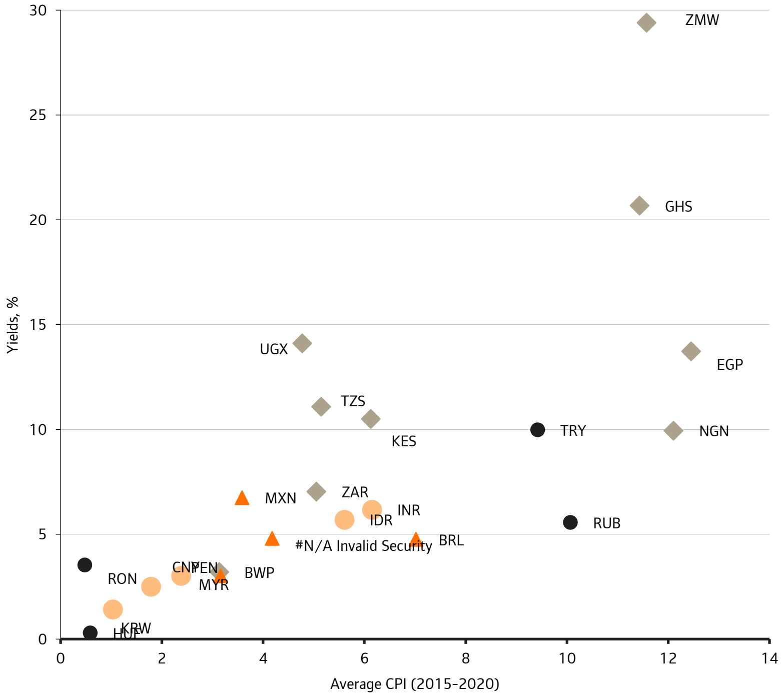
Source: Bloomberg; Standard Bank Research

Figure 14: African Eurobonds spread over UST (1-y)



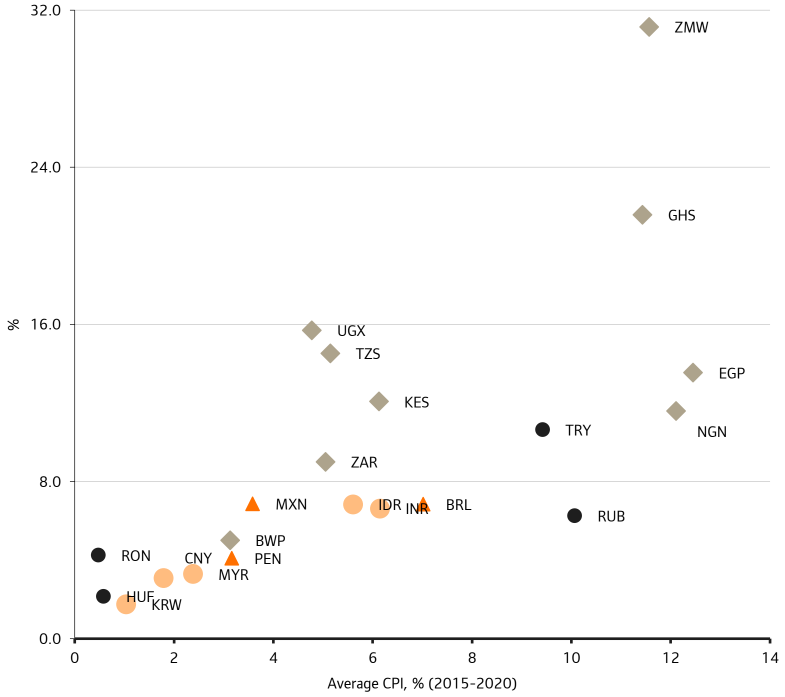
Source: Bloomberg; Standard Bank Research

Figure 15: Local 2-year bonds vs. past and forecast inflation



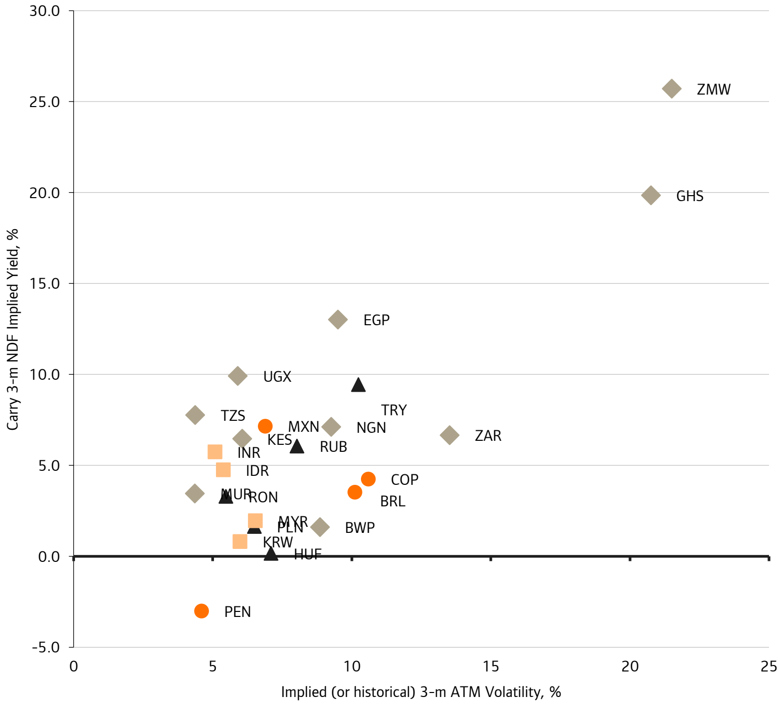
Source: Bloomberg; Standard Bank Research

Figure 16: Local 10-year bonds vs. past and forecast inflation



Source: Bloomberg; Standard Bank Research

Figure 17: NDF carry rates vs. implied vols



Source: Bloomberg; Standard Bank Research

Table of expected returns over the next 3 months

		Yield, %				Total return, %		
Country	Tenor	Current yield	Slide	Forward	SB forecast	Slide	Forward	SB forecast
Botswana	2Y	2.58	2.48	2.63	2.90	1.1	0.4	0.1
	5Y	3.79	3.70	3.88	3.58	1.6	0.2	1.9
	10Y	4.85	4.82	4.93	5.20	1.5	0.6	-1.5
Egypt	2Y	13.71	13.82	13.62	13.40	3.3	3.6	3.9
	5Y	13.53	13.54	13.47	13.55	3.4	3.6	3.3
	10Y	13.60	13.62	13.58	13.73	3.3	3.5	2.7
Ghana	2Y	19.03	18.65	19.94	21.40	5.3	3.4	1.3
	5Y	20.86	20.89	21.46	20.80	5.1	3.5	5.4
	10Y	19.56	19.67	19.90	19.00	4.4	3.4	7.2
Kenya	2Y	10.69	10.47	11.20	10.7	3.0	1.8	2.7
	5Y	11.87	11.83	12.17	11.7	3.1	1.9	3.6
	10Y	12.28	12.28	12.50	12.6	3.1	1.9	1.3
Nigeria	2Y	8.95	8.84	8.56	9.66	2.4	2.9	1.0
	5Y	11.07	10.95	11.05	10.86	3.2	2.8	3.5
	10Y	12.33	12.31	12.37	11.65	3.2	2.9	6.8
Tanzania	2Y	7.85	7.38	8.45	11.5	2.7	0.9	-4.2
	5Y	11.94	11.69	12.48	12.1	3.9	1.0	2.4
	10Y	14.78	14.71	15.29	14.8	4.1	1.1	3.6
Uganda	2Y	14.26	13.94	14.89	14.5	4.1	2.6	3.2
	5Y	16.20	16.16	16.63	16.3	4.2	2.6	3.7
	10Y	16.12	16.15	16.40	15.6	3.9	2.7	6.5
Zambia	2Y	32.51	32.46	35.37	31.50	8.2	4.5	9.4
	5Y	31.33	31.45	32.79	31.20	7.6	4.4	8.1
	10Y	30.82	30.88	31.92	30.80	7.5	4.5	7.8

Source: Bloomberg; Standard Bank Research

Notes: Yield curve scenarios: "Slide" = the bond yields slide along the unchanged yield curve, "Forward" = the yield curve evolves according to its embedded forward rates, "SB forecasts"= Standard Bank Research expectations

Asset class expected performance summary (3 months)

	FX	Rates	Credit
Angola	↑	↓	↓
Botswana	↓	→	
Côte d'Ivoire	→	↑	↑
Democratic Republic of the Congo	↓	↓	
Egypt	↑	↑	↑
Ethiopia	↓	→	↑
Ghana	↓	→	↑
Kenya	→	→	↑
Malawi	→	↓	
Mauritius	↑	→	
Morocco	↑	→	↑
Mozambique	→	↓	↓
Namibia	↑	↑	→
Nigeria	↑	↓	↑
Rwanda	→	↓	→
Senegal	→	↑	↑
Tanzania	↓	↓	→
Tunisia	↑	↑	↓
Uganda	↓	↑	
Zambia	↓	→	→

Source: Bloomberg; Standard Bank Research

Recommended trades: performance

Open trades

	Entry date	Entry yield, %	Entry FX	Latest yield, %	Latest FX	Total return, %	
Positions						**Since inception**	**1-month**
Ghana: buy GHGB '20	31-Oct-16	20.00	3.99	19.36	5.58	22.7	2.7
Zambia: buy ZAMGB '26	18-Nov-16	24.50	9.81	31.12	14.55	18.0	2.2
Egypt: buy Egypt '27	23-Nov-17	15.88	17.69	13.61	15.77	63.0	5.4
Nigeria: buy NIGB '27	27-Feb-18	13.70	361.00	11.20	362.24	34.6	6.5
Uganda: buy Uganda '29	14-Oct-19	14.90	3700	15.71	3680	0.3	-1.7
Kenya: buy INF 2035	28-Oct-19	12.40	103.60	11.50	100.83	11.6	4.4
Zambia: sell USD/ZMW 6-m NDF	10-Dec-19	25.02	15.25	24.67	14.55	7.6	
Total portfolio internal rate of return since prev. AMR (15-Sep-2019)						**7.6**	

Source: Bloomberg; Standard Bank Research

Zambia: likely trough the only silver lining

GDP growth: probably now at the bottom

We see 2019 as the trough, with GDP growth then likely to rise modestly in the next 2-y. We forecast GDP growth of 2.4% y/y in 2020 and 2.8% y/y in 2021, from what we estimate was 2.2% y/y growth in 2019 and 4.0% y/y growth in 2018.

Perhaps our forecasts are conservative, as growth could surprise to the upside 2020, setting a decent base for 2021. Though drought had hampered both electricity and agricultural production, rainfall in the current season seems to have normalised, with the volume of water flowing down the Zambezi River exceeding that of last year already, boding well for agricultural production (which contracted by 10.5% y/y and 5.1% y/y in Q1:19 and Q2:19 respectively).

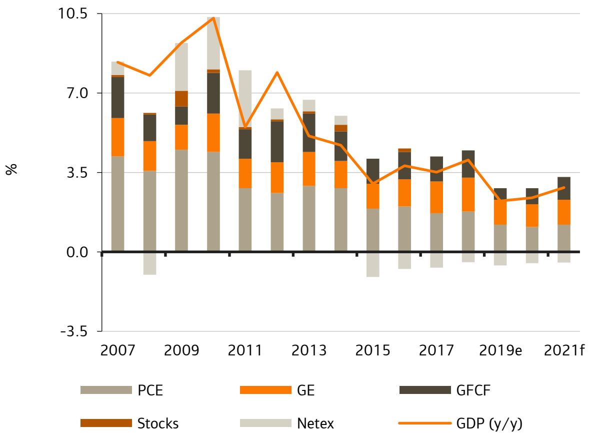
The agricultural sector contracted by 31.9% y/y in Q4:18 and 15.4% y/y in Q3:18. The upward pressure on some food prices during 2019 was therefore due to the drought – but output now should recover meaningfully.

Despite the drastic reduction in hydro-electricity generation capacity, the electricity and gas sector contracted just 6.1% y/y in Q2:19 after average growth of just over 10.5% y/y a quarter in the prior 5-q. It is highly probable that the data will be revised downwards to reflect the challenges the sector faced in 2019.

The trajectory of the Stanbic Bank Zambia PMI illustrates just how depressed economic activity has been. Bar the 50.4 in Feb 19, the index has been below 50 since Aug 18. The index trended upwards, but remained in contraction, during H2:19, to an average of 48.6 in the 3-m to Nov, from a low of 43.9 in May, before then sliding to 46.9 in Dec.

Zambia remains bedevilled by liquidity challenges which make it hard for government to effect timely payments. Even employees get paid late. This is also true of other payment arrears. Over the past 3-y, such payment arrears have undermined economic activity.

Composition of GDP growth by demand



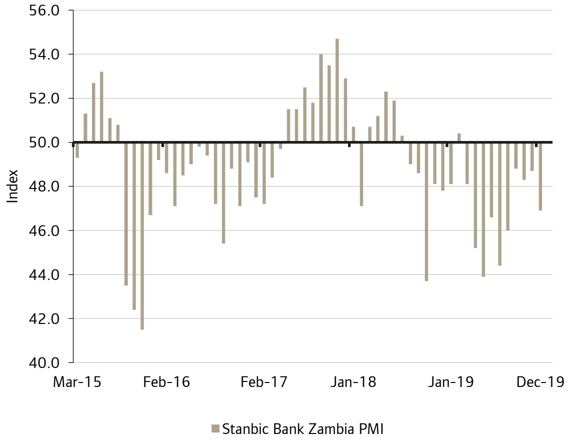
Source: Central Statistics Office; Standard Bank Research

Contribution to GDP by sector

	2011	2015	2017
Agriculture, forestry and fishing	9.6	7.3	8.2
Mining and quarrying	12.1	10.3	10.4
Manufacturing	7.7	8.1	8.0
Construction	9.7	10.3	11.0
Wholesale and retail trade	20.5	22.8	21.3
Financial and insurance activities	3.7	3.9	3.5
Real estate activities	4.0	3.4	3.4
Public administration and defence	3.2	5.0	5.2
Education	7.0	7.4	7.7

Source: Central Statistics Office

Purchasing Managers' Index



Source: Stanbic Bank Zambia; Markit

Quarterly indicators

	Q1:18	Q2:18	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19e	Q1:20f	Q2:20f	Q3:20f	Q4:20f
GDP (% y/y) pa	3.0	4.7	6.0	2.5	2.3	2.2	1.9	2.6	2.9	2.0	2.0	2.7
CPI (% y/y) pe	7.1	7.4	7.9	7.9	7.5	8.6	10.5	11.7	12.3	11.5	10.3	9.0
M3 (% y/y) pe	9.9	15.6	24.7	16.5	17.6	15.4	6.0	12.3	14.6	13.2	19.7	23.5
CA/GDP (%) pe	-3.8	-3.2	-3.0	-1.4	-3.7	-4.5	-6.6	-0.8	-6.7	-5.5	-4.5	-0.4
FX reserves (USD bn) pe	1.8	1.8	1.9	1.6	1.8	1.9	2.0	1.4	1.4	1.3	1.3	1.5
Import cover (months) pe	2.1	2.1	2.2	1.8	2.5	2.6	2.7	1.9	1.8	1.7	1.7	2.0
3-m rate (%) pe	10.0	10.0	10.0	12.0	14.8	15.5	15.8	16.5	16.6	16.8	17.0	18.5
5-y rate (%) pe	17.9	20.0	20.0	21.0	23.5	24.5	25	25.5	25.0	25.0	22.5	22.5
USD/ZMW pe	9.8	10.0	12.0	11.9	12.1	12.8	13.1	14.0	14.6	14.9	14.5	14.3

Source: Bank of Zambia; Central Statistics Office; Bloomberg; Standard Bank Research

Notes: pe — period end; pa — period average

Political risks: both pre-election and fiscal

By far, fiscal policy conduct remains the biggest risk to Zambia's economy, and this could derail macroeconomic stability. The government has given assurances of progress in implementing the fiscal consolidation measures that it announced last year and has stopped contracting new commercial loans. However, the build-up in external debt is due to the disbursement of debt that has been contracted but not yet drawn down.

The next elections will be in 2021. There will be political noise, with parliamentary and local government by-elections indicating the ruling party or opposition as gaining ground. President Lungu has been asserting his authority within the ruling party, with some high-profile party members leaving the party. But to be fair, the party has also garnered defectors from other parties.

Using the 2016 elections as guide, the upcoming election will be close fought. Although President Lungu obtained just over 50% of the votes cast in the presidential election, he had just over 100k more than Hakainde Hichilema. The parliamentary results were much closer. Of course, the Patriotic Front won 80 seats as opposed to 58 for the United Party for National Development. But, in terms of the votes garnered, the PF had just over 12.5k votes more than the UPND.

The closer the election, the higher the chance of violence erupting. Actually, attempts by the police to disrupt mass mobilisation efforts by the opposition would likely trigger such incidents of violence.

Elections 2016

Presidential election (Aug 2016)

	Party	% of votes
Edgar Lungu	PF	50.4
Hakainde Hichilema	UPND	47.7
Edith Nawakwi	FDD	0.7

Composition of parliament

	Seats	% of votes
Patriotic Front	80	42.0
United Party for National Development	58	41.7
Movement for Multi-party Democracy	3	2.7
Forum for Democracy and Development	1	2.2
Independents	14	9.5
Total	156	100

Source: Electoral Commission of Zambia; National Assembly of Zambia

Balance of payments: supported by official inflows

While the downward pressure on gross FX reserves persisted for much of H1:19, FX reserves were, remarkably, hardly changed in H2:19. Given that data for H1:19 shows that the C/A balance was in a small deficit, then capital flows were clearly enough to bolster FX reserves.

We expect relative stability in FX reserves this year, ending the year at USD1.5bn, covering 2.0-m of goods and services imports. We estimate that they ended 2019 at USD1.4bn, covering 1.9-m of goods and services imports.

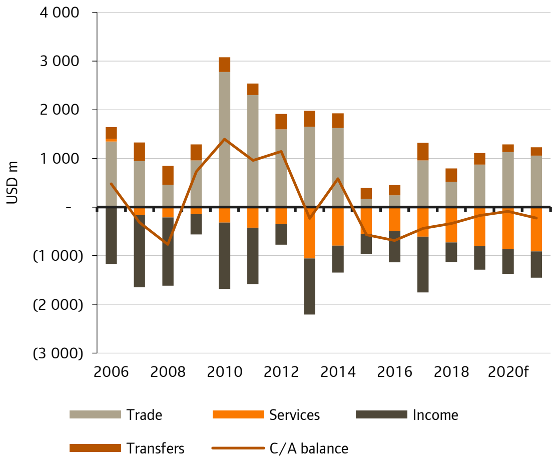
Of course, a notable development during 2019 was the decline of both goods exports and imports. The decline in goods exports was mainly a function of lower copper export volumes. Naturally, much of this decline reflected a reduction in the volume of copper concentrate imported from the DRC to be processed in plants in Zambia. This resulted from the government imposing a duty on imported copper concentrate.

We do not expect this to recur in 2020. Hence, we expect copper export volumes to recover somewhat, which would bolster overall exports. But, notably, we expect exports to remain below the level reached in 2018. Nevertheless, the overall C/A balance will likely remain in deficit in both 2020 and 2021, amounting to 0.4% and 0.8% of GDP respectively. We anticipate that some acceleration in the growth of economic activity in 2021 will lead to a widening of the C/A deficit that year.

Capital flows are likely to be dominated by official flows. Even though the government is restricted from accessing the Eurobond market, it seems to be able to tap previously contracted but undisbursed debt. This will likely remain the most important source of external financing.

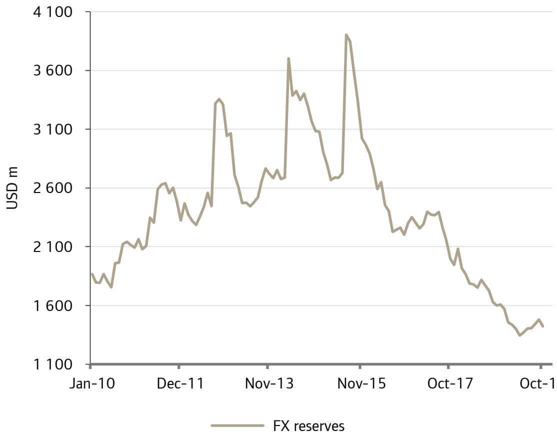
With copper prices evidently remaining elevated, it is likely that FDI inflows will also remain in excess of USD500m a year in the next 2-y.

Current account developments



Source: Bank of Zambia; Standard Bank Research

FX reserves



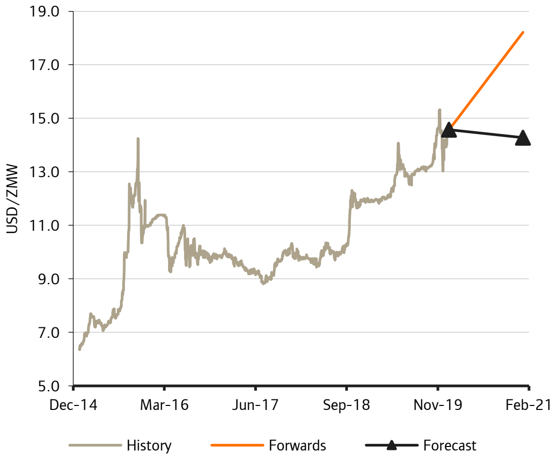
Source: Bank of Zambia

FX outlook: volatility to remain elevated

Periods of relative USD/ZMW stability tend to be punctuated by sharp depreciation. This will likely persist on a multi-month basis, with the bias being for ZMW depreciation. Note that, for all the intermittent volatility, the ZMW depreciated by just about 15.7% in 2019, far lower than the level of the 1-y T-bill yield. It seems likely that this volatility will prove enduring.

However, we expect the recent stability of USD/ZMW to persist in the near term. The pair is likely to be trading near 14.60 by Mar and 14.90 by Jun. The challenge in forecasting this pair is that BOP developments do not suggest that the pair can remain stable for a prolonged period. Yet, it seems as if the BOZ can achieve a measure of stability after exerting pressure on FX traders. An abiding danger is the amount in excess of ZMW7bn in local bonds held by foreign investors.

USD/ZMW: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Monetary policy: approaching hiking cycle peak

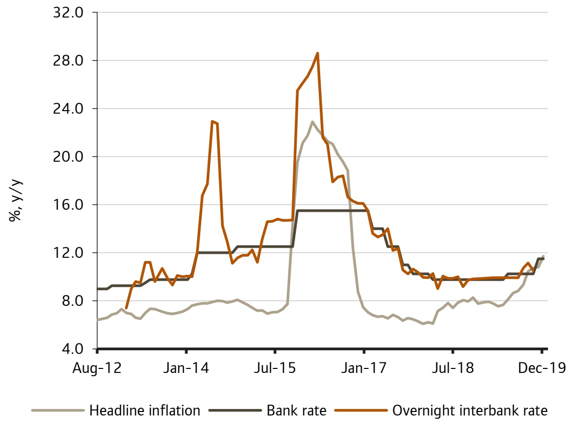
It looks increasingly likely that the BOZ's MPC will soon conclude this hiking leg of the monetary policy cycle. We still see scope for one more hike, perhaps in May. The committee could even reverse course, and cut rates, before year-end.

Previously, we'd expect a further 125 bps of rate hikes this year. But now, the most significant factor changing our expectations is good rainfall which could restrain food inflation. Last year we believed that upside pressure on food inflation would push headline inflation higher to a peak in the mid-teens. We also anticipated that a depreciation of the ZMW would exert further upward pressure on headline inflation.

However, upside pressure on headline inflation has been far more subdued. Headline inflation ended 2019 at 11.7% y/y. Sure, food inflation pressures have become evident, with food inflation rising to 15.2% y/y in Dec. However, the transport index, rising by 17.6% y/y in Dec, and averaging a 16.8% y/y pace of increase in Q4:19, was the only other sub-index rising at a pace in excess of the 8.0% y/y upper bound of the inflation target range. Indeed, non-food inflation exceeded 8.0% y/y in the 4-m to Sep.

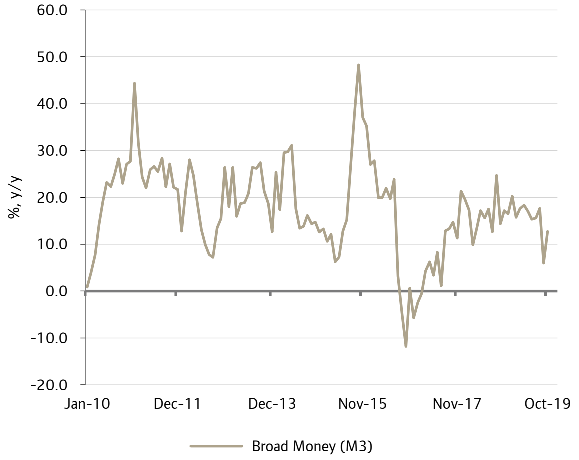
Weather forecasts by the Meteorological Department indicate rainfall of normal to above normal in most parts of Zambia. Furthermore, the Zambezi River Authority says that water volume down the river now exceed that of last year. So, food inflation pressures may peter out in the coming months. Also, despite the ZMW depreciating by more than 15% in 2019, pass-through to inflation has been limited.

Inflation and interest rates



Source: Bank of Zambia; Central Statistics Office

Money supply growth



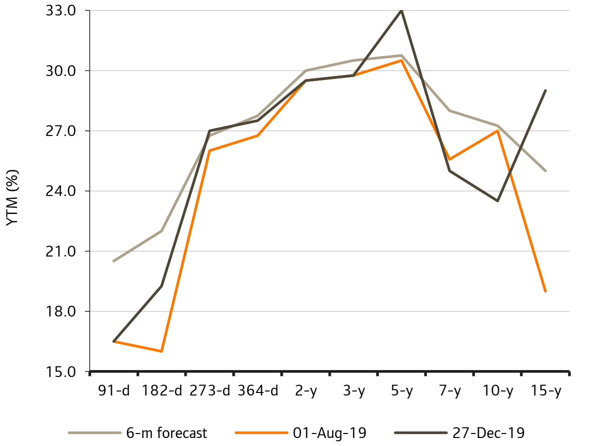
Source: Bank of Zambia

Yield curve outlook: erratic yield movements

The dynamics in the market would ordinarily have led to an increase in yields, especially T-bill yields. In 2019, especially in H2:19, inflation risks were elevated. Also, demand for paper was hardly sufficient to allow the government to fully issue the paper it made available in most T-bill and bond auction. Yet, yields hardly budged, rising only fitfully when they did move.

For example, the 91-d T-bill yield was flat at 16.5% in H2:19, while the 1-y yield eventually settled at 27.5% from 26.5% in Jun. The 10-y yield was mostly at 27% between May and Nov, up from 25.85% in Apr, but then dropped to 23.5% in the last auction of the year in Dec. Meanwhile, the 15-y yield jumped to 29% in Dec having been in the high teens for most of the year. Chances are these dynamics will not change much, with demand for paper likely to remain inadequate to absorb the amount on offer.

Yield curve changes



Source: Bank of Zambia; Standard Bank Research

Fiscal policy: mounting external debt service

It is hard to argue that much has changed since the IMF reiterated its assessment when publishing its Article IV report that, under current policies, public debt is on an unsustainable path. The fiscal consolidation that the market has been hoping for is not materialising.

The government entered into contracts for debt some years ago. But, that debt is only now being disbursed. So, in effect, the government pre-financed projects that, at the time the debt was contracted, were yet to be approved through the parliamentary budgeting process. So, when the budget is prepared now, the government essentially seeks parliamentary approval for these ‘pre-financed’ projects.

But one can’t overlook the fact that there is a build-up of expenditure arrears. The IMF sees this as a manifestation of the inevitable fiscal adjustment which is occurring in a disorderly fashion. One also can’t overlook the fact that external debt service payment obligations are a consistent strain on FX reserves. They keep government demand for FX elevated, a situation that is only likely to escalate in coming years.

The IMF optimistically states that there is a narrow window of opportunity for policymakers to tackle fiscal challenges in an orderly and planned manner. The latter would require large front-loaded and sustained fiscal adjustment, centred, among others, on prioritisation of public investment projects, scaling back of tax exemptions and postponing the contracting of new external non-concessional debt.

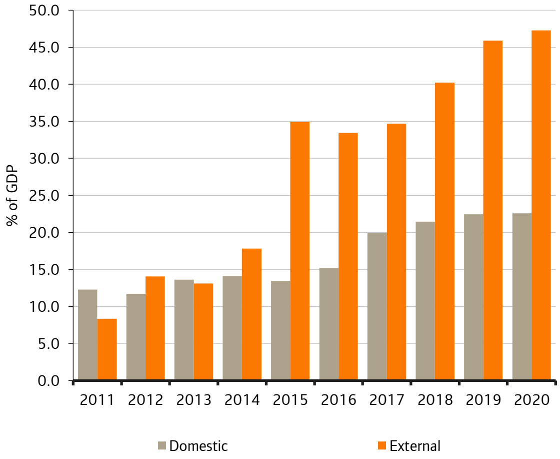
The government has conceded the last point, committing itself to not contracting new debt.

Central government budget

% of GDP	2017	2018	2019
Total revenue and grants	17.7	19.1	18.3
Total expenditure	25.4	25.4	24.7
- Interest	4.7	4.0	4.7
- Salaries		8.6	8.2
Overall balance (+ grants)	-7.7	-6.3	-6.4
Net domestic borrowing	4.9	4.1	1.1
Net external borrowing	2.9	2.2	5.2
Donor support (grants)	0.2	0.9	0.0

Source: Ministry of Finance and National Planning

Debt to GDP



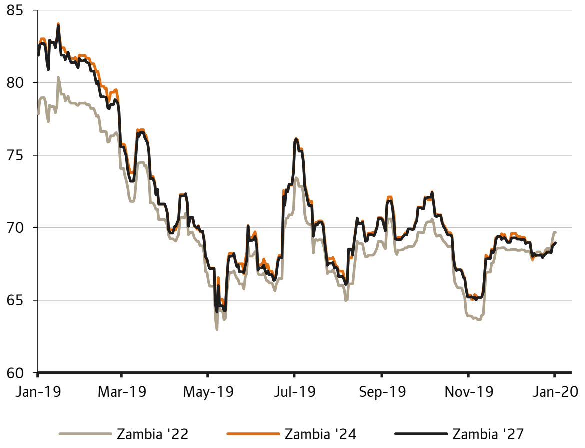
Source: Ministry of Finance and National Planning

Eurobond outlook: range-bound

The bonds are likely to trade mostly in a range of 65 – 75 over the coming 4 – 6 months. This range has predominated over the past 12-m. Occasionally, bond prices rise whenever the market hopes for an IMF-funded program rise. But when prices approach 75, optimism wanes and prices drop to 65 – 70. It seems like there is a limited set of statements that the government can make that would move the prices definitively out of this range.

For one thing, the government seems keen to portray an image of self-sufficiency. But the market is unlikely to be reassured by this. Perhaps, if the government were to resolve to invite the IMF to help it craft an economic program that the IMF would fund, then prices would break through 75. But that likelihood seems remote. Another action that the market would probably find heartening would be a restructuring of non-Eurobond external debt that pushes maturities further into the future.

Eurobond prices – mid



Source: Bloomberg

Annual indicators

	2015	2016	2017	2018	2019e	2020f	2021f
Output							
Population (million)	15.6	16.0	16.4	16.9	17.4	17.6	17.9
Nominal GDP (ZMW m)	183 381	217 225	243 127	271 160	301 996	342 818	380 576
Nominal GDP (USD bn)	19.2	20.8	25.2	24.2	23.2	23.5	27.6
GDP / capita (USD)	1 235	1 302	1 537	1 432	1 332	1 338	1 541
Real GDP growth (%)	3.0	3.8	3.5	4.0	2.2	2.4	2.8
Copper production ('000 tons)	711	775	755	830	850	875	905
Central Government Operations							
Budget balance / GDP (%)	-9.3	-8.8	-7.7	-6.2	-6.4	-6.1	-5.8
Domestic debt / GDP (%)	13.5	15.2	19.9	21.4	22.5	23.0	23.8
External debt / GDP (%)	34.9	33.5	34.7	40.1	46.2	51.0	52.8
Balance Of Payments							
Goods and services exports (USD bn)	8.2	7.4	9.1	10.0	8.8	9.6	10.5
Goods and services imports (USD bn)	8.6	7.7	8.7	10.2	8.7	9.4	10.4
Trade balance (USD bn)	-0.4	-0.2	0.4	-0.2	0.1	0.3	0.1
Current account (USD bn)	-0.6	-0.7	-0.4	-0.3	-0.2	-0.1	-0.2
- % of GDP	-3.0	-3.3	-1.7	-1.4	-0.8	-0.4	-0.8
Capital and Financial account (USD bn)	0.0	0.3	0.4	-0.1	0.2	0.2	0.3
- FDI (USD bn)	1.2	0.5	1.2	0.4	0.8	0.6	0.7
Basic balance / GDP (%)	3.2	-1.0	3.0	0.1	2.5	2.2	1.7
FX reserves (USD bn) pe	3.0	2.4	2.1	1.6	1.4	1.5	1.7
- Import cover (months) pe	4.1	3.7	2.9	1.8	1.9	2.0	2.0
Sovereign Credit Rating							
S&P	B	B	B	B	B	B	B
Moody's	B2	B3	B3	B3	B3	B3	B3
Fitch	B	B	B	B-	B-	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	10.0	18.2	6.6	7.5	9.1	11.1	8.2
Consumer inflation (%) pe	21.1	7.5	6.1	7.9	11.7	9.0	8.4
M3 money supply (% y/y) pa	22.0	7.2	7.8	16.3	14.9	16.1	24.7
M3 money supply (% y/y) pe	35.2	-5.7	21.4	16.5	12.3	23.5	24.2
Policy interest rate (%) pa	13.00	15.50	12.31	9.79	10.29	12.00	10.38
Policy interest rate (%) pe	15.50	15.50	10.25	9.75	11.50	11.50	10.00
3-m rate (%) pe	15.0	20.5	9.8	12.0	16.5	18.5	19.0
1-y rate (%) pe	21.5	25.0	16.5	19.5	20.0	21.0	22.0
3-y rate (%) pe	23.5	23.2	18.0	20.0	21.5	22.0	25.0
5-y rate (%) pe	28.0	25.0	18.0	21.0	25.5	22.5	25.5
USD/ZMW pa	9.6	10.5	9.6	11.2	13.0	14.6	13.8
USD/ZMW pe	11.0	9.8	10.0	11.9	14.0	14.3	13.6

Source: Bank of Zambia; Central Statistics Office; Bloomberg; Standard Bank Research; Ministry of Finance and National Planning

Notes: pe — period end; pa — period average

Glossary

For brevity, we frequently use acronyms that refer to specific institutions or economic concepts. For reference, below we spell out these and provide definitions of some economic concepts that they represent.

14-d	14-day, as in 14-d deposit, which denotes 14 day deposit
10-y	10-year
16 Jan 13	16 January 2013
3-m	3 months
3m	3 million, as in USD3m, which denotes 3 million US dollars
3bn	3 billion, as in UGX3bn, which denotes 3 billion Ugandan shillings
3tr	3 trillion, as in TZS3.0tr, which denotes 3 trillion Tanzanian shillings
AOA	Angola Kwanza
BAM	Bank Al Maghrib
BCC	Banque Central du Congo (Central Bank of Congo)
BCEAO	Banque Central des États de L'Afrique de l'Ouest (Central Bank of West African States)
BCT	Banque Central de Tunisie
BM	Banco de Moçambique
BNA	Banco Nacional de Angola
BOB	Bank of Botswana
BOG	Bank of Ghana
BOM	Bank of Mauritius
BON	Bank of Namibia
BOP	Balance of payments – a summary position of a country's financial transactions with the rest of the world. It encompasses all international transactions in goods, services, income, transfers, financial claims and liabilities.
BOT	Bank of Tanzania
BOU	Bank of Uganda
BOZ	Bank of Zambia
BR	Bank Rate (Reserve Bank of Malawi)
BRVM	Bourse Régionale des Valeurs Mobilières (Regional Securities Exchange)
BWP	Botswana Pula

C/A	Current account balance. This is the sum of the visible trade balance and the net invisible balance of a country. The latter includes net service, income and transfer payments.
Capital account	Captures the net change in investment and asset ownership for a nation by netting out a country's inflow and outflow of public and private international investment.
CBE	Central Bank of Egypt
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CDF	Congolese Franc
CPI	Consumer Price Index – An index that captures the average price of a basket of goods and services representative of the consumption expenditure of households within an economy.
Discount rate	Policy rate for Bank of Uganda
Disinflation	A decline in the rate of inflation. Here prices are still rising but with a slower momentum.
Disposable income	After tax income
DM	Developed markets
ECB	European Central Bank
EGP	Egyptian pound
EM	Emerging markets
ETB	Ethiopian Birr
Eurobond	A bond denominated in a currency other than the home currency of the issuer.
Exports	The monetary value of all goods and services produced in a country but consumed broad.
FMDQ	FMDQ OTC Securities Exchange, Nigeria
FX	Foreign Exchange
FY2016/17	2016/17 fiscal year
GCE	Government Consumption Expenditure - Government outlays on goods and services that are used for the direct satisfaction of the needs of individuals or groups within the community. This would normally include all non-capital government spending.
GDE	Gross domestic expenditure, the market value of all goods and services consumed in a country – both private and public – including imports but excluding exports. This is measured over a period of time – usually a quarter/year.
GFCF	Gross Fixed Capital Formation – this is investment spending, the addition to capital stock such as equipment, transportation assets, electricity infrastructure, etc to replace the existing stock of productive capital that is used in the production of goods and services in a given period of time, usually a year/quarter. Normally, the higher the rate of capital, the faster an economy can grow.
GDP	Gross Domestic Product – the monetary value of all finished goods and services produced in a country in a specific period, usually a year/quarter.

GHS	Ghanaian Cedi
H1:16	First half of 2016
Imports	The monetary value of goods and services produced abroad and consumed locally.
Inflation	The rate at which the general level of prices of goods and services are rising. It is usually measured as the percentage change in the consumer price index over a specific period, usually a month/year.
Invisible trade balance	The value of exports of services, income and transfers, less imports of same.
Jan 16	January 2016
KBRR	Kenya Bankers' Reference Rate
KES	Kenya Shilling
KR	Key Rate (Bank Al Maghrib)
KRR	Key Repo Rate
m/m	Month on month, in reference to a rate of change
MAD	Moroccan Dirham
MLF	Marginal Lending Facility
MOF	Ministry of Finance
MPC	Monetary Policy Committee, the committee that makes the decision on policy rates
MPR	Monetary Policy Rate
MUR	Mauritian Rupee
MWK	Malawian Kwacha
MZN	Mozambican Metical
NAD	Namibian Dollar
NBE	National Bank of Ethiopia
NBR	National Bank of Rwanda
NEER	Nominal Effective Exchange Rate. This is the weighted average rate at which a country's currency exchanges for a basket of currencies, usually trading partner currencies. It is measured in index format.
NGN	Nigerian Naira
Nominal GDP	The monetary value of all finished goods and services produced in a country in a specific period, usually a year/quarter, measured in current prices.
NPL	Non-Performing Loans

Parity	Refers to the par or nominal value of a debt instrument. This is usually the price at which the said instrument is redeemed on maturity.
PCE or HCE	Personal or Household Consumption Expenditure: The monetary value of household purchases of durable goods, non-durable goods, semi durables and services within a given period of time, usually a year/quarter.
PR	Policy Rate
Prime rate	key lending rate
q/q	quarter on quarter, in reference to a rate of change
Q1:16	First quarter of 2016
RBM	Reserve Bank of Malawi
Real GDP	The monetary value of all finished goods and services produced in a country in a specific period, usually a year/quarter, measured in constant prices.
REER	Real Effective Exchange Rate. This is the weighted average rate at which a country's currency exchanges for a basket of currencies - usually trading partner currencies – while taking into account any changes in relative prices between the host country and its trading partners. It is often measured in index format.
RWF	Rwandan Frank
SARB	South African Reserve Bank
SDF	Standing Deposit Facility (Mozambique)
SLF	Standing Lending Facility (Mozambique)
T-bill	Treasury bill – A short-dated, government backed security that yields no interest but is issued at a discount over a period of less than one year.
TND	Tunisian Dinar
Treasury bond	A marketable government debt security with a maturity of a year or longer
TZS	Tanzanian Shilling
UGX	Uganda Shilling
USD	US Dollar
VAT	Value Added Tax
Visible trade balance	The value of exports of visible goods less imports.
WAEMU	West African Economic and Monetary Union, also known as Union Economique et Monetaire Ouest Africaine (UEMOA)
XAF	Central African Franc
XOF	West African Franc
y/y	Year on year, in reference to a rate of change

Yield	The return on an investment, usually expressed as a percentage over a period of time, usually a year.
YTD	Year to date
ZAR	South African Rand
ZMW	Zambian Kwacha

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Ferishka Bharuth
+27-11-415-4553
Ferishka.Bharuth@standardbank.co.za

Mulalo Madula
+27-11-415-4552
Mulalo.Madula@standardbank.co.za

Phumelele Mbiyo
+27-11-415-4486
Phumelele.Mbiyo@standardbank.co.za

Fausio Mussa
+258-215-01012
Fausio.Mussa@standardbank.co.mz

Jibran Qureishi
+254-203-638138
Jibran.Qureishi@stanbic.com

Dmitry Shishkin
+44-203-145-6963
Dmitry.Shishkin@standardbank.com

Gbolahan Taiwo
+234 1 422 8290
Gbolahan.Taiwo@stanbicibtc.co.za