While African markets are facing extensive macro challenges, there are reasons to be optimistic. Although foreign investment in Africa has declined due to negative sentiment about emerging markets in general, the withdrawals have been partially offset by increased domestic investor activity. Local investors are fuelling growing interest in both traditional and non-traditional asset classes, including alternative investments.

At the same time, African markets are embracing post-trade reforms and adopting regulations aimed at promoting best practices. Experts from Standard Bank participated at The Network Forum (TNF) Africa Meeting in South Africa, where they discussed some of the key issues facing the region's capital markets.

A region facing choppy waters ahead

According to IMF (International Monetary Fund) data, GDP (gross domestic product) growth in sub-Saharan Africa is expected to be relatively flat this year – hovering at around 3.8% – as the region continues to recover from COVID-19, and deal with various market headwinds. [1]

"We have some pressing challenges in the region, namely the debt burden and the growing cost of servicing that debt; inflation and its impact on living costs, especially for those on low incomes; an expected global slowdown which could affect commodity producing markets; and high interest rates, which will affect growth," commented Rajesh Ramsundhar, Group Head, Investor Services at Standard Bank.

Shireen Darmalingam, Senior Macroeconomic Strategist at Standard Bank, said the IMF expected South Africa's GDP to grow by 1.2% in 2023, which is broadly aligned with the bank's own predictions, as the country continues to grapple with weak external demand, power shortages and structural constraints. [2] Although GDP growth could rise to 1.7% in 2024, Darmalingam warned South Africa's economy risks being held back by potential political instability, high unemployment and ongoing concerns about load shedding.

"Load shedding was a major downside risk to economic growth in 2022, and it will continue to weigh down the recovery in 2023," said Darmalingam.

Foreign outflows accelerate, but a domestic investor base emerges

Foreign investors may be exiting Africa, but the continent's domestic institutions are in solid shape. Chenge Besa, Head of Custody Products for Growth Markets, Africa Regions at Standard Bank said Africa's savings base has increased exponentially, which in turn is driving AUM (assets under management) growth in the region's pension funds.

Others agreed. "While we have seen foreign investors withdraw from markets in the region, there has been a substantial growth in the domestic savings and investment market. We need to keep growing this domestic market as it will create a fertile ground for foreign investors once they return," noted Ramsundhar.

Looking further ahead, experts believe the continent's youthful population will be instrumental in facilitating liquidity in local markets. "In some of the leading African financial centres, the population

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[1] IMF – January 2023 – World Economic Outlook Update
[2] IMF – January 2023 – World Economic Outlook Update

is youthful and affluent and highly knowledgeable," said Selvan Kistnasamy, Head of Equities, Global Markets at Standard Bank.

Local investors seek out alternative income streams within Africa

Many of these local institutions are eschewing offshore investments in favour of obtaining returns closer to home, and for good reason. Domestic equity markets are flourishing, said Besa, who added there were 71 IPOs (initial public offerings) in Africa between 2017 and 2021, cumulatively raising $8billion.

Cross-border trading is also expected to be given a boost by the Africa Exchanges Linkage Project (AELP), an African Development Bank sponsored initiative designed to remove some of the obstacles impeding cross-border investment, capital raising and IPOs in the participating markets (i.e. the Bourse Régionale des Valeurs Mobilières markets; Egypt; Morocco; Kenya; Nigeria; Mauritius, South Africa, and most recently Ghana and Botswana). If successful, the AELP could unleash a wave of liquidity across Africa as it will provide regional investors with greater access to a wider pool of assets.

New and historically restrictive African markets are also stirring interest among regional and global investors as they start developing their own domestic capital markets. "Positive regulatory reforms in Angola – particularly of its bond market – has generated interest among banks. We are also seeing a number of new listing announcements on various African stock exchanges. For instance, there are several oil and gas companies potentially looking to list in Mozambique in the near future, while the Ethiopian Stock Exchange (ESX) is expected to start operating from next year. There are already 50 companies waiting to list on the ESX," said Besa.

Despite the growth in pension fund assets in Africa, and the transition away from defined benefit to defined contribution schemes, investments into alternatives – loosely defined here as private equity funds, venture capital, infrastructure, exchange traded funds (ETFs), real estate investment trusts (REITs), asset backed securities, Environmental Social and Governance (ESG) linked financing and affordable housing – have traditionally been very limited.

However, appetite for alternatives is slowly gathering momentum among some of the return hungry local investors. The opportunities available from investing into alternative products – such as infrastructure – should not be underestimated. "Africa has an infrastructure funding gap of between $130 billion and $170 billion per year, and this gap needs filling if the continent's power and transportation requirements are to be met," said Besa.

The value-add of digital assets

Digital assets were covered at length during TNF. Firstly, there is a glaring divide between the attitudes among retail investors to crypto-currencies versus risk-averse institutions. Hari Chaitanya, Head of Investor Services: Product Management at Standard Bank commented that retail investors in Kenya, Nigeria and South Africa are among the most enthusiastic buyers of crypto-currencies in the world, however institutions have not shown much interest so far. "Most institutional investors do not focus on crypto-currencies due to the lack of regulatory clarity as well as restrictions in their investment mandates," said Chaitanya.

Despite the reservations institutions have about crypto-currencies, there is growing interest in asset tokenisation. This is where digitally-native or existing securities are digitalised and turned into tokens that can be traded and fractionalised using Blockchain technology. Through fractionalisation, tokenised assets are much cheaper than traditional securities. If the concept takes off, it could potentially trigger a wave of retail investment and with it, liquidity throughout Africa. “I believe asset tokenisation will promote greater inclusion in African capital markets just as the mobile banking revolution enabled the democratisation of banking on the continent,” commented Chaitanya.

Although markets such as South Africa are imposing supervisory frameworks on crypto-asset service providers, Chaitanya said developing a regulatory regime for digital assets would not be entirely straightforward. “Firstly, there needs to be a distinction between the different types of digital assets such as crypto-currencies and tokens. In the case of tokens, we need to ask ourselves if there should be a separate regulatory framework for tokens versus existing securities. If not, then we will need to tweak the current regulatory framework. We must also decide if separate regulations are required for digitally-native tokens directly issued on-chain versus tokens representing underlying assets such as equities or bonds,” said Chaitanya.

Post-trade reforms in Africa start to take off

Through post-trade reforms and the implementation of best practices, African markets are making themselves more attractive to foreign institutional investors. FMIs (financial market infrastructures) are being established or upgraded in several countries. TNF heard that South Africa is hoping to go live with a CCP (central counterparty clearing house) shortly, while Namibia is due to launch its first standalone CSD (central securities depository). A number of other countries – including Botswana – are also eschewing manual processes by adopting SWIFT connectivity so as to support STP (straight-through processing).

And finally, the industry is positing how the decision by India, the US and Canada to shorten their equity trade settlement cycles to T+1 will impact financial institutions in Africa. Despite the logistical challenges involved with shorter settlements, some African markets – namely Nigeria – are consulting on whether it makes sense to adopt T+1. This has elicited criticism from some quarters who argue Nigeria should be focusing on more pressing matters – such as shortening its CCI (Certificate of Capital Importation) process – rather than prioritising a potential move to T+1. Chaitanya said that while Nigeria does have some structural issues to address, T+1 could help attract more investors to the market, thereby driving up liquidity.

However, there are concerns that the adoption of shorter settlement cycles in the US, Canada and India could impact African financial institutions with exposures to those markets. With less time to match and reconcile trades, the number of fails is likely to increase, and this will disproportionately affect African markets with the biggest time-zone differences to the US, Canada and India respectively.

Despite the challenges, Standard Bank is optimistic that global allocators will once again return

African markets have been under a lot of pressure recently, first because of the impact of COVID-19 and now the knock-on effects caused by inflation and tighter monetary policy. Despite global investors exiting the region in favour of safer alternatives, domestic institutions are becoming more active, and seeking out returns in Africa as opposed to globally.

Buoyed by the investment opportunities available inside Africa, Standard Bank is optimistic that global allocators will once again return to the continent very soon.