AGI Markets Monitor: African equity markets gain, sovereign bonds face pressure, and most currencies decline against the dollar

July 2018 update

Amadou Sy & Amy Copley

The *Africa Growth Initiative (AGI) Markets Monitor* aims to provide up-to-date financial market and foreign exchange analysis for Africa watchers with a wide range of economic, business, and financial interests in the continent. Following the previous updates in 2016 and 2017*,* the *July 2018 update* continues tracking the diverse performances of African financial and foreign exchange markets through the first half of 2018 (2018 H1) and provides a summary of developments throughout 2017. We offer our main findings on key events influencing the region's economies: rising energy prices, gains in certain African equity markets, a reversal in sovereign bond sentiment, and declines in dollar terms for most of the region's currencies.

Key trends in 2018 H1

- **Commodity markets:** Energy and agricultural prices rose in 2018 H1, but metal prices fell slightly. In particular, throughout 2017 and 2018 H1, energy prices continued to recover from the 2014 slump, which adversely affected macroeconomic conditions in oil-exporting countries such as Angola, Cameroon, Chad, Gabon, Nigeria, and the Republic of the Congo. Strengthening oil prices—which have risen from a monthly averages of $54 per barrel in January 2017 to $73 per barrel in May 2018—have eased some of the fiscal pressure on these countries.

- **Equity markets:** In 2018 H1, the MSCI Emerging Frontier Markets in Africa (excluding South Africa) Index overperformed the emerging markets benchmark while several African equity markets—including Ghana, Kenya, and Nigeria—continued to rally after noteworthy performances in 2017. These positive returns signal that certain African stock exchanges have, for now, managed to weather investor concerns over risks posed by the strengthening U.S. dollar, rising U.S. treasury rates, and trade tensions between the U.S. and China.

- **Sovereign bond markets:** There was a reversal in sentiment towards African sovereign bonds in 2018 H1 as spreads increased over the board in contrast to 2017. Investors cut exposure to high-yielding, riskier emerging market assets on signs of a stronger dollar and rising U.S. treasury rates. A stronger dollar has renewed investor concerns that some African countries may not be capable of repaying their foreign currency-denominated debts.

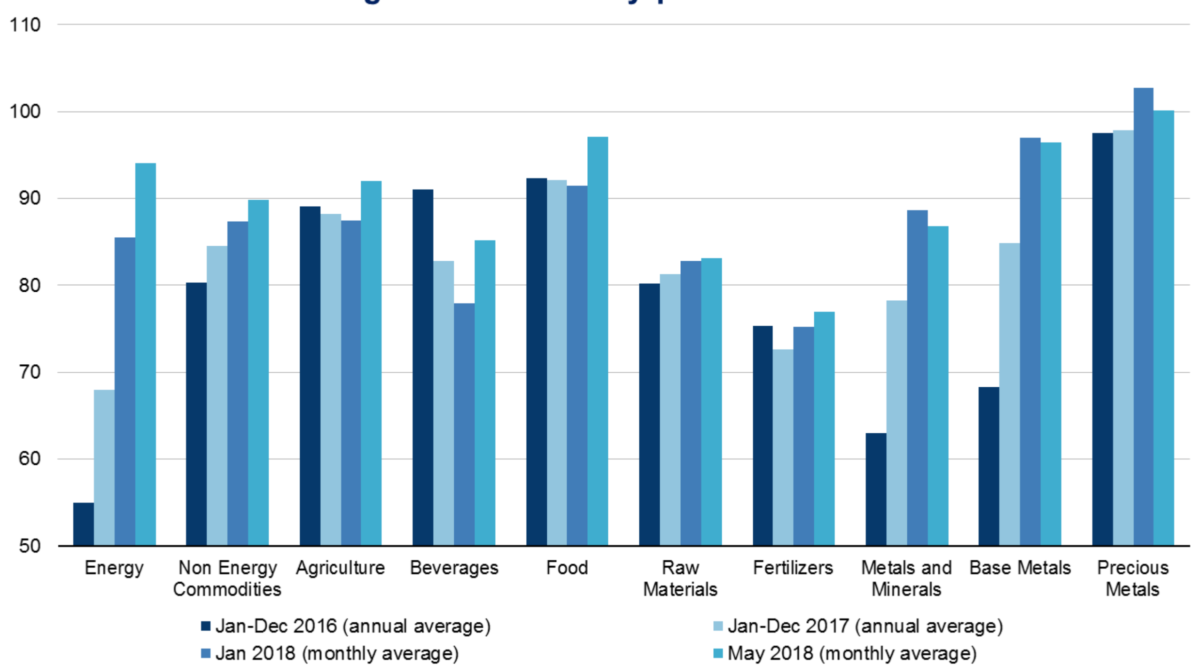
- **Foreign exchange markets:** While most African currencies weakened against the U.S. dollar in 2018 H1, the Kenyan shilling and Zambian kwacha strengthened slightly. These countries benefited from inflows of foreign exchange from offshore investors and international firms, whereas many resource-rich countries are still making fiscal adjustments and rebuilding their foreign reserves following the commodity price slump in 2014.

Commodity markets

In 2018 H1, energy and agricultural prices increased while metals prices dropped

- **Energy:** In 2018, the World Bank's energy price index—which measures the prices of oil, coal, and natural gas—increased by roughly 10 percent from January to May, as crude oil and natural gas prices continued to rise relative to the previous year (see Figure 1). Crude oil prices climbed on average from $66 per barrel in January 2018 to $73 per barrel in May due to OPEC (Organization of the Petroleum Exporting Countries) and its allies' compliance with production cuts, as well as supply-side constraints in Venezuela, Libya, and Canada. Still, the U.S.—which has now surpassed Saudi Arabia as the second-largest oil producer in the world—offset some of the impact of the production cuts with its rapid increase in shale oil production. In June, OPEC and its allies agreed to a total production increase of 1 million barrels a day in order to ease rising oil prices. However, several countries are expected to fall short of the required output, and, according to *Bloomberg*, the likely production increase will likely amount to 700,000 barrels a day instead. Meanwhile, natural gas prices—which remained relatively stable throughout 2017—jumped almost 27 percent from December 2017 to January 2018, due to supply disruptions in the North Sea and wintry weather in the northern hemisphere.

Figure 1. Commodity price indices



Source: World Bank, Commodities Price Data (The Pink Sheet), updated on June 4, 2018.
Note: Index (2010 = 100).

The future outlook for 2018 energy prices suggests that several factors will continue to influence oil prices in the near future, including rising demand from developed and developing economies alike, as well as changes in oil supply possibly influenced by the evolving balance between production cuts by OPEC and its allies, production increases of U.S. shale, or disruptions due to geopolitical risks. In particular, tensions related to U.S. sanctions on Iran—and the U.S. demand that its allies cut their imports of Iranian oil by November—could reduce Iranian oil exports, which, under prior sanctions, fell by 1 million barrels per day.

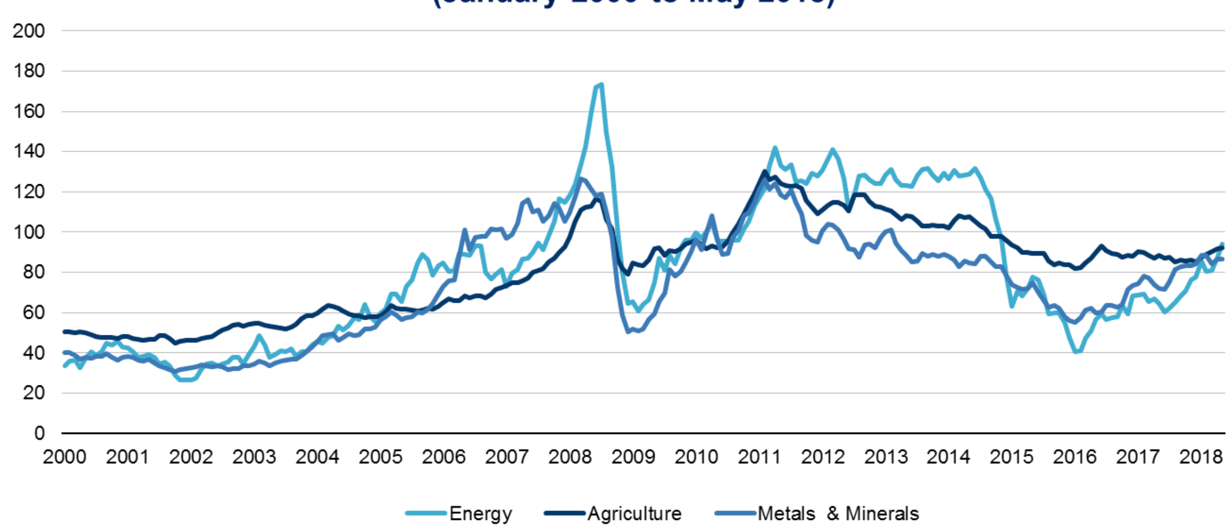
- **Metals:** The World Bank's metals and minerals price index fell by 2 percent from January to May 2018 over concerns that more tariffs and a trade war between China and the U.S. could slow global manufacturing and growth. On the upside, further tightening in Chinese metal production levels could prop up aluminum, steel, and iron ore prices for exporters in Africa. Then again, potential new tariffs on metals—in the U.S., China, and elsewhere—could limit global manufacturing, growth, and demand for metals.

- **Agriculture:** The World Bank's agricultural price index increased by 5 percent, due in large part to increases in food prices, mainly in grains and vegetable oils and meals as the U.S. reduced plantings of wheat, maize, and soybeans. The climate event La Niña also decreased soybean production in Argentina. Moving forward into 2018, food prices could continue to be influenced by supply-side risks, particularly energy and fertilizer prices, weather events, trade policies, and production subsidies.

In 2017, energy prices surged, driving a rise in overall commodity prices

Africa's fuel and metals exporters benefited from higher energy and metals prices in 2017, while agricultural prices remained fairly stable throughout the year, as noted below (Figure 2).

Figure 2. Commodity price indices (January 2000 to May 2018)



Source: World Bank, Commodity Price Data (The Pink Sheet).
Note: Monthly indices based on nominal U.S. dollars, 2010=100.

- **Energy:** The energy price index increased by 13 percent in 2017, with crude oil prices climbing from monthly averages of nearly $54 per barrel to $61 per barrel throughout the year. Oil prices remained low in 2017 H1, due in large part to growing inventories, increased production of U.S. shale, and high oil output levels from Libya and Nigeria—two OPEC members that were exempted from a November 2016 OPEC production cut agreement. However, greater compliance by oil producers to cuts later in 2017, coupled with growing demand for oil and more subdued U.S. shale oil production led prices to increase by the end of the year. Furthermore, coal prices rose late in 2017 as China reduced its coal production in an attempt to cut excess capacity and curb air pollution. The rise in energy prices in 2017 eased pressures on certain African natural resource-exporting countries adversely affected by the 2014 slump in commodity prices, such as Angola, Cameroon, Chad, Gabon, Nigeria, and the Republic of the Congo.

- **Metals:** Metals prices were also affected by China's efforts to curtail surplus production, rising 13 percent throughout the year. The metals and minerals price index rose in the third quarter of 2017 due largely to reduced supply of metals from China. Global demand for metals remained high, and consumption of metals continued to be driven by China. Higher, consistent metals prices provided a solid foundation for economic growth in certain metals exporters, such as Zambia, whereas other metals exporters, like the Democratic Republic of the Congo (DRC), Sierra Leone, and Mozambique, continued to see a lag in economic recovery as they suffered from domestic challenges and weaknesses in non-metals sectors.

- **Agriculture:** The agricultural price index fell by 5 percent in 2017 as food markets—particularly maize, rice, and sugar—continued to be well supplied. Although stocks for some grains reached relative highs at the global level, local conditions such as drought (in Ethiopia, Somalia, and Kenya, for example) and conflict (in South Sudan and Nigeria) limited food availability in some areas.

Equity markets

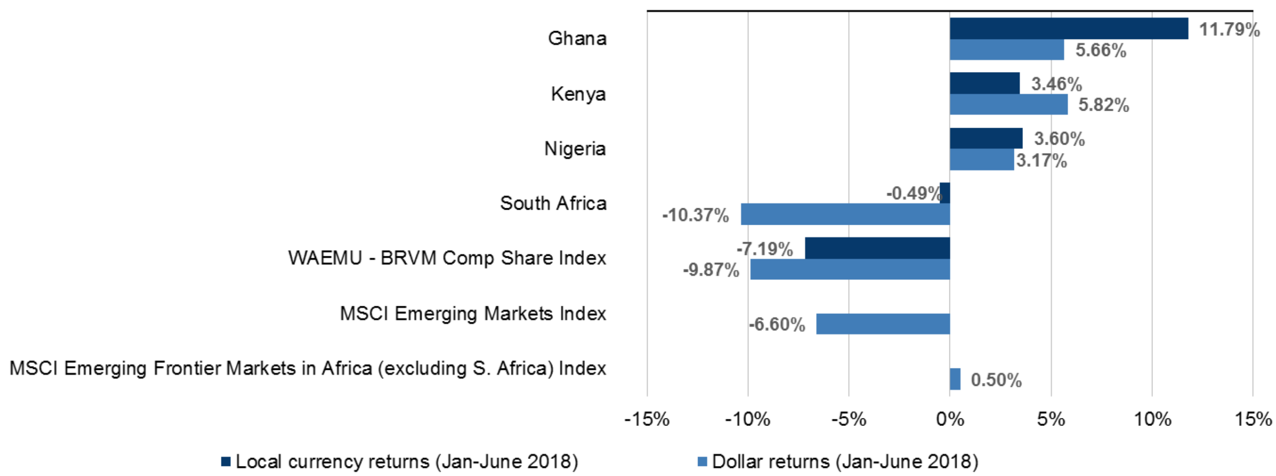
Several equity markets continued to see gains in 2018 H1

Growing investor concerns over an escalating trade war, slowing demand in China, and changes in U.S. interest rates have weighed on several African equity markets so far in 2018. Interestingly, the benchmark MSCI Emerging Markets Index saw a decline of 6.6 percent in dollar terms in 2018 H1 reflecting these uncertainties, although the MSCI Emerging Frontier Markets in Africa (excluding South Africa) Index saw a slight increase (0.5 percent) over the period.

Ghana's stock exchange index continued to rise by an additional 5.7 percent in dollar terms in 2018 H1 (see Figure 3). However, despite being the top-performing stock index earlier in the year, it dropped significantly in June due to downward pressure on stocks in the financial, energy, and consumer goods sectors. Still, the Ghana stock exchange maintained positive year-to-date gains.

Furthermore, Kenya's Nairobi Securities Exchange Ltd All Share Index gained 5.8 percent in dollar terms from Janaury to June 2018 as banking and Safaricom stocks continued to post high gains. Moving forward, *Business Daily* suggests that investors will be watching how bank firms respond to new accounting rules and a revision of the interest rate cap law in Kenya, which may affect profit margins and, in turn, the firms' performance on the stock market.

Figure 3. Returns for select equity market indices (January to June 2018)



Source: Bloomberg Finance L.P.
Note: Total returns for the period are calculated assuming that dividends are reinvested in the index at the spot price. Returns for the MSCI Indices are in U.S. dollars.

The Nigerian Stock Exchange (NSE) continued to rise 3.2 percent in dollar terms as the banking and industrial goods sectors outperformed other sectors. In contrast, the West African Economic and Monetary Union's BRVM saw sizable declines in dollar returns (-9.9 percent) in the first half of 2018. In March 2018, the CEO of the BRVM alongside CEOs of companies listed on the exchange launched an international roadshow to share investment opportunities with potential investors in the hopes of attracting new interest in the exchange.

Meanwhile, South Africa's FTSE/JSE Africa All Share Index also declined in dollar terms by 10.4 percent in the first six months of 2018. A strong rand and several corporate scandals deterred investors from equities, *Business Day Live* reported.

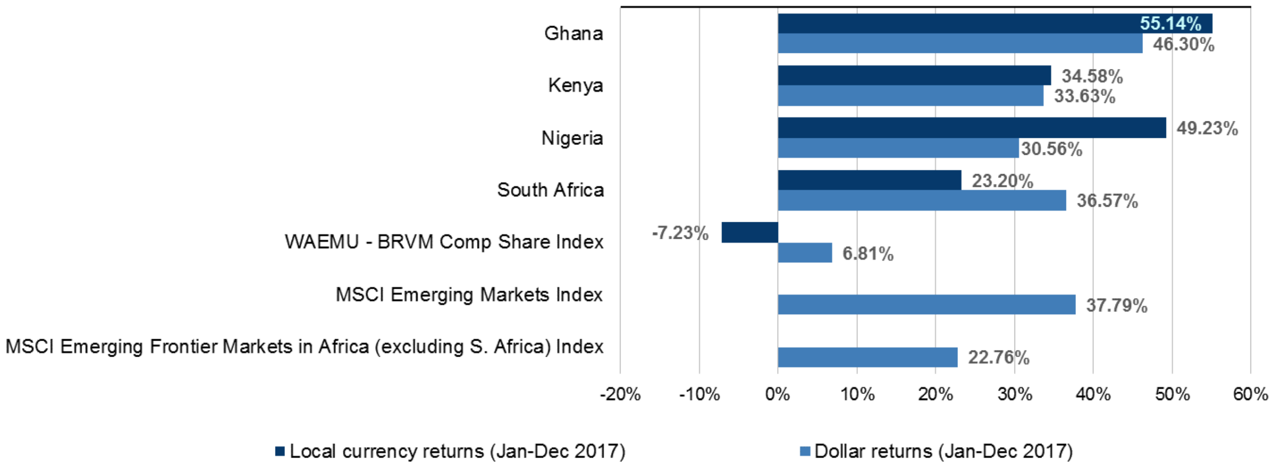
Equity markets in Ghana, Kenya, Nigeria, and South Africa rallied in 2017

Several African equity markets experienced a revival in 2017, nearly matching (or surpassing) the benchmark MSCI Emerging Market Index's dollar returns of 37.8 percent (see Figures 4 and 5). The West African Economic and Monetary Union's BRVM meanwhile saw modest increases in dollar returns in 2017 (6.8 percent), but losses in local currency terms (-7.2 percent). Poor performances in the region's largest stocks on the index—including Senegal's Sonatel, Ecobank Transnational Inc., and Societe Generale de Banques en Côte d'Ivoire—and low dividends contributed to the index's slump in local currency terms. However, U.S. dollar investors benefited from exchange rate effects of the euro appreciating against the dollar in 2017, leading them to still experience positive returns.

Notably, Ghana's benchmark stock index rose 46.3 percent in dollar terms last year. Ghana's achievements in the stock market stem from greater participation by local institutional investors—primarily private pension funds. In early 2017, Ghana's National Pensions Regulatory Authority increased the threshold at which pension funds can hold equity investments from 10 percent to 20 percent. Then in December the government transferred $690 million to private pension funds enabling them to take on more stocks. The

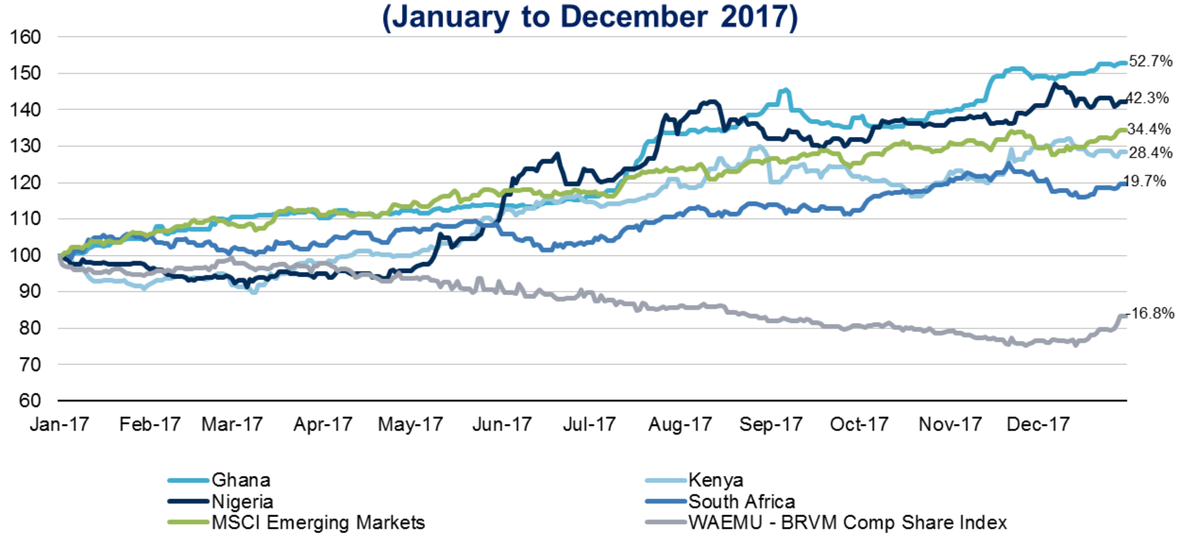
World Bank's prediction that Ghana's gross domestic product (GDP) growth in 2018 would be the fastest in the continent at 8.3 percent boosted investor confidence in the equity market.

Figure 4. Returns for select equity market indices (January to December 2017)



Source: Bloomberg Finance L.P.
Note: Total returns for the period are calculated assuming that dividends are reinvested in the index at the spot price. Returns for the MSCI Indices are in U.S. dollars.

Figure 5. Returns for select equity market indices (January to December 2017)



Source: Bloomberg Finance L.P.
Note: Index (January 1, 2017 = 100). Equity indices are denoted in local currency terms, except for the MSCI Emerging Markets Index which is denoted in U.S. dollars. Percentages listed are total returns calcuclated using only price change for the period.

Kenya's and Nigeria's equity markets also grew in 2017. Kenya's Nairobi Securities Exchange All Share Index increased by 33.6 percent in dollar terms throughout 2017, despite a year fraught by heavily contested elections. The banking and telecommunications sectors gained the most in value, with Safaricom recording a capital gain of 29 percent over the year.

The Nigerian Stock Exchange (NSE) increased by 30.6 percent in dollar terms in 2017 as oil prices rose and the economy escaped from recession. The CEO of the Nigerian Stock Exchange, Oscar N. Onyema, attributed the market's gains in 2017 partly to the central bank's monetary policies that increased liquidity in the foreign exchange market. A new foreign exchange trading window was established in April 2017 and allowed for a more liberal currency market, which began to draw back foreign investors who exited Nigeria over exchange rate uncertainties.

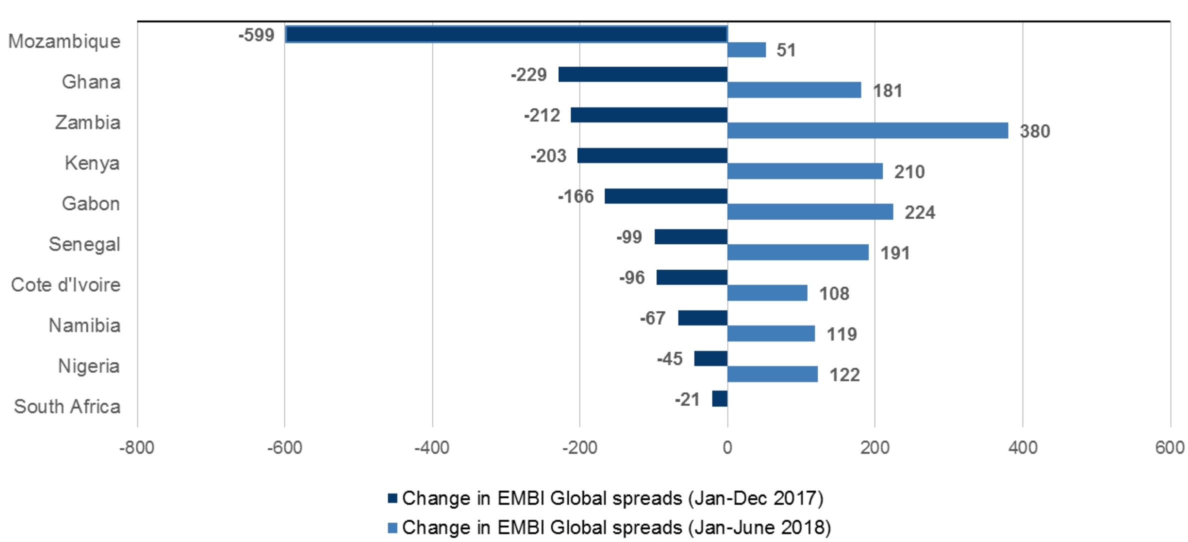
South Africa's FTSE/JSE Africa All Share Index rose by 36.6 percent in dollar terms over the course of 2017. The positive performance in 2017 was due in large part to gains in commodity firms (especially coal and iron miners) as well as Naspers, which dominated the large- and mid-cap space.

Sovereign bond markets

In 2018 H1, bond spread sentiment reversed in Africa

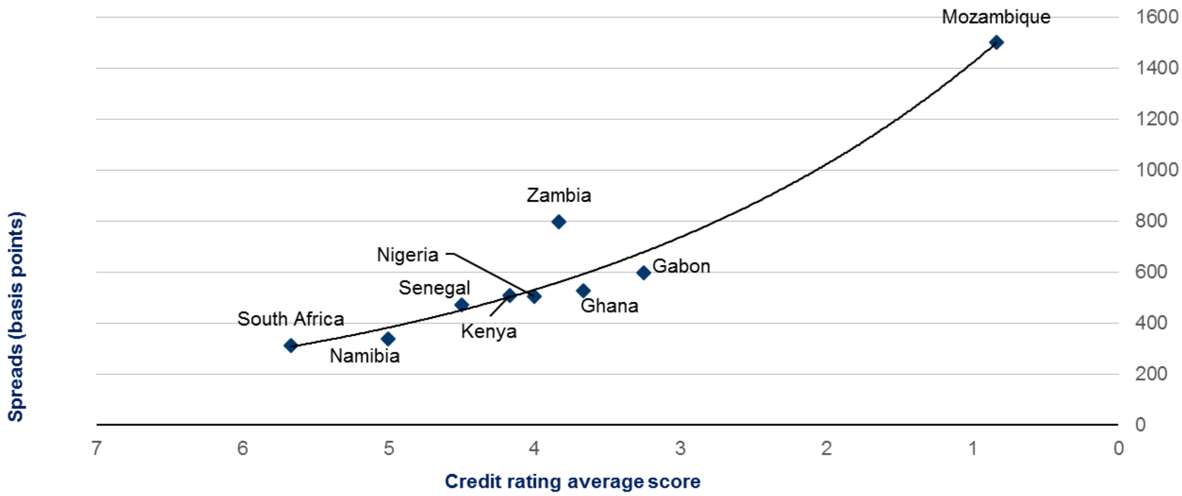
While improved global sentiment toward emerging and frontier markets led African bond spreads to decline in 2017, from January to June 2018 spreads increased in all observed African countries (see Figures 6 and 7). An increase in spreads reflects growing perceptions of high default risk. Indeed, the uptick in bond spreads could reflect investor concerns of a looming global trade war or of the mounting foreign currency denominated debt in many African countries, compounded by a strengthening U.S. dollar. For example, in Zambia, which saw its spread increase by 380 basis points in 2018 H1, investors are concerned over the International Monetary Fund's (IMF) warning that the country is at a high risk of debt distress. The Zambian government is currently canceling infrastructure projects and renegotiating external loans in efforts to not only manage its debt, but also re-engage in talks with the IMF over possible a support package.

Figure 6. Change in EMBI Global spreads in basis points



Source: Bloomberg Finance L.P., J.P. Morgan Emerging Market Bond Index Global (EMBI Global)

Figure 7. Sovereign spreads v. credit rating scores



Source: Bloomberg Finance L.P., J.P. Morgan EMBI Global
Note: Spreads are as of June 29, 2018. Credit rating average scores refer to the average ratings of Fitch, Moody, and S&P ratings. Numerical values correspond to the following credit rating categories: 7 = A, 6 = BBB/Baa, 5 = BB/Ba, 4 = B, 3 = CCC/Caa, and 2 = CC/Ca.

Meanwhile, Mozambique's dramatic drop in spreads in 2017 and slight increase in 2018 relate to the government's ongoing efforts to restructure its debt since its $2 billion hidden loan scandal came to light in 2016. The government's failure to repay a coupon payment in January 2017 for its eurobond due in 2023 led the spread to peak at 2264 basis points. Since then, however, the government has renewed its engagement with creditors for debt restructuring talks, and the spread has fallen to 1500 basis points as of the end of June 2018 (see Figure 8). Still, Mozambique has failed to make payments on its eurobonds and loans since that time, and the exact timeline of the negotiations remains uncertain. Furthermore, credit ratings agencies Standard & Poor's and Fitch have listed the rating as in default, and Moody's downgraded the rating to Caa3, the lowest level of junk status in July 2017 (see Table 1).

Table 1. Sovereign credit ratings and outlooks for select African economies (Updated: June 29, 2018)

	S&P		Fitch		Moody's	
Country	**Credit Rating**	**Outlook**	**Credit Rating**	**Outlook**	**Credit Rating**	**Outlook**
Ethiopia	B	Stable	B	Stable	B1	Stable
Gabon	Not Rated	Not Rated	B	**Negative**	Caa1	Stable
Ghana	B-	Positive	B	Stable	B3	Stable
Kenya	B+	Stable	B+	Stable	B2	Stable
Mozambique	SD	Not rated	RD	Not Rated	Caa3	**Negative**
Namibia	Not Rated	Not Rated	BB+	Stable	Ba1	**Negative**
Nigeria	B	Stable	B+	**Negative**	B2	Stable
Senegal	B+	Positive	Not Rated	Not Rated	Ba3	Stable
South Africa	BB	Stable	BB+	Stable	Baa3	Stable
Zambia	B	Stable	B	**Negative**	B3	Stable

Source: Bloomberg Finance L.P., Standard & Poor's, Fitch, and Moody's.

Bond spreads for African and emerging markets fell in 2017

In 2017, the gap between African and global emerging market bonds and U.S. Treasuries continued to narrow, falling by 84 and 52 basis points, respectively (see Figure 8). As a measure of borrowing costs, falling yield spreads over safe haven U.S. Treasuries indicate that borrowing conditions improved throughout the year for many investment-grade frontier and emerging market borrowers in Africa and globally. As a result, countries such as Côte d'Ivoire, Egypt, Kenya, Nigeria, and Senegal took advantage of these lower costs and issued bonds—some with remarkably longer maturities—on international capital markets in 2017. For example, Senegal issued a eurobond including a $1 billion 29-year tranche, a significant development for the continent. Still, the African bond index's yield finished the year 324 basis points higher than the U.S. 10-year Treasury bond rate, whereas the global bond index's yield was 311 basis points higher, suggesting a slightly higher premium demanded by investors to hold African bonds compared to their global emerging market peers. Lowering borrowing costs are important in African countries, where governments can use debt instruments to reduce current account deficits and make public investments in infrastructure, health care, and education.

Figure 8. EMBI Global spreads in basis points (January to December 2017)

Source: Bloomberg Finance L.P., J.P. Morgan Emerging Market Bond Index Global (EMBI Global)
Note: The EMBI Global includes only USD-denominated emerging markets sovereign bonds and uses a traditional, market capitalization weighted method for country allocation. The Africa sovereign spread includes coverage of Angola, Cote d'Ivoire, Egypt, Gabon, Ghana, Kenya, Morocco, Mozambique, Namibia, Nigeria, Senegal, South Africa, and Zambia.

Foreign exchange markets

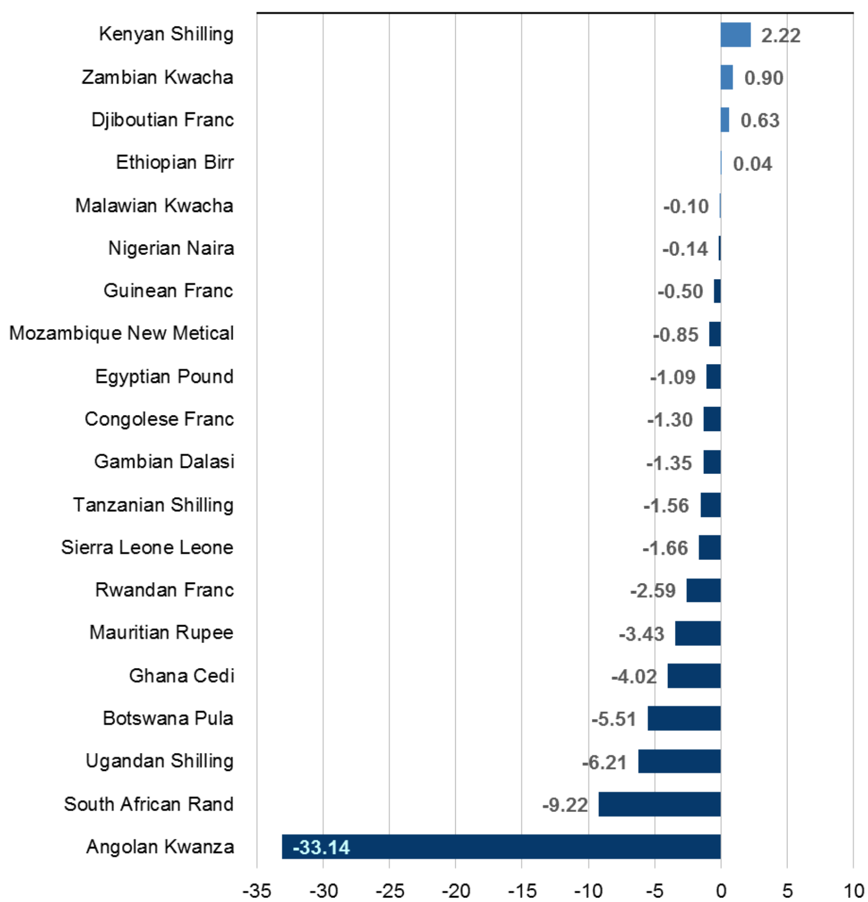
In 2018 H1, Kenya's shilling and Zambia's kwacha strengthened against the dollar

So far in 2018, the Kenyan shilling followed by the Zambian kwacha experienced the best dollar returns of any African currency, while the Angolan kwanza had the worst (see Figure 9). The Kenyan shilling has buoyed against the dollar thanks to inflows from offshore investors and remittances. The Zambian kwacha is being reinforced by a net supply of foreign exchange as companies converted currencies in order to pay taxes.

On the other hand, like most African currencies, the Angolan kwanza declined against the dollar. Angola's central bank abandoned its peg to the dollar in January 2018 and allowed the kwanza to depreciate to help with fiscal adjustment. Angola also suffered during the 2014 oil price slump, which drew down the country's foreign reserves. By floating the currency within a trading band, monetary policy officials aim to realign the currency's official value with that of the market rate, which in January reached 440 kwanza per dollar compared to the official rate of 185.5 kwanza per dollar immediately following a January 2018 foreign exchange auction. In devaluing the kwanza and bringing it closer to its market rate, officials also aimed to lower currency risk for bondholders as it launched $3 billion of debt in international markets in May 2018.

Almost four years since the beginning of the commodity price slump—which affected energy, metals, and to a certain extent agricultural prices—resource-rich countries such as Angola, the DRC, Nigeria, and Sierra Leone are still striving to rebuild their foreign reserves, regain macroeconomic stability, and improve prospects for economic growth. As they continue to make fiscal adjustments, implementing policies that promote economic diversification would help prevent the detrimental and protracted effects of future commodity price shocks.

Figure 9. Spot returns of select African currencies against the U.S. dollar (%, January to June 2018)

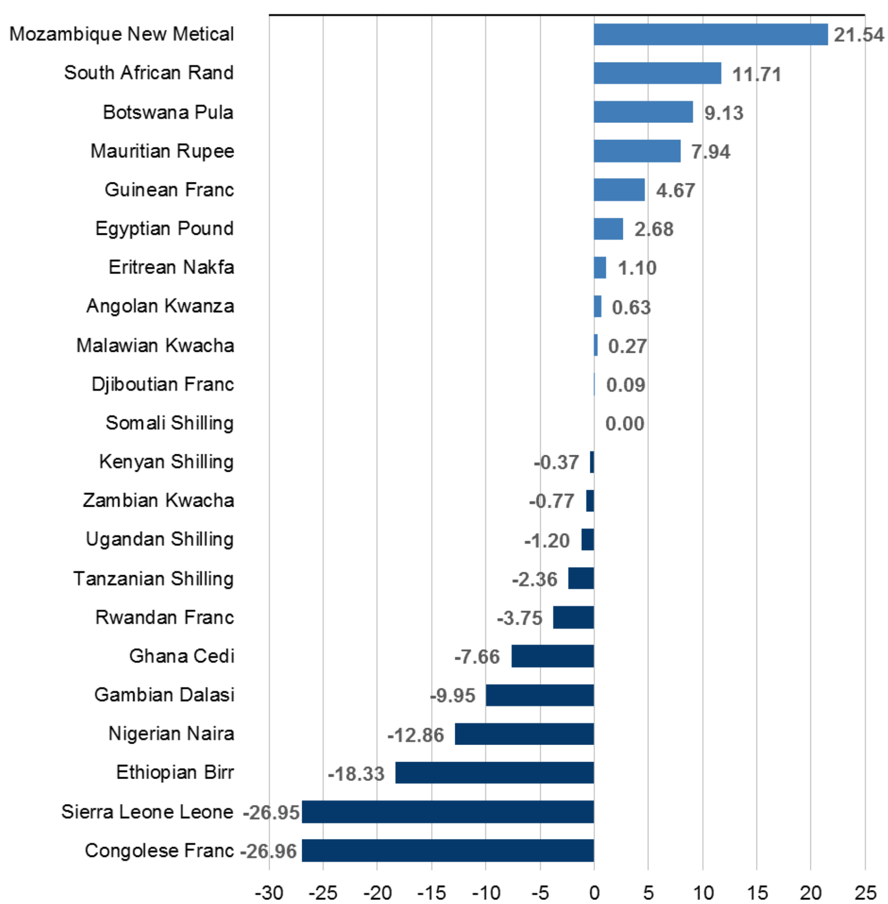


Source: Bloomberg Finance L.P.

Mozambique's metical rebounded against the dollar in 2017 as Nigeria's naira weakened

Mozambique's new metical topped the list of best-performing African currencies against the U.S. dollar in 2017 (see Figure 10). Following its dramatic depreciation against the U.S. dollar in the wake of the 2016 hidden government debt scandal, tight monetary policy and higher prices for coal and aluminum exports, which helped build up the country's finances, also helped the currency to strengthen.

Figure 10. Spot returns of select African currencies against the U.S. dollar (%, January to December 2017)

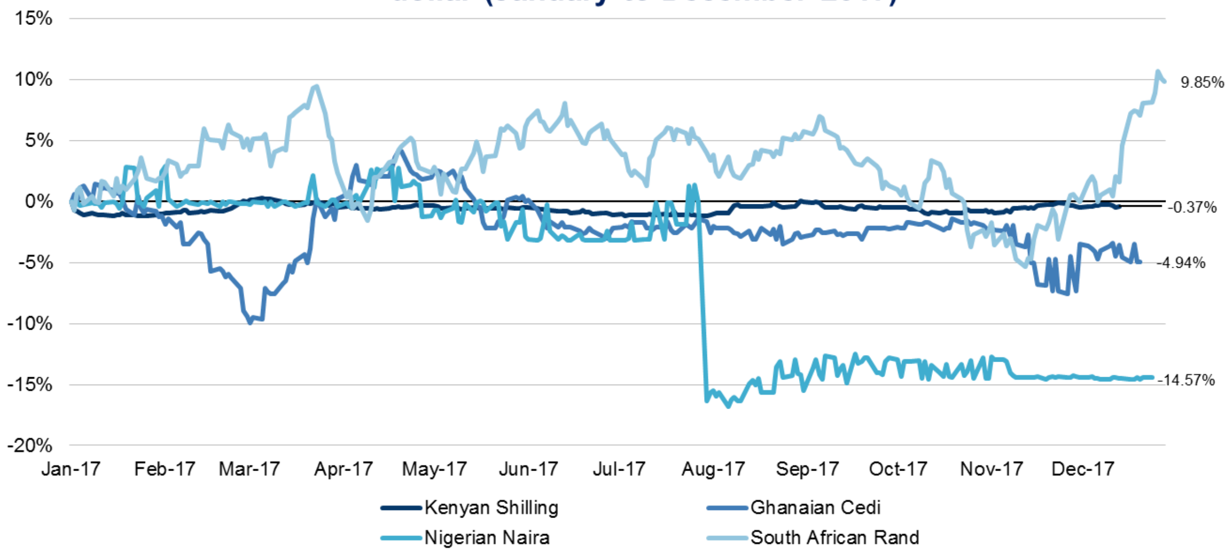


Source: Bloomberg Finance L.P.

For other currencies, especially Sierra Leone's leone and the Congolese (DRC) franc, 2017 was a less successful year, during which they both declined by more than a quarter. The [leone depreciated in 2016 and 2017](#) as the country continued to grapple with the ongoing effects of the decline in donor-related aid following the end of the Ebola crisis, the drop in iron ore export revenues due to the 2014 commodity price slump, and rapidly increasing inflation. Somewhat similarly, in the DRC, withdrawal of donor aid, two years of low commodity prices, and political instability have all contributed to the Congolese franc's depreciation. After having depleted existing financial buffers and losing financial support from the international community over its deteriorating political situation, the DRC government required advances from its central bank to fund its budget deficit. These advances caused inflation that in turn led the currency to weaken by over 70 percent from June 2016 to late 2017.

Other notable developments in African foreign exchange markets in 2017 include the volatility of the rand and the weakening of the naira against the dollar (see Figure 11). In South Africa, the rand fluctuated wildly throughout the year in line with investor concerns over political uncertainties. The rand peaked in March at 12.43 rand to the dollar—just before former President Jacob Zuma fired then-Finance Minister Pravin Gordhan, sending the rand tumbling and reaching its lowest point in mid-November at 14.47 rand to the dollar. Then, in December, as Cyril Ramaphosa was elected to lead the ruling African National Congress, the rand strengthened, finishing the year almost 10 percent firmer against the dollar.

Figure 11. Movements of select African currencies against the U.S. dollar (January to December 2017)



Source: Bloomberg Finance L.P.
Note: A positive move indicates currency strengthening against the dollar, while a negative move indicates currency weakening against the dollar.

In Nigeria, officials chose to unify multiple exchange rates in August 2017. The officials aligned the interbank exchange rate with the exchange rate from the currency window for investors, known as the Nafex rate, effectively merging the two markets. This led the interbank rate to weaken 14 percent against the dollar, to about 365 naira per dollar, essentially matching the black market rate. Still, the central bank maintains an official rate of 305 per dollar; however, this rate is only used to provide dollars for government transactions and fuel importers. This decision to merge the rates is an important step toward simplifying Nigeria's exchange rate system and enticing back bond investors who fled the market during the oil price slump in 2014 and 2015, when the central bank implemented strict currency controls.