S&P Global
Ratings

Emerging Markets:

Sub-Saharan Africa's Fading Tailwinds And Missed Opportunities

May 30, 2023

This report does not constitute a rating action.
Editor's note: This report was republished on June 2 to include Congo, D.R. and amend data for Ethiopia in table 2.

Key Takeaways

- Sub-Saharan Africa's (SSA) growth will weaken this year before likely rebounding in 2024, albeit with large variations. Sustaining rapid growth will be challenging due to weaker global expansion and a reluctance to invest due to high interest rates.
- Selected SSA sovereigns will continue to grapple with structural weaknesses. But the end of the pandemic, the reopening of tourism and services sectors, and falling food and fuel prices should support growth and bring some fiscal relief, although we see limited upside for ratings absent relevant structural reforms.
- Long term corporate growth has slowed due to persistent elevated inflation and interest rates (exacerbated by softer non-oil commodity prices), which have weighed on margins and discouraged capital investment. Limited debt-issuance needs offset the impact of risk averse capital markets, for now.
- Tighter credit conditions due to inflationary pressures and interest rates will restrict lending and exacerbate already elevated credit risk at Sub-Sahara African banks, leading to somewhat higher credit losses.

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Macroeconomic Environment

Toughing-Out Growth Amid Uncertain Global Prospects

(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of rating committees exercising their analytical judgment in accordance with publicly available ratings criteria.)

- S&P Global Ratings expects Sub-Saharan region growth will weaken this year before rebounding in 2024, albeit with significant variations. Sustaining strong growth will prove difficult given diminished post-pandemic catch up momentum, weaker global expansion, and a reluctance to invest due to high interest rates.
- Next year’s mild rebound will likely be driven by non-oil economies. An agricultural sector rebound and continued growth in the service sector, including tourism, will support growth in non-resource led economies. Countries with significant mine assets, notably D.R. Congo, will continue to benefit from new investment in mining. South Africa's growth should benefit in 2024 from an easing of its electricity crisis. Meanwhile, oil producers, including Nigeria and

Angola, are likely to struggle in our forecast period due to oil production-related issues and the negative impact of OPEC quotas.

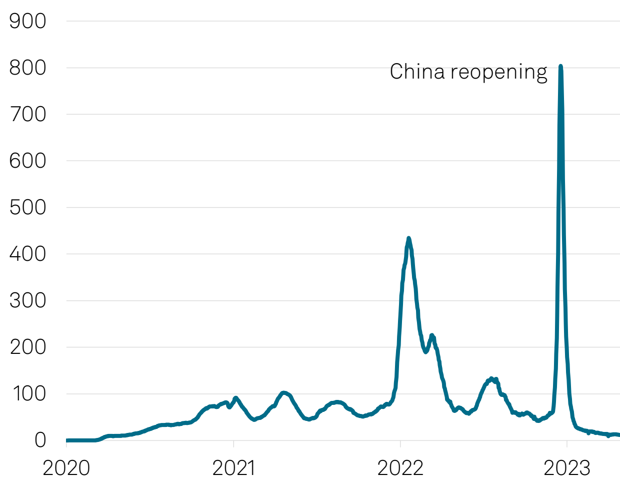
- Slowing inflation will provide some relief over the rest of 2023, but elevated inflation levels will continue to erode consumer purchasing power and fuel food insecurity.
- Policymakers face a tricky trade-off between public debt management, especially given higher interest rates, and macroeconomic stability.

Supply and demand imbalances have subsided with COVID-19's retreat and fears easing of supply-side shocks from the war in Ukraine (see charts 1 and 2). The World Health Organization recently declared an end to the pandemic as a public health emergency after death rates decreased significantly and pressure on once overwhelmed health systems eased. COVID-19 remains a major international concern, but the moderating health trend has allowed most countries to return to pre-pandemic norms. The Russia-Ukraine war continues with no end in sight, yet the peak effect of the resultant geopolitical risk appears to be behind us, at least for now.

Chart 1

Reported COVID-19 cases have slumped

Daily new confirmed COVID-19 cases per million people

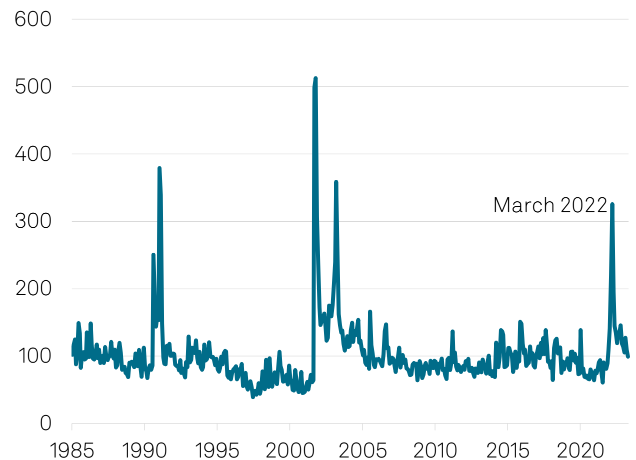


As of May 10, 2023. Source: Ourworldindata.org

Chart 2

Fear of Russia-Ukraine war spillover has eased

Geopolitical Risk Index (1985-2019=100)



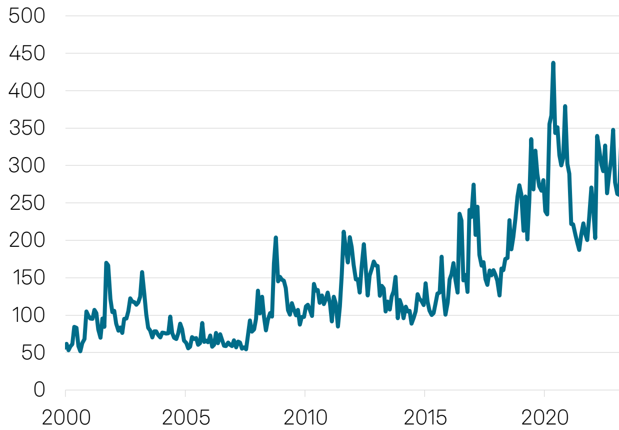
As of end-April 2023. Source: Caldara, Dario and Matteor Iacoviello (2022), "Measuring Geopolitical Risk", American Economic Review, April, 112(4) ,pp. 1194-1225.

The economic environment remains far from growth friendly, reflecting elevated policy uncertainty and above-average systemic financial stress (see charts 3 and 4). Those conditions are underpinned by forecasts of faltering growth for the US and Europe in the next 12 months. China's rebound is positive, but its GDP growth target of about 5% for 2023 is low by historical standards. Major central banks (excluding Japan and China) remain committed to restrictive monetary policies, at least in the near term, to address above-target inflation. We expect the Fed to hold its policy rate steady at 5%-5.25% for the rest of 2023 and part of 2024, keeping upward pressure on real rates while inflation falls gradually to the 2% target over the next two years.

Chart 3

Global Growth faces elevated policy uncertainty...

Global Economic Policy Uncertainty Index

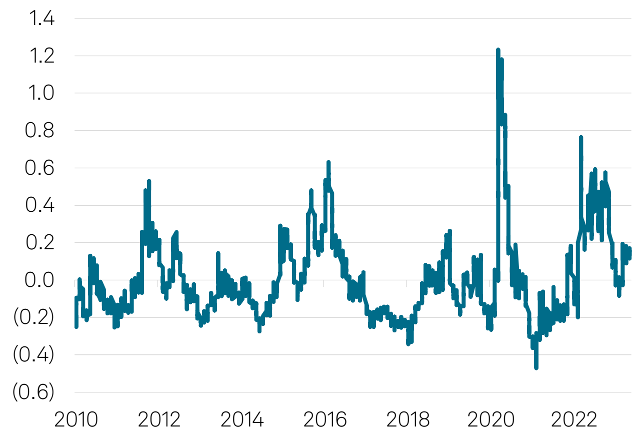


As of end-March 2023. The GEPU Index is a GDP-weighted average of national EPU indices for 21 countries: Australia, Brazil, Canada, Chile, China, Colombia, France, Germany, Greece, India, Ireland, Italy, Japan, Mexico, the Netherlands, Russia, South Korea, Spain, Sweden, the United Kingdom, and the United States. Source: Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review, October.

Chart 4

And above average financial stress

OFR Financial Stress Index (emerging markets)

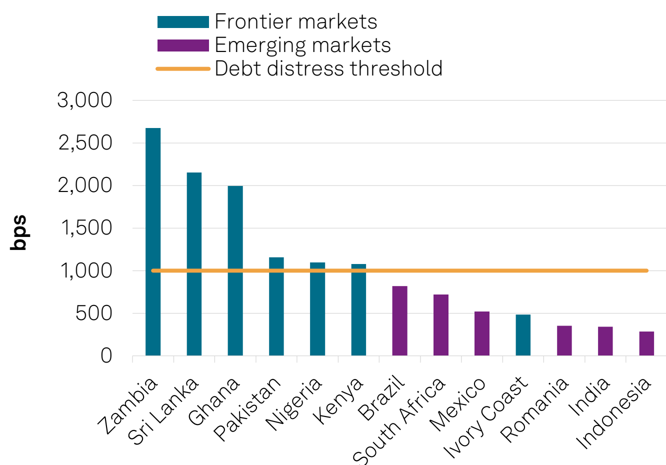


Index is zero when average systemic financial stress (incorporating indicators of credit, equity valuation, funding, safe assets, and volatility) is zero, suggesting that stress is at normal levels. Higher than zero indicates more than average stress, lower than zero indicates less than average stress. OFR--Office of Financial Research, U.S. Department of the Treasury. Source: Office of Financial Research.

SSA's financial conditions have tightened significantly, and proportionately more than other emerging markets. High global interest rates and the risk averse environment mean the region's frontier economies--which already had lower credit ratings -- have faced markedly high borrowing costs in domestic and international markets. The region's sovereign spreads soared and its currencies weakened against the dollar last year, adding to underlying vulnerabilities (see charts 5 and 6).

Chart 5

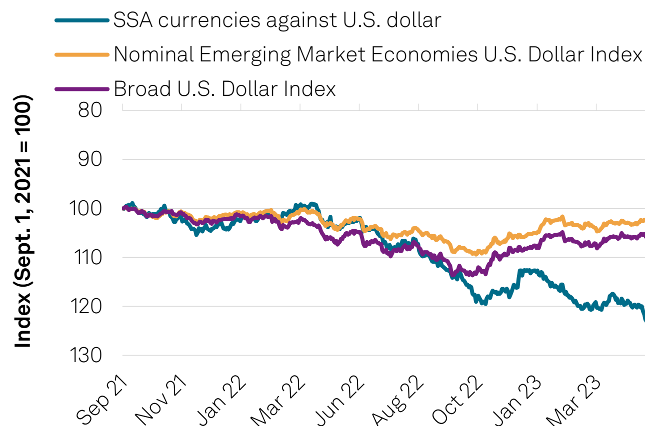
Frontier market risk premiums are high



Data as of May 15, 2023. The spread is the difference between U.S. 10-year bond yield and respective countries 10-year bond yield. bps--Basis points. Sources: Refinitiv, S&P Global Ratings Economics.

Chart 6

SSA currencies tumbled more than other EMs over the past year



Data as of May 17, 2023. Sub Saharan Africa currency index against US dollar consists of 12 countries and is calculated based on trade weighted average. Sources: Refinitiv, St Louis FRED, S&P Global Ratings Economics,

Spreads over U.S. Treasuries are above or about 1,000 basis points (bps). That spread is commonly considered a threshold for sovereign debt distress, and as such Africa's frontier economies, such as Zambia, Ghana, and Mozambique are firmly in debt distressed territory, while Kenya and Ethiopia are on the cusp. Angola and Nigeria are also near the 1,000 bps spread, though their debt headroom has benefited from higher oil prices among other factors. Chinese debt relief played the biggest part in Angola, and Nigeria has very low external debt as percentage of GDP. Currency depreciation means the local currency value of dollar-denominated debt and dollar-denominated interest payments have increased. This has particularly weighed on Kenya where the share of debt denominated in foreign currency has increased and the interest burden is high.

The financing squeeze arrived prior to the region's recovery to pre-pandemic trends. As of the end of 2022, none of the region's countries (except Ethiopia and Kenya) had seen GDP at or above the level suggested by their pre-pandemic trends though they had recovered their 2019 levels. Most of that shortfall is attributable to industrial sector underperformance (see table 1).

Table 1

Most of SSA's GDP shortfall is attributable to industrial sector underperformance

	Percentage deviation from pre-pandemic level in 2022				Percentage deviation from pre-pandemic trend in 2022			
	Agriculture	**Industry**	**Services**	**GDP**	**Agriculture**	**Industry**	**Services**	**GDP**
Angola	22.7	(16.5)	5.8	(4.4)	12.6	(14.4)	12.1	(1.5)
Ethiopia	16.8	23.4	20.7	20.1	3.5	(2.9)	3.4	1.5
Ghana	21.2	(2.1)	16.2	10.0	12.1	(13.9)	8.1	(0.02)
Kenya	2.5	15.4	14.7	12.4	(5.8)	2.8	2.7	1.1
Mozambique	12.2	(0.4)	3.1	4.7	4.8	(6.2)	(4.9)	(2.6)
Nigeria	6.3	(30.4)	10.1	0.2	(3.8)	(30.0)	(0.7)	(7.5)
South Africa	25.4	(9.3)	3.1	0.6	10.4	(10.5)	(2.4)	(4.0)

Pre-pandemic level deviation is the percentage change from the 2019 level. Deviation from pre-pandemic trend refers to trend growth between 2011-2019. Ethiopia GDP refers to fiscal year July-June. Sources: S&P Global Market Intelligence, Refinitiv, S&P Global Ratings Economics.

Real GDP growth in eight key Sub-Saharan countries (we rate 22 countries in the region) is forecast to slow to a weighted average 2.9% in 2023 , down from an estimated 3.4% in 2022, before rebounding to 3.5% per year over 2024-2026 (see table 2). That weaker growth should be viewed in the wider context of advanced economy growth slowing to well below longer-run potential. The regions' major trading partners--the U.S. and euro area--will likely experience near-recessionary conditions in the second half of 2023 and early 2024. Meanwhile, China's rebound is expected to be led by the COVID-19 impacted service sector, and not the infrastructure and property sectors, which drive demand for SSA's precious metals and commodity exports.

Table 2

SSA growth will weaken in 2023 due to weaker global expansion and high interest rates

Real GDP growth (%)								
	2017-19	2020	2021	2022	2023F	2024F	2025F	2026F
Angola	(0.7)	(5.6)	1.1	3.2	2.3	3.0	3.0	3.0
Congo, D.R.	4.6	1.7	6.2	6.6	6.0	6.5	6.5	6.5
Ethiopia	8.9	6.1	6.3	6.0	6.0	6.5	7.0	7.0
Ghana	6.9	0.5	5.4	3.2	2.1	3.4	5.4	5.5
Kenya	4.9	(0.3)	7.5	5.5	5.4	5.4	5.5	5.5
Mozambique	3.2	(1.2)	2.3	4.2	4.8	5.8	6.5	6.5
Nigeria	1.6	(1.8)	3.7	3.3	3.3	3.1	3.0	3.0
South Africa	1.0	(6.3)	4.9	2.0	0.7	2.0	1.9	2.3
Sub-Saharan (8)	**2.6**	**(2.4)**	**4.5**	**3.4**	**2.9**	**3.4**	**3.5**	**3.6**
Resource-intensive* countries	1.7	(3.4)	4.1	3.0	2.3	2.9	2.9	3.0
Non-resource intensive countries	6.7	2.7	6.5	5.6	5.6	6.0	6.3	6.3
Other selected								
U.S.	2.5	(2.7)	6.0	2.1	0.7	1.2	1.8	2.0
Eurozone	2.1	(6.5)	5.3	3.5	0.3	1.0	1.7	1.6
China	6.5	2.2	8.1	3.0	5.5	5.0	4.7	4.5
India	5.7	(6.6)	9.1	7.0	6.0	6.9	6.9	7.1

Aggregate growth is based on PPP weighted GDP share. PPP-Purchasing power parity. India GDP (Fiscal Year). Ethiopia GDP (fiscal year July-June). F--S&P Global Ratings Q4 2022 Forecast. Resource intensive countries are Angola, Congo D.R., Ghana, Nigeria, and South Africa as per IMF classification. Source: S&P Global Ratings Forecast, IMF.

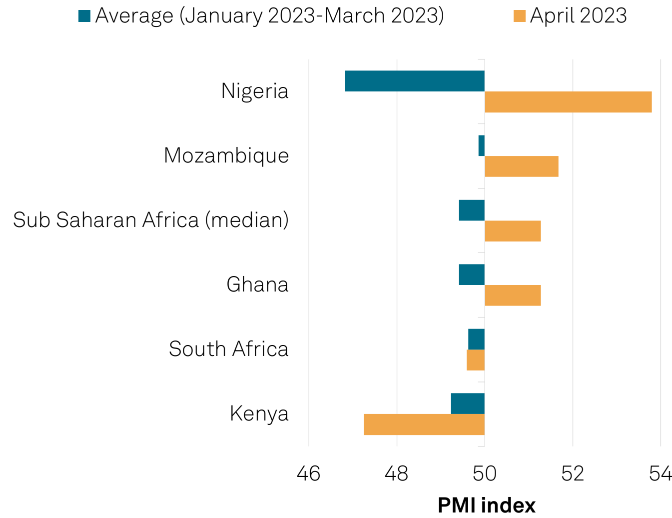
D.R. Congo and Ethiopia are poised to be the growth leaders with 6% GDP growth forecast for 2023 and an average 6.5%-7% per year over the following three years. Growth impulse for D.R. Congo will come from mining Investments, which depends on demand from China, its largest trading partner. Growth in Ethiopia--supported by recovery in investment--hinges on the ceasefire between the government and Tigray People's Liberation Front to last. Kenya will grow only slightly slower at about 5.5% average over the same period**,** while Angola, Nigeria, and Mozambique are all expected grow faster than their pre-pandemic average rates. South Africa's growth expectations for 2023 have been revised down from our November 2022 forecast, and is now expected to trail the pre-pandemic average, slowed by crippling power shortages. Growth should be a sustainable 2.9% and 6.3% on average over the following three years for resource intensive and non-resource intensive countries, respectively.

Persistent energy and transport infrastructure problems are preventing exporters from realizing their potential. South Africa historic power shortages have curtailed production capacity across the whole economy. Nigeria and Angola are struggling to increase oil exports, due to technical issues. Nigeria, in particular, has seen crude oil production fall over the past three years (output remains 34% below the pre-pandemic levels), due largely to rising oil thefts, workers strikes, and a lack of adequate investment. The combination of those issues contributed to a decline in industrial sector growth in the region, to almost zero over late 2022. Q1 2023 GDP numbers are yet to be published, but Purchasing Manager's Index (PMI) numbers indicated a weak start to the year. Orders picked up in April, suggesting the emergence of the green shoots of growth in Q2 (see charts 7 and 8).

Chart 7

PMIs indicate a weak start to the year

PMI: Whole economy

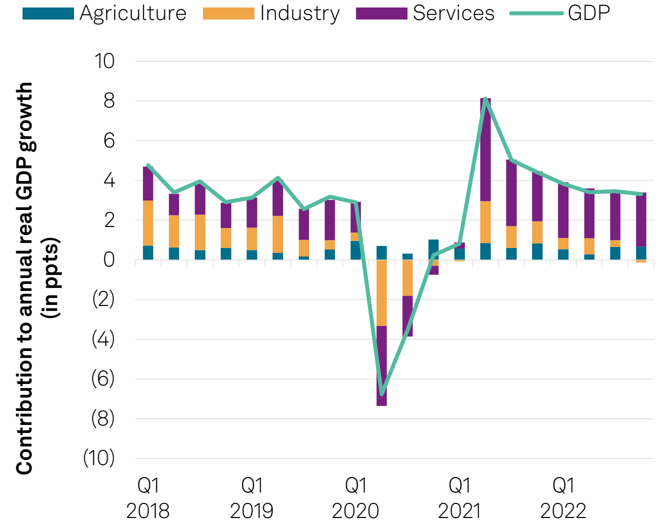


Data as of April 2023. PMI--Purchasing managers' index, reflects the whole economy. Note: Sub-Saharan Africa Median includes: Kenya, South Africa, Ghana, Mozambique and Nigeria. Sources: S&P Global Market Intelligence, S&P Global Ratings Economics.

Chart 8

Services are driving recovery in SSA

Contribution to annual GDP growth (%)



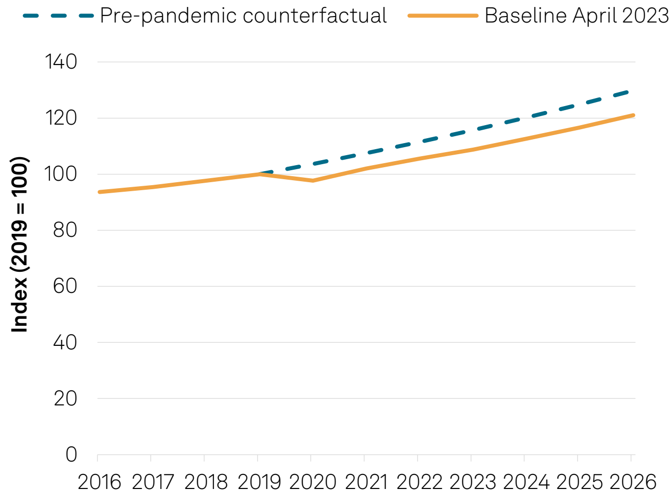
Countries included: Ghana, Kenya, Nigeria, South Africa and Mozambique. Aggregation is based on median value of the mentioned countries. Sources: Refinitiv (National Sources), S&P Global Ratings Economics.

Projected growth isn't sufficient to return the economies to their pre-pandemic trajectories. The eight key SSA economies are on track to be 6.8% smaller by the end of 2026 than indicated by the long-run (2011-2019) trend prior to the pandemic (see chart 9). Kenya is an exception and should continue to close the gap to its pre-pandemic trajectory in the coming quarters, perhaps even avoiding permanent loss. D.R. Congo is also expected to catch up to trend. Nigeria, and Angola's shortfall, compared to the pre-pandemic trends, is likely to remain generally stable, while South Africa's, Ethiopia's and Ghana's shortfalls will likely grow in the next two years.

Chart 9

SSA's pandemic dip is proving lasting

SSA: Real GDP forecast evolution

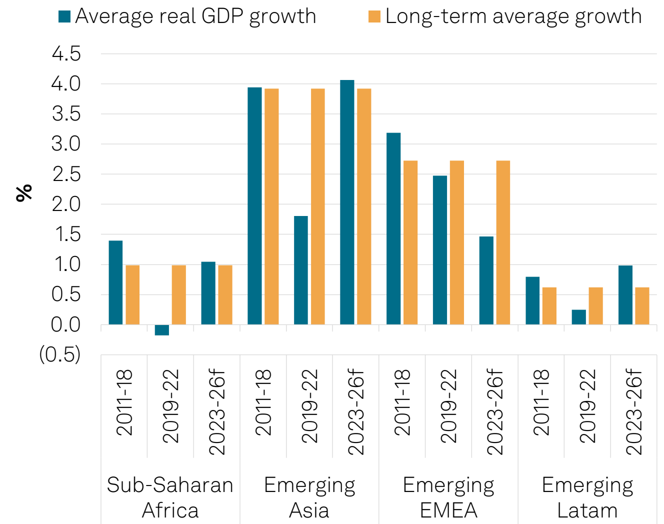


Aggregate GDP is based on GDP purchasing power parity (PPP) weights. Counterfactual GDP is calculated based on average of real and potential GDP growth between 2011-2019. Sources: S&P Global Ratings, S&P Global Market Intelligence, S&P Global Ratings Economics.

Chart 10

Per-capita income growth remains low

Average per capita income growth (%)

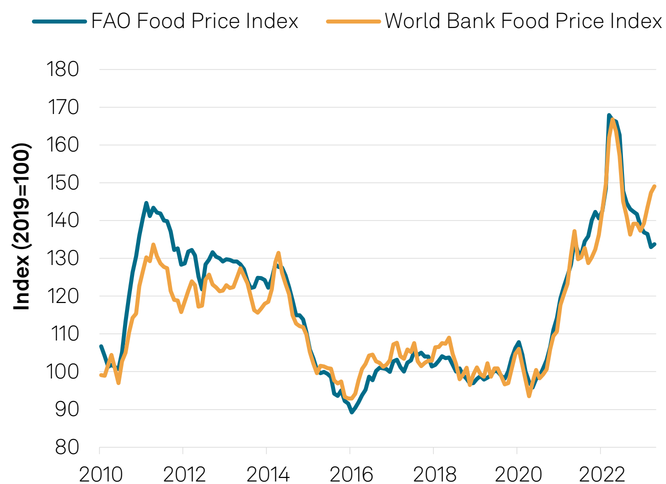


Aggregate real per capita GDP growth is based on GDP purchasing power parity share. f--S&P Global Ratings Forecast. Long term average period is 2011-2019. Emerging Asia: IDN, MYS, PHP, THA and VNM. Emerging EMEA: HUN, POL, SAU, TUR. Emerging Latam: ARG, BRA, CHL COL. Sources: S&P Global Ratings, S&P Global Market Intelligence, S&P Global Ratings Economics.

Regional food insecurity Is underpinned by strong inflation, fluctuating energy prices, and the effects of the Russia-Ukraine war. Consumer price index (CPI) inflation peaked in late 2022 in most countries, but is going to remain above central bank targets over the next couple of years before falling toward target (see Table 2). Food and fuel constitute a large share of consumer baskets in most SSA economies. While lower food and fuel prices in global markets are a welcome sign of easing global pressures, pass through to local prices has been weak due to currency depreciation and local idiosyncratic factors, including weather, power shortages, and the removal of subsidies and tax exemptions. For most countries' current policy rates (on a nominal basis) are above the average of the past decade, yet inflation adjusted rates in the region were mostly negative and slightly below the past decade's average. Policymakers will have to continue to balance keeping inflation in check while supporting the incomplete recovery.

Chart 11

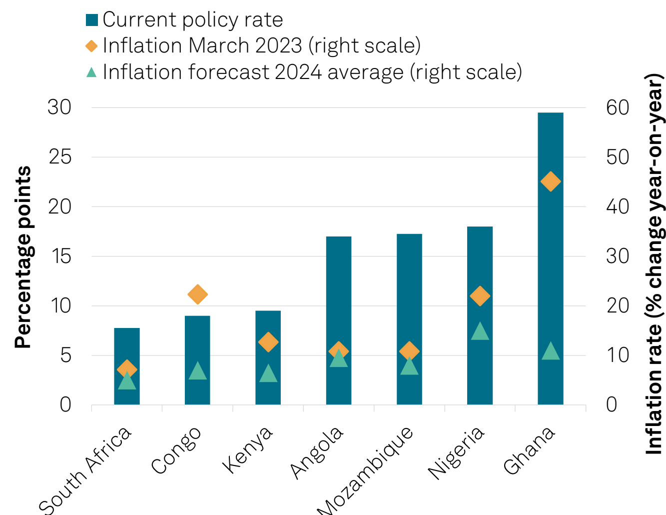
Food prices have fallen but remain elevated



As of end April 2023. Source: Refinitiv (FAO Food Price Index), S&P Global Ratings Economics.

Chart 12

Central bank raised policy rates amid elevated inflation



Policy rate through May 15, 2023. Inflation in Ghana was 45.1% in March. Sources: Refinitiv, S&P Global Ratings Economics.

Table 3

Consumer price index inflation peaked in late 2022 or early 2023 in most countries

CPI Inflation (%)	2017-19	2020	2021	2022	2023F	2024F	2025F	2026F	Inflation Target (%)
Angola	22.2	22.3	25.8	21.4	10.5	9.5	9.0	8.0	--
Congo, D.R.	23.9	11.4	6.0	12.0	8.5	7.0	5.0	5.0	7.0
Ethiopia	11.5	19.9	20.2	33.7	28.0	16.0	14.0	14.0	--
Ghana	10.2	8.7	10.0	33.0	20.0	11.0	9.0	9.0	8.0
Kenya	6.0	5.4	6.1	7.7	7.0	6.5	6.0	5.5	5.0
Mozambique	7.3	3.1	5.7	10.5	9.0	8.0	7.0	7.0	--
Nigeria	13.3	13.3	17.0	18.9	17.0	15.0	14.0	12.0	7.5
South Africa	4.6	3.3	4.5	6.9	6.0	5.0	4.4	4.8	4.5
Sub-Saharan (8)	**11.0**	**10.6**	**12.7**	**16.4**	**13.3**	**10.6**	**9.7**	**8.9**	**--**
Resource-intensive* countries	11.5	10.3	12.7	15.7	12.6	10.6	9.7	8.7	--
Non-resource intensive countries	8.7	12.2	12.9	20.5	17.3	11.2	9.9	9.7	--
Other Selected									
U.S.	2.1	1.2	4.7	8.0	4.2	2.4	1.6	1.5	2.0
Eurozone	1.5	0.3	2.6	8.4	5.9	2.7	2.0	1.9	2.0
China	2.2	2.5	0.9	2.0	2.3	2.7	2.2	2.2	3.0
India	3.9	6.2	5.5	6.8	5.0	4.3	4.4	4.7	4.0

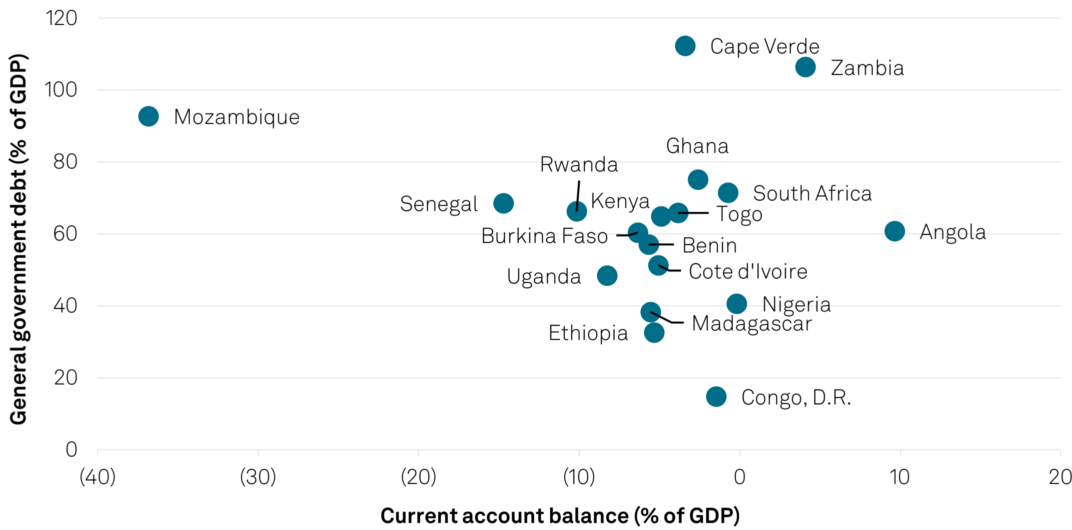
Aggregate growth is based on purchasing power parity-weighted GDP share. India GDP (Fiscal Year). Ethiopia GDP (Fiscal Year Jul-Jun).F--S&P Global Ratings Q4 2022 Forecast. Resource intensive countries are Angola, Congo D.R., Ghana, Nigeria, and South Africa as per IMF classification. Source: S&P Global Ratings Forecast, IMF.

Tight financial conditions and a challenging growth environment makes fiscal adjustment trickier. Prices of many hard commodities, including oil and metals, have declined from 2022 highs, ending last year's terms of trade windfall opportunities for countries like Angola, Nigeria and South Africa. Meanwhile, lower global food and oil prices should provide some relief for importers. Unlike many major advanced economies, SSA countries had limited fiscal leeway entering the pandemic-induced recession, and that has hampered policymakers' ability to mount an effective response. Policymakers in many of the countries in the region continue to face a difficult fiscal and current account climate, which undermines prospects for strong economic recovery.

Chart 13

Selected SSA sovereigns have limited fiscal flexibility and most have relevant external imbalances

Current account and gross general government debt



CA--Current account. CA data represents current account balance as a percentage of GDP for 2022. Debt is general government debt for 2022. Sources: S&P Global Ratings, S&P Global Ratings Economics.

Key Selected SSA Sovereign Profiles

- The selected SSA sovereigns share a key weakness reflected in their limited fiscal flexibility; the reasons however are idiosyncratic. Overall, the pandemic significantly damaged the region's budgetary performance while weak economies have prevented a quick fiscal recovery. We expect a very gradual fiscal consolidation will continue to weigh on key SSA sovereigns' ratings.
- Except for South Africa, external imbalances are also relevant for the selected SSA economies, which are driven mostly by external financing and in many cases have volatile terms of trade due to their dependence on hydrocarbons, exports, and related investment. These are structural weakness which are unlikely to be resolved over the short term.
- While selected SSA sovereigns will continue to struggle with structural weaknesses, we expect that the end of the pandemic, the reopening of tourism and services sectors, and falling food and fuel prices will be supportive of growth and bring some fiscal relief. Nonetheless, we see limited upside for ratings absent relevant structural reforms.

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Table 4

There is limited upside for sovereign ratings absent relevant structural reforms

Foreign currency ratings

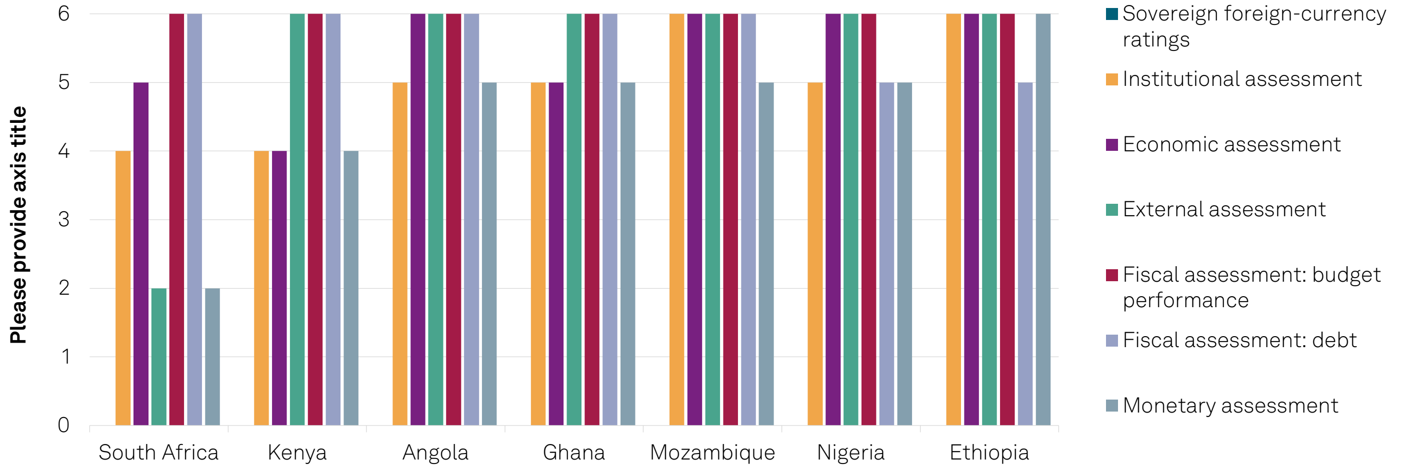
	May. 22, 2023	Dec. 31, 2022	Dec. 31, 2021	Dec. 31, 2020	Dec. 31, 2019
Angola	B-/Stable/B	B-/Stable/B	CCC+/Stable/C	CCC+/Stable/C	B-/Negative/B
Democratic Republic of Congo (DRC)	B-/Stable/B	B-/Stable/B	CCC+/Positive/C	CCC+/Stable/C	CCC+/Positive/C
Ethiopia	CCC/Negative/C	CCC/Negative/C	CCC/Negative/C	B/Negative/B	B/Stable/B
Ghana	SD/--/SD	SD/--/SD	B-/Stable/B	B-/Stable/B	B/Stable/B
Kenya	B/Negative/B	B/Stable/B	B/Stable/B	B+/Negative/B	B+/Stable/B
Mozambique	CCC+/Stable/C	CCC+/Stable/C	CCC+/Stable/C	CCC+/Stable/C	CCC+/Stable/C
Nigeria	B-/Negative/B	B-/Stable/B	B-/Stable/B	B-/Stable/B	B/Stable/B
South Africa	BB-/Stable/B	BB-/Positive/B	BB-/Stable/B	BB-/Stable/B	BB/Negative/B

Source: S&P Global Ratings

Chart 14

Selected SSA sovereigns have limited fiscal flexibility and most have significant external imbalances

Selected SSA sovereigns' score snapshot*

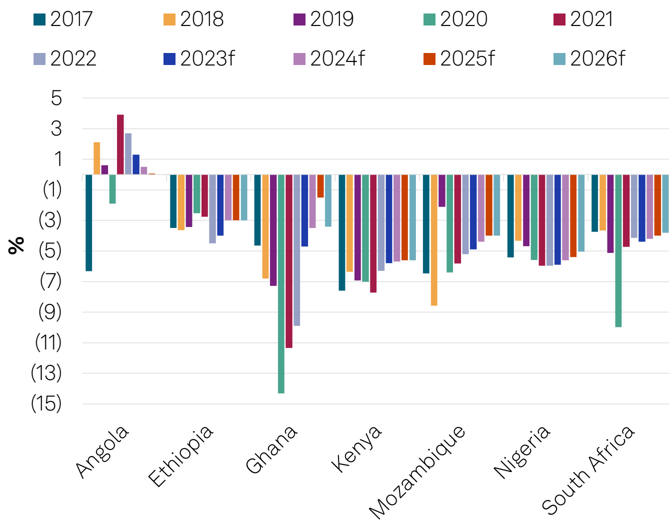


*Sovereign scores range on a scale from '1' to '6', strongest to weakest. Source: S&P Global Ratings.

Chart 15

We expect only gradual fiscal consolidation

General government current account balance/GDP

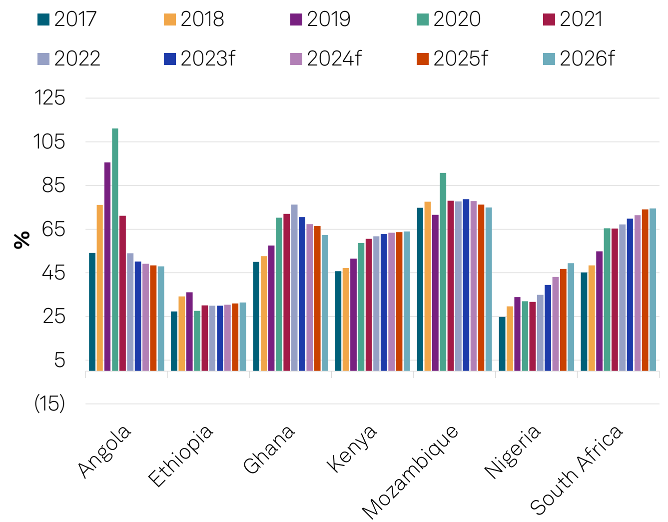


Source: S&P Global Ratings.

Chart 16

Debt has stabilized and we expect a gradual decrease

Net general government debt/GDP



Source: S&P Global Ratings.

Angola (B-/Stable/B)

Macroeconomic conditions in Angola are gradually improving, although from a weak base, driven by relatively supportive oil prices, ongoing reforms, falling inflation, and more moderate exchange rate pressures. We expect public debt to continue moderating as a share of GDP, however Angola is likely to maintain an elevated debt service profile over the coming years, which is a key rating weakness.

Economic growth and public finances are on a better footing following a deep recession and sharp exchange rate depreciation which led to a significant increase in public debt over 2016-2021. We forecast the economy to grow by 2.3% in 2023 and an average 3% annually in 2024-2026. This is from a low base after the economy contracted by a cumulative total of 10% between 2015 and 2020. Oil remains a key driver of headline growth. We expect Angola's oil production to stabilize at about 1.16 million barrels per day in 2023 and oil prices to remain supportive at $85 per barrel between 2024 and 2026. The operating environment has improved due to incentives tied to higher production from marginal fields and changes to governance and management of the hydrocarbons and mineral sectors. Non-oil sectors should also support growth given ongoing reforms and improving macroeconomic conditions.

Nevertheless, fiscal, debt and external pressures persist due to high external debt service costs alongside moderating fiscal and external tailwinds. Despite international oil prices rising to over $100 per barrel in 2022, the general government surplus moderated to 2.7% of GDP in 2022, down from 3.9% in 2021, as expenditure outpaced revenue. That result reflected higher fuel subsidies, to address the spillover from the Russia-Ukraine conflict, and increased capital expenditure in the lead up to the August 2022 elections. General government debt net of liquid assets is forecast to moderate gradually to about 48% of GDP in 2026, from 54% in 2022, on continued primary surpluses and fiscal prudence. We do however expect some fiscal slippage following the end, in December 2021, of an IMF-funded program to mitigate the impact of high imported refined fuel costs and to promote domestic food production, but the government is likely to stick to fiscal prudence.

Angola’s public debt dynamics remains highly sensitive to exchange rate movements and oil prices. Around 74% of total public debt is denominated in foreign currency. Our base scenario includes a moderation of currency weakness compared to recent years. Angola’s high external debt servicing costs remain a key rating weakness--we expect external principal redemptions will increase to about $4.3 billion over 2023-2024 and $5.1 billion in 2025, compared to $2.3 billion in 2022. This will limit government’s fiscal flexibility.

Democratic Republic of Congo (DRC) (B-/Stable/B)

DRC’s growth prospects remain favorable, but risks persist, particularly in the next year. Risks to our forecast primarily relate to economic developments in China (which is easily the DRC’s largest trading partner and a demand base for DRC’s commodities), and to the expected global economic slowdown.

We consider that elevated uncertainty will continue ahead of the presidential election, which is due by the end of 2023. Domestic tensions have abated since the most recent presidential election in 2018, allowing authorities to restore relations with international partners and implement some structural reforms. Nevertheless, given the political landscape's fragmentation, a flare-up in tensions could once again hinder policymaking. Furthermore, while the conflict in the east of the country hasn’t disrupted economic performance so far, risk remains. Fiscal and external pressures should gradually moderate over the next four years, despite short-term risks. Inflation and the deterioration of the security situation in the east have put pressure on the budget, but we project that strong mining sector performance and reform implementation,

supported by a funded IMF program, will lead to lower twin deficits and foreign exchange reserve accumulation over the next few years.

Ethiopia (CCC/Negative/C)

Ethiopia's rating stands at CCC with a negative outlook. The negative outlook captures the risk that we could lower the ratings on Ethiopia over the next 12 months due to increasing uncertainty over the availability of government external funding and the potential inclusion of commercial creditors, including Eurobond holders, in the government's debt restructuring plans.

In November 2022, the Ethiopian government and the Tigray People's Liberation Front (TPLF) agreed to a permanent "cessation of hostilities" following negotiations mediated by the African Union. This is a major turning point in the conflict, which broke out in September 2020 after local Tigrayan authorities accused Prime Minister Abiy Ahmed of centralizing power at the expense of the country's regions. Ethiopia's access to foreign funding has been significantly curtailed since the government imposed a nationwide state of emergency in November 2021 (in response to the TPLF's forces advance toward the capital, Addis Ababa), which led to the freezing of official disbursements under the country's former IMF arrangement and halted progress on the debt restructuring. Our current base case assumes that a re-escalation of fighting is unlikely, because it would stymie the government's efforts to secure international donor assistance against a still-precarious economic, fiscal, and external backdrop. Both the Ethiopian government and the TPLF are keen on a comprehensive end to hostilities.

Notwithstanding the setbacks tied to the domestic conflict, since taking office in 2018, Prime Minister Abiy Ahmed has put forward an ambitious economic agenda to generate sustainable private-sector-led growth under the Homegrown Economic Reform Plan. To this end, the government is aiming to liberalize the telecommunications and financial sectors and reduce debt vulnerabilities stemming from state-owned enterprises (SOEs).

Ethiopia approached bilateral lenders for debt relief to restructure some of its official bilateral debt via the G-20 Common Framework in February 2021. The external creditor committee set-up to manage the process is co-chaired by China and France (the latter as representative of the Paris Club Group of creditors). China is Ethiopia's largest creditor. We understand the committee's delivery of a debt restructuring plan will be guided by an IMF-led debt sustainability analysis (DSA), which will assess the size of Ethiopia's funding gap and guide the new extended credit facility (ECF) and potential extended fund facility (EFF) with the IMF. Following the finalization of the DSA (and the negotiation of a new ECF/EFF facility), we expect the creditor committee to agree on the final parameters of a debt restructuring. The timing between the signing of the IMF deal and the credit committee's delivery of the debt restructuring plan remains unclear, but it could take place as early as mid-2023.

The G-20 Common Framework's comparability of treatment clause could mandate the participation of commercial creditors, including Eurobond holders, as part of Ethiopia's debt restructuring process. We would likely consider commercial participation under the debt restructuring as a default event under our sovereign criteria, since our credit ratings reflect our view of a sovereign's capacity and willingness to service its scheduled commercial obligations (see "Beyond DSSI: S&P's Perspective On The G20 Common Framework For Debt Relief," Feb. 17, 2021).

We project Ethiopia's economic growth will remain relatively muted at 6.0%-6.5% over the fiscal years 2023/2024, compared with 8%-10% prior to the pandemic, as the government re-orients public spending away from productive projects and toward rehabilitation and reconstruction needs.

Ghana (SD/--/SD)

On the back of budgetary pressures, declining foreign currency reserves, and sustained depreciation of the exchange rate, Ghanaian authorities announced, on Dec. 19, 2022, that they would suspend interest and principal payments on commercial foreign currency debt, including Eurobonds. Consequently, we lowered our foreign currency ratings on Ghana to 'SD/SD' on Dec. 20, 2022. We also continue to lower the ratings on individual commercial bond issues to 'D' upon the verification of missed interest or principal payments.

On Feb. 24, 2023, we raised our local currency ratings on Ghana to 'CCC+/C' because we now consider the selective default on local currency instruments as resolved following a local currency bond exchange, accepted by the majority of market participants, and the delivery of new securities to bondholders. We viewed the domestic debt exchange as distressed, rather than opportunistic, owing to the government's weak market access. Our methodology indicates that we classify exchanges as distressed when, in our view, absent participation, a conventional default would likely ensue.

In our view, the successful completion of the domestic debt exchange (with an estimated 85% of holders participating) and Ghana's suspension of foreign commercial and official (except multilateral) debt servicing should reduce interest expenditure by over 4 percentage points (ppts) of GDP in 2023, compared with 2022. Moreover, the maturity extension of Ghana's domestic debt profile, alongside the suspension of principal and interest payments on foreign commercial and bilateral debt, will reduce general government gross borrowing requirements by as much as 6 ppts of GDP this year to about 11% of GDP, according to our preliminary estimates.

We understand that the authorities aim to lower debt to GDP to about 55% by the end of 2028. To improve debt sustainability further, they are also engaging with Ghana's external bilateral and commercial creditors to formally restructure foreign-currency-denominated debt, which, after the domestic debt rescheduling, now makes up close to 60% of all general government obligations.

We assume that multilateral lending to Ghana from the World Bank, African Development Bank, and other multilateral institutions, which makes up about 30% of Ghana's foreign currency debt, will be excluded from foreign debt forgiveness and rescheduling, as is normal practice.

Under a scenario of a 30% haircut on external debt (excluding multilaterals' obligations), and assuming that the dollar value of Ghanaian GDP over the next three years remains close to last year's figure of $67 billion--calculated at average exchange rates--we estimate that general government debt to GDP (excluding guaranteed debt) would decline to about 58% by 2026, from about 80% at year-end 2022. Those calculations are based on an exchange rate of Ghanaian cedi (GHS) 10.15 to $1, versus the current spot exchange rates of about GHS12.86. This assumes cumulative fiscal consolidation of the underlying budget (excluding interest payments) of about 3 ppts of GDP between year-end 2022 and year-end 2026, and a solid recovery of GDP growth to above 5% starting 2024.

A stronger exchange rate or even higher GDP growth outcome could push debt to GDP lower (and vice versa). Under scenarios of haircuts closer to 50%, the target of 55% debt to GDP by end-2028 is more achievable, in our view. All these projections remain highly sensitive to the exchange rate. If we use today's spot rate of GHS12.86 to calculate 2022 U.S.-dollar GDP then the starting point for debt is 93% of GDP, rather than 80%. The underlying assumptions on growth, the exchange rate, and the size of the haircut, among others, would thus have to be more favorable to bring debt down to 55% of GDP by 2028.

On May 17th, 2023, The IMF approved a SDR 2.24 billion (about $3 billion) 36-month External Credit Facility (ECF) for Ghana, with the immediate disbursement of $600 million. The program

targets frontloaded fiscal consolidation and structural reforms, such as attempting to widen the tax take and improve public financial management alongside improving the energy and cocoa sectors. The IMF also noted that securing timely debt restructuring agreements with external creditors will be essential to the success of the program.

Kenya (B/Negative/B)

In February 2023 we revised our outlook on Kenya to negative from stable and affirmed our 'B/B' local and foreign currency ratings. Kenya's medium-term fiscal and external refinancing risks are increasing due to a challenging Eurobond issuance environment and recent tightness in domestic debt markets. Meanwhile, pressure in the interbank foreign exchange market has exacerbated U.S. dollar shortages and stoked currency depreciation, further inflating the stock of external debt in local currency terms.

Our base-case scenario assumes Kenya's 2023 financing requirements are largely in place, while the new administration's commitment to reducing its net borrowing requirement, via a comprehensive fiscal consolidation agenda, should help ease funding pressures. Nevertheless, risks to our base-case scenario are weighted to the downside, given Kenya's sizable external financing needs and uncertain market conditions.

Since assuming office in September 2022, President William Ruto's administration has tried to display a commitment to fiscal discipline, including by targeting a lower overall budget deficit of 5.7% of GDP in the current 2022/2023 fiscal year (year ending June 30, 2023), compared with 6.2% under the original budget. To this end, the new administration has eliminated gasoline and electricity subsidies and reduced contingent liabilities associated with Kenya Power. It has also accelerated efforts to strengthen tax administration, mobilization, and compliance to boost total revenue.

We expect these measures will help reduce Kenya's high net borrowing requirement. Fiscal slippage could arise due to ongoing drought relief, contingent liabilities tied to Kenya Airways, potential litigation risk from project cancellations, and carryovers of unbudgeted expenditure from the previous administration (amounting to about 1.9% of GDP).

Our base-case scenario assumes that Kenya will meet its financing requirements for fiscal 2022/2023, but risks remain for fiscal 2023/2024, especially given relatively high foreign debt service obligations coming due (including a $2 billion Eurobond maturing in June 2024) and a backdrop of still-difficult debt issuance conditions. Recent tightness in the Kenyan interbank foreign exchange (FX) market has also reduced FX liquidity and accelerated currency depreciation, driving up the cost of external interest in local currency terms. Difficult external financing conditions and looming elections led to Kenya suspending plans to tap international capital markets in 2022, prompting the country to draw more extensively on its FX reserves to meet its external debt repayments.

In the domestic bond market, the government initiated a voluntary switch transaction in January 2023 that invited select market participants to convert Kenyan shilling (KSH) 88 billion of maturing T-bills and T-bonds into a tax-free, six-year infrastructure bond. We understand that 80% of investors participated in the exchange, and the nonconverted redemptions were settled on time and in full.

We did not consider the debt liability management exercise a distressed exchange (owing to its opportunistic nature and the new instrument's higher yield), and understand it was undertaken to manage short-term refinancing risks by lengthening the maturity profile of the government's domestic debt. This has proven challenging given investors' recent oversubscriptions in short-term T-bills, at the expense of longer-dated securities. That resulted in the government reaching

only 30% of its target in its latest February 2023 bond auction and has implications for domestic debt-servicing costs. Positively, the average time to maturity of T-bonds increased to 9.1 years in 2022, compared with 6.3 years in 2019.

Our ratings on Kenya are constrained by the country's still relatively low GDP per capita (despite strong GDP growth), high fiscal deficits and debt stocks, and a history of ethnic loyalties that supersede national loyalty and sometimes lead to social tensions. The ratings are supported by Kenya's track record of strong GDP growth (allowing it to rise from low-income to middle-income status), dynamic private sector, and its diversified economy (including a large and diversified agricultural and services sectors relative to peers'), which should help cushion its economy in a downturn and support a rebound. Kenya also benefits from flexible monetary settings, supported by its relatively deep and dynamic domestic capital markets, the market capitalization of its local currency debt at over 25% of GDP, and a developed institutional framework relative to peers' at the same rating level.

Mozambique (CCC+/Stable/C)

Mozambique’s economic prospects and ability to repay debt hinges on the resumption of large gas projects, which remain delayed following insurgent attacks in 2021. We believe the $20 billion Area 1 project, led by TotalEnergies under a consortium structure, could restart in the second half of 2023 if improvements in security in the region are maintained. The project, which should produce 12.88 million metric tons of LNG per year for 25 years from completion, has been under force majeure since March 2021. Meanwhile, Exxon Mobil Corp's $30 billion gas project in Area 4 has not progressed since 2021 and a final investment decision has not been met. The export and fiscal revenue from the projects could support Mozambique’s fiscal and external positions, although production might only start in late 2026.

The country should also benefit from the Eni Coral South Floating Natural Gas Platform, which began operations in November 2022, as well as from high aluminum and coal prices. The Eni project will not, alone, provide sufficient fiscal revenue to alleviate high debt servicing costs. Increasingly erratic weather has prevented more significant economic expansion and will require additional government spending to rebuild infrastructure and provide humanitarian support. The northern parts of Mozambique have experienced damage from multiple cyclones since 2019, and most recently from a large cyclone in late February and early March 2023.

Mozambique’s fiscal and public debt position will remain key rating weaknesses until government revenue receives support with the operational debut of the TotalEnergies gas project. We believe Mozambique can meet its debt obligations over the next 12 months, as it did in 2022, but there is limited fiscal headroom in coming years due to sizeable debt service costs. If security does not improve and projects face protracted delays the prospect of a further restructuring of the outstanding $900 million Eurobond increases, in our view. General government debt principal and interest payments took up over 70% of revenue in 2022, equivalent to Mozambique metical (MZN) 240 billion or $3.8 billion. That sum will likely rise once the country’s Eurobond begins amortizing over 2028-2031, when $225 million per annum in principal payments will be due.

Mozambique's external imbalances are also sizeable because the mega gas projects have significant import requirements. The current account deficit is forecast to average about 34% of GDP over 2023-2026, meaning external indebtedness will remain elevated. The return of concessional funding from multilateral institutions such as the IMF and World Bank should provide some relief in terms of dollar inflows, however external financing needs will remain large.

Nigeria (B-/Negative/B)

In February 2023 we revised our outlook to negative from stable and affirmed our 'B-/B' sovereign credit ratings on Nigeria. Low (albeit recently rising) crude oil production, large refined-petroleum subsidy costs, high debt service expenditure, and associated sizable fiscal deficits are exacerbating Nigeria's fiscal and external imbalances. In addition, limited and expensive access to international capital markets, and a consequent increasing reliance on significant domestic funding at relatively high interest rates, are weighing on net interest costs and the government's fiscal position. Nigeria held general elections on Feb. 25, 2023, when a close three-way presidential race ended with the appointment of the ruling party's candidate, Bola Tinebu. He has pledged significant reforms, but will inherit a deteriorating fiscal story.

The economy is estimated to have expanded by about 2.8% in 2022 and we forecast real GDP to average 3.1% in 2023-2026. Below-capacity oil production will likely continue to affect export growth, while inflationary pressure, fiscal constraints, and sluggish investment will weigh on consumption and investment growth. These factors are likely to be partially counterbalanced by the new, potentially more business-friendly administration. Oil production (including condensates) averaged about 1.37 million barrels per day (mbpd) in 2022, below the budgeted 1.60 mbpd and below Nigeria's OPEC production quota of 1.8 mbpd. Those low volumes more than offset relatively high average oil prices (of $98 per barrel, compared with a budgeted $73), leaving the general government fiscal deficit at 6.2% of GDP for 2022. Oil revenue's significant underperformance in 2022 and higher debt service expenditure support our view that the government's financial commitments will come under strain unless there is credible fiscal consolidation.

External buffers are also under pressure. Rising prices of imported goods, payments to clear FX backlogs, the Central Bank of Nigeria's (CBN's) intervention in the FX market to stabilize the naira (NGN), and the low volume of oil exports reduced gross foreign exchange reserves by about $3 billion, to $38 billion in 2022. We lowered our estimate of usable reserves to $28 billion for 2023 to account for what S&P Global Ratings estimates to be encumbered reserves of about $10 billion.

The 2023 federal budget (excluding that of the states) estimates a fiscal deficit of NGN11.34 trillion ($24.5 billion), or 5% of GDP for this year. Debt service expenditure is budgeted at NGN6.3 trillion ($13.7 billion), or 57% of federal revenue of an estimated NGN11.9 trillion. The budget is based on the assumption that petrol subsidies will be removed by mid-2023. At the general government level (federal budget plus states), we forecast a fiscal deficit of 5.9% of GDP in 2023, and an average of about 5.4% over 2024-2026, on the assumption the new government will pursue a degree of fiscal consolidation.

Alongside fiscal and external imbalances, expensive access to external capital markets (due to currently high global interest rates demanded from emerging market issuers) and an increasing reliance on significant domestic funding at higher interest rates will weigh on ratios. Average annual interest as a share of general government revenue is likely to rise to an historically high average of 31% over 2023-2026, while the federal tax take--general government revenue as a percentage of GDP--will average only 10%, significantly lower than among peers. The government will largely rely on domestic borrowings to finance its deficit in 2023, with limited planned external issuance.

Despite increasing external and fiscal pressures, we think the government has sufficient debt-servicing capacity to pay the Eurobond maturity of $500 million due in July 2023. A bill aimed at restructuring debt accumulated under the Central Bank of Nigeria's Ways and Means facility (an overdraft facility provided to the ministry of finance) was passed in early May 2023. When implemented, it will not constitute a default as per S&P Global Ratings' criteria because we do not classify central bank financing as a commercial debt obligation, while the restructuring will

deliver significant interest-cost savings. We already include the Ways and Means facility in our debt stock calculations.

South Africa (BB-/Stable/B)

An intensifying electricity crisis and infrastructure bottlenecks are key risks to South Africa's growth and public finances, despite reforms aimed at alleviating these pressures. Electricity generation is at historic lows, resulting in widespread power outages of up to 12 hours per day, while insufficient rail and port capacity is straining South Africa's ability to export key commodities. Reforms aimed at incentivizing private sector investment in renewable power are ongoing, but slow implementation and ageing power sector infrastructure means pressures continue to build. We expect private sector investment will help reduce demand for electricity from state-owned Eskom, but outages are likely to continue as baseload generation from Eskom remains strained.

We forecast the economy to slow to 0.7% in 2023, from 2% in 2022, and that gross public debt levels will continue rising to about 78.5% of GDP in 2026, primarily driven by ongoing operational and financial weakness at large state-owned entities (SOEs). The government's relief package for Eskom, alongside wider deficits, will require additional debt financing. That will drive debt and debt servicing costs higher--we forecast interest costs to approach 20% of general government revenue by 2026, up from 13.5% in 2019. Contingent liabilities from weak SOEs are significant and drag on public finances. Government has exposures to SOE guarantees amounting to South African rand (ZAR) 396.1 billion ($20.1 billion), or 6.0% of 2022 GDP, as of end-March 2023. Eskom's guaranteed exposure is ZAR337.8 billion, 5.1% of 2022 GDP. The government has repeatedly had to settle government guaranteed loans and has recapitalized SOEs, including South African Airways, Denel and Land Bank.

South Africa's rating receives support from deep local financial markets, relatively low external indebtedness compared to peers, and a credible central bank. We expect the country to return to current account deficits, averaging 2% of GDP through 2026, but external debt net of liquid assets will remain low at about 20.6% of current account receipts. South Africa's deep local market and increasing use of concessional external debt should provide an adequate funding base for the government. Inflationary pressures have risen over the past two years, but at a more moderate pace compared to advanced economies. The central bank (the South African Reserve Bank, or SARB) has proactively tightened its policy rate by 425 bps cumulatively since late 2021. Strong central bank credibility, strong banking supervision, a well-capitalized banking sector and low government foreign currency debt (about 10% of total public debt is in foreign currency) should partially insulate South Africa from heightened global uncertainty, especially following recent instability among some international banks.

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Global And Local Risks Pressure Corporate Resilience

- The key factors influencing SSA corporate entities' prospects are similar to those affecting most global economies, and include:
    - Receding geopolitical risks, offset by policy uncertainty and systemic financial stress;
    - Persistent high inflation and interest rates, and
    - Financial conditions that are tighter than in other emerging markets, due to SSA's largely frontier-market status, and global capital markets risk-off stance.
- The diversity of economies and companies in the SSA region implies that the extent of each factor's influence will reflect regional, local, and industry specifics.
- We expect the average GDP growth of the eight SSA countries featured in this report will be a modest 2.9% in 2023 and 3.4% in 2024.

Continued policy uncertainty and systemic financial stress are offsetting the benefits of receding geopolitical risks, and weighing on regional economic growth and resilience. Consumers remain under pressure due to elevated inflation and currency weakness (driven by capital markets' risk-off stance and some countries' policy missteps). Affordability issues for goods and services are compounded by large-scale infrastructure challenges, that reduce economic growth, and, in many cases, prompt companies to raise prices. China's post-COVID 19 re-opening, while positive for global growth, is unlikely to specifically benefit SSA's commodity exporters because growth is not expected to be linked to real estate or infrastructure.

Persistent elevated inflation and interest rates (exacerbated by softer non-oil commodity prices) weigh on margins and discourage capital investment, leading to lower long-term corporate growth. Inflation's effects have been felt across all industries and SSA countries. Mining and other commodity exporters have been affected by softening prices (excluding gold and oil for now) and above-inflation cost growth, which are combining to pressure margins--although this can largely be absorbed. Rising costs could weaken affordability, and thus the performance of consumer-focused sectors such as retail and domestic utilities. Elevated food and fuel prices, in particular, could put pressure on the budgets of lower-income households and reduce consumption. Despite these issues, tourism activity is starting to recover from its recent dip.

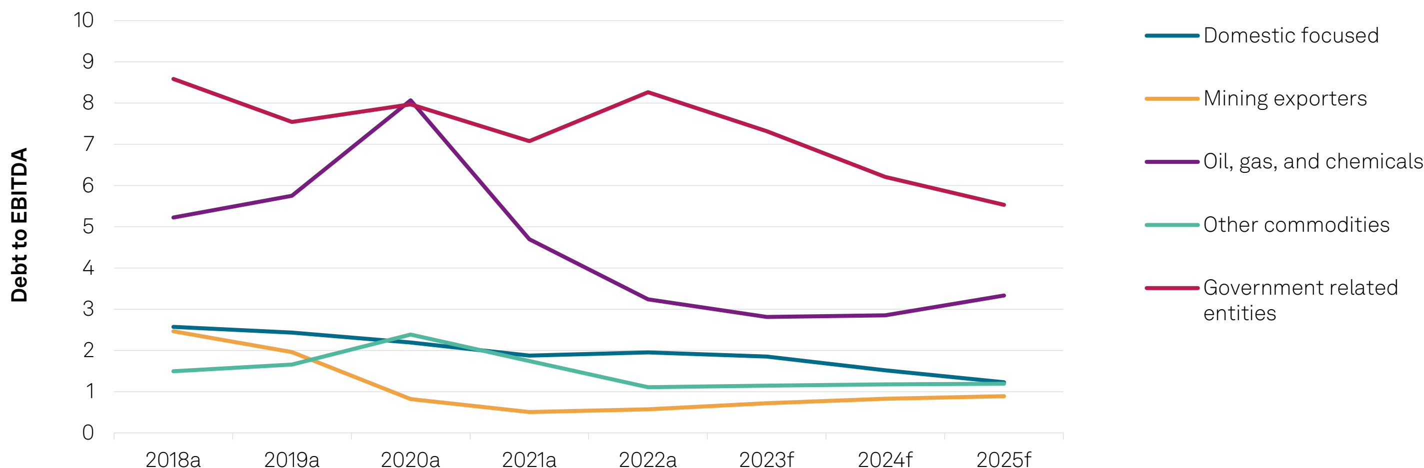
Limited debt-issuance needs are offsetting the impact of capital markets' reduced risk appetite, for now. Many SSA corporates raised capital market debt in 2020, 2021, and the first quarter of 2022, during periods of lower interest rates and ample demand for speculative grade credit. Most of that issuance was used to refinance existing debt or fund acquisitions, generally contributing to improved leverage metrics and longer maturity profiles. However, since March 2022, risk aversion has reduced liquidity, particularly in international markets and for speculative grade credit, with the impact felt acutely in the region's frontier markets. This has not yet had a material effect on the region's corporate issuers, but the need for debt refinancing will increase and higher interest rates will put more pressure on liquidity and balance sheets. It is notable that South Africa's deep domestic markets remain largely supportive of new issuance, though other local markets across the region are relatively underdeveloped.

SSA corporate deleveraging has reduced debt-to-EBITDA ratios below the average for all emerging markets (see chart 17). Corporate entities in many emerging market economies,

including in the SSA, have been able to pass through some of their increased costs to consumers of their products and services, supporting EBITDA margins. Furthermore, manageable leverage (with net debt to EBITDA below 3.0x in most sectors, excluding state owned entities) is supporting financial resilience.

Chart 17

Debt to EBITDA has declined for all SSA corporate industry groups



Figures are EBITDA weighted. a--actual. f--Forecast. Source: S&P Global Ratings.

Net debt to EBITDA is falling across most corporate sectors in SSA (see chart 17), while our breakdown of leverage by sector highlights useful industry-specific trends. Many companies took advantage of the windfall from strong commodity prices in 2021 and 2022 to de-leverage their balance sheets, and average net debt to EBITDA is now below pre-pandemic levels. Looking ahead, we expect corporates to remain committed to lower leverage through the economic cycle, though we forecast Increased leverage in 2023 and beyond for some commodity players due to weaker prices. We are also monitoring the negative EBITDA impact of declining consumer affordability on the retail, telecommunications, and healthcare sectors.

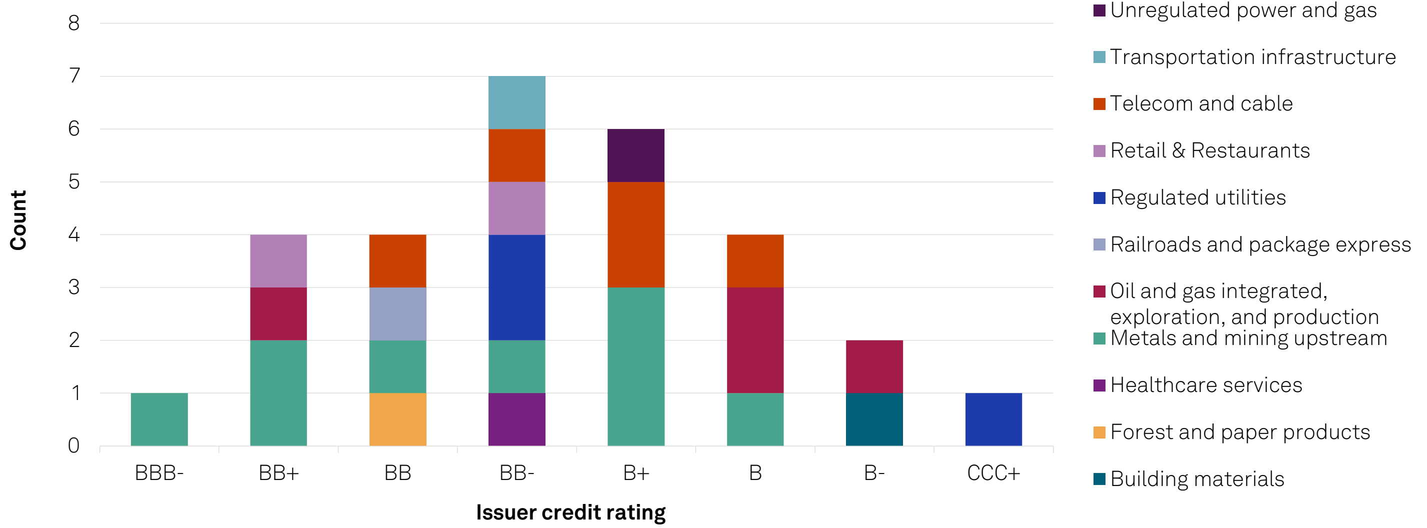
Tighter financing conditions, particularly in global markets, may limit emerging market companies' financial resilience, making it difficult for high-yield issuers to refinance or issue new debt. South Africa's mature domestic capital markets are the exception in SSA. We have seen development and increased capacity for debt issuance in local markets, including Nigeria, Kenya, and Ghana, but these markets are typically only open to the largest corporates.

South Africa listed and/or headquartered companies account for about 60% of the companies we rate in the region. Many South Africa-based corporations also have pan-African operations and/or exposure to developing and developed end markets. In collating our corporate regional statistics, we have included corporates headquartered in SSA, as well as those headquartered outside SSA that derive at least 50% of their earnings from the region.

Most of our SSA ratings are speculative grade (see charts 18 and 19). This reflects the smaller size of many SSA companies relative to global peers as well as key rating constraints emanating from country and sovereign risks. For example, in South Africa our ratings range from 'CCC+' to 'BBB-' with the median rating at 'BB-', in line with the long-term foreign currency sovereign rating on South Africa.

Chart 18

Ratings distribution mix by industry highlights a speculative grade bias



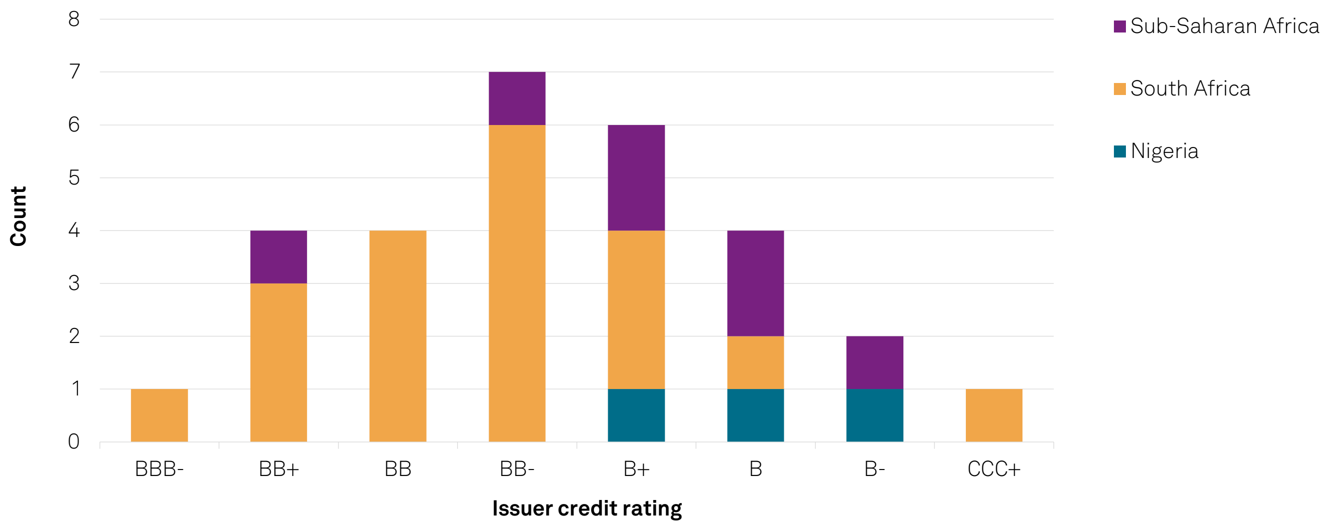
Source: S&P Global Ratings.

For issuers that are highly exposed to Nigeria (>50% of EBITDA), our ratings range from 'B-' to 'B+', with the primary constraint being high exposure to economic and currency exchange developments in Nigeria. For SSA companies outside South Africa, our ratings range from 'B' to 'BB+'.

Chart 19

Ratings reflect country and sovereign risk in operating jurisdictions

Ratings distribution mix by geography



Source: S&P Global Ratings.

South Africa: Intensifying Infrastructure Challenges Add To Inflationary Risks

We view inflation, infrastructure constraints, and currency weakness as the main (and intertwined) factors weighing on the financial resilience of rated South Africa-based corporates--though slower global growth and policy uncertainty could also have an effect. Some mining companies are also exposed to lower commodity prices, although the impact varies depending on what commodities they produce.

Inflation

Companies with material South African operations are experiencing inflationary pressures that are elevated and rising. We expect CPI growth of about 6% in 2023, slowing from 6.9% in 2022. Most companies' financial flexibility has improved due to cost efficiency initiatives and deleveraging undertaken through 2020 and 2021, meaning they can absorb higher costs. We will be watching for issues arising from wage pressures stemming from the elevated inflation, which increases the risk of strikes, especially at commodity producers. Security risks are also a concern given the severe civil unrest in July 2021.

Cost of living pressures are negatively affecting purchasing power and weighing on the affordability of some goods and services. South Africa's lower per capita income means food, fuel, and utilities occupy an outsized portion of the average South African consumption basket (compared to nations with higher average incomes). We are starting to see the effects of spending pressures on domestically focused companies such as retailers, telecommunications, and health care providers, and particularly those without geographic diversification.

Power costs are one of South Africa's key inflation drivers, with price rises linked to power supply challenges and integrated electricity provider Eskom’s poor financial performance. Eskom’s 2023 tariff increase was 19%--almost three times the CPI increase--, while increasingly common generating failures at coal-fired plants forces uses onto expensive diesel generation (both at Eskom and in power-backup solutions). Eskom's increased use of diesel-fired generation has increased its cost base, while the slow development of alternative power sources makes elevated electricity tariffs likely in the future.

Energy cost inflation, in the form of a higher cost of fuel (and its derivative products), has also affected companies, particularly in the bulk commodity space. This has been exacerbated by the poor performance of the rail and port operations of Transnet, a major South African logistics provider (despite the country's generally improving logistics landscape). Use of road transport has increased significantly in South Africa due to capacity constraints on several key bulk-commodity rail lines. We understand that road transport for bulk commodities is around 10% more expensive than the rail equivalent. Moreover, we view denigration of South Africa's largely well-maintained road infrastructure as an emerging risk. It is also notable that, several South African mine operators are using road and rail links to Mozambique’s ports to access export markets.

Infrastructure

Much of South Africa's infrastructure constraints are due to the combination of woes experienced (and delivered) by its two largest SOEs Eskom and Transnet. Rolling power outages (referred to as loadshedding) by Eskom, and severe capacity constraints on some rail lines operated by Transnet have exacerbated the negative consequences of weak global demand and higher inflation on South Africa's economy. Power outages, which average 6 to 12 hours a day, are expected to lower South Africa's already under-pressure economic growth outlook.

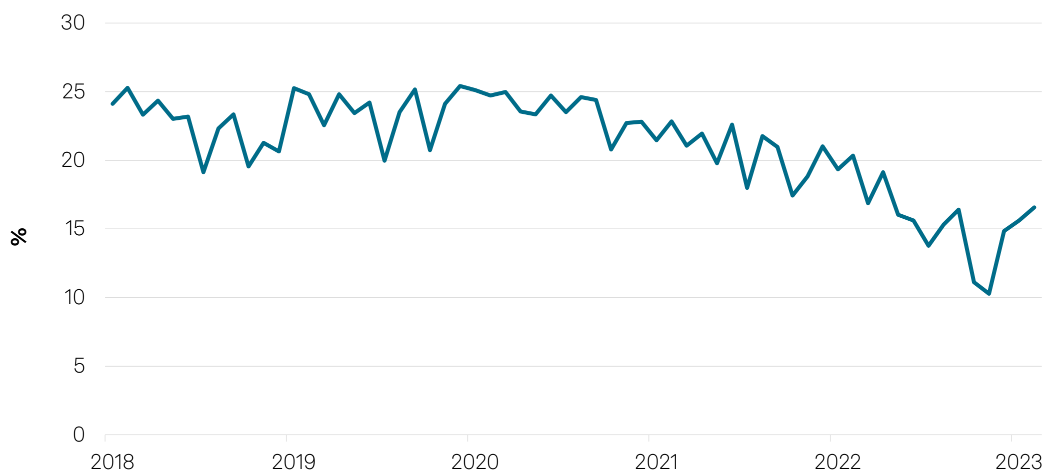
Recent corporate results have also highlighted the negative impact of outages. Mining companies, including Sibanye-Stillwater and Gold Fields, have noted that back-up generation and alternative-planning solutions are insufficient to facilitate 'business as usual' and are forecasting production will fall 10% to 25% below expectations, based on current loadshedding levels (while self-generation and work stoppages are pushing up cash costs). Telecommunications companies have lamented poor network availability and the higher costs of diesel-powered backup generation, while domestically focused businesses, such as food retailers and health-care providers, also face significant additional costs due to diesel generation. Furthermore, with inflation eroding consumers' real disposable incomes, corporations will find it increasingly difficult to pass on the additional costs.

As already noted, rail and port infrastructure issues have forced companies to use more expensive road transport (see chart 20). That has also diminished export volumes, contributing to base metal and mineral commodity exporters' inability to take full advantage of the commodity price boom. For example, Richards Bay Coal Terminal, which exports coal delivered via Transnet's coal line (its largest revenue contributing business segment and a key indicator of rail performance) only managed to export 50.3 million tons in 2022, down from 58.7 million tons in 2021, and well short of its almost 80 million ton annual capacity.

Chart 20

Rail's faltering reliability has boosted road haulage

Rail as a % of total freight volumes



Source: StatsSA.

South Africa's infrastructure problems are weighing on its economic performance and resulted in the revision of our South Africa rating outlook to stable from positive (see "South Africa Outlook Revised To Stable As Infrastructure Constraints Weigh On Growth; 'BB-/B' FC Ratings Affirmed," published March 8, 2023). Outlooks on sovereign-constrained SOEs were similarly affected.

At present, we see generally low leverage and solid operational efficiency across rated private sector corporates, with sufficient financial headroom at current rating levels. This should provide a cushion against the challenging operating environment in the country, assuming challenges begin to abate by the start of 2024. Cost-containment strategies and geographic diversification also partly protect some issuers from power supply, inflation, and currency risks. Elevated commodity prices are supportive for some commodity exporters.

For the largest SOEs--Eskom and Transnet--some relief from perennial liquidity stress has arrived in recent months. Transnet refinanced a $1 billion loan in February 2023 and received ZAR5.8 billion in government support. The National Treasury also announced a ZAR254 billion debt relief package for Eskom, which—if implemented as planned—will reduce near term liquidity risks and support deleveraging. These measures will provide breathing room for Eskom and Transnet to focus on improving their poor operational performance. However, the aging infrastructure, sub-optimal maintenance and investment, inflationary pressures, vandalism, and slow pace of sector reforms continue to constrain recovery.

Currency

Currency weakness impacts industries differently. For commodity exporters, the higher local currency prices of commodities traded in hard currency largely offsets the higher cost of imports in capex. In addition, the currency of debt and revenue is typically well-matched.

However, companies that have a domestic focus, especially those with imported capital needs such as telecommunications providers, can experience burgeoning capex costs that could be exacerbated if they have unhedged foreign currency funding. A weak rand will pressure the capex budgets of Eskom and Transnet, given that both import components (for their power stations and rail operations, respectively) and have significant maintenance backlogs.

Nigeria: Higher Oil Prices Do Not Compensate for Foreign Exchange Shortages

Nigerian corporates face near term challenges with high inflation (of 15%-20%) and low economic growth likely to slow the pace of revenue growth. Rated corporates, which benefit from strong market positions, have been able to pass costs on to consumers through higher pricing. Issuers in the oil sector saw weaker than expected production during 2022, due to disruptions on key oil extraction pipelines. This was offset by higher oil prices during the year. Foreign exchange shortages remain acute, and structural bottlenecks and security issues are perennial constraints to growth. The long-awaited commissioning of the 650,000 barrel/day Dangote oil refinery is also expected in mid-2023 and should support GDP growth and the government's fiscal and balance-of-payments positions. It may also moderate inflationary effects in the country, to some extent, since Nigeria currently imports most of its refined fuel.

Nigeria held its presidential elections in February 2023, with the new president, Bola Tinubu, expected to take office at the end of May 2023. We believe his policies will be fairly business-friendly, with top priorities including stimulating GDP growth, exchange rate liberalization, fiscal consolidation, revenue mobilization, and the removal of oil subsidies. Positively, there was little election-related disruption and the transfer of power is expected to remain peaceful.

Sub-Saharan African Corporate Considerations

The corporate entities we rate in SSA operate primarily in the oil and gas, mining, telecom, utility/power, and retail sectors. Some companies, particularly in the telecommunications and mining industries, have extensive operations across Africa. Notably, we do not rate any corporates domiciled in Angola, D.R. Congo, Ethiopia, Ghana, Kenya, or Mozambique, but many rated pan-African issuers have extensive exposure to these and other countries in the region.

Most of S&P Global Ratings-rated non-South Africa-headquartered companies are commodity exporters with limited product and/or country diversification. Domestic-focus companies--such as mobile network operators and tower companies, and fuel retailer Vivo Energy--are more diversified across the region but typically have significant exposure to one or more regional

jurisdictions. In general, country risk (typically assessed as high or very high for African countries other than South Africa, Botswana, and Morocco) constrains ratings, with factors such as infrastructure, logistics, skills availability, and underdeveloped capital markets and regulations increasing the cost of doing business in the region. Sovereign ratings across the region also constrain most corporate ratings and have been under pressure in recent months with many (such as Ghana and Mozambique) being in or close to default. Given the negative impact of country risk and/or sovereign constraints on many ratings in SSA, some regional issuers have lower ratings than their business and financial risk profiles imply.

While inflation and higher interest rates have been financially tolerable for most SSA companies we rate, we cannot ignore the impact on corporate resilience of increasing sovereign stress, persistent high inflation and policy rates, and civil unrest-related risks posed by elevated food insecurity and changes in political regimes. Furthermore, we can't discount the recent deterioration in investor sentiment linked to fears that sovereign stress could lead to capital controls or other cash-upstreaming challenges in some countries. In the region, as always, the only certainty is change.

SSA Banks: A Look At South Africa, Nigeria and Kenya

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- Increasingly tight credit conditions will restrict lending and exacerbate already elevated credit risk in SSA's banking sectors, leading to higher credit losses.
- Geographically diverse banking groups are inevitably vulnerable to broader sovereign risks, as shown by Ghana 's default on its sovereign debt leading to higher impairments for South African and Nigerian banks in 2022.
- The link between sovereign and banking risks has increased, and poses risks to banking sector resilience in the context of high government debt levels and funding costs. The latter is, however, supporting banks' net interest margins and earnings.
- Banks in SSA have recovered from the pandemic quickly, recording robust risk adjusted returns in 2021 and 2022. This underpins their ability to strengthen their capital through earnings retention.

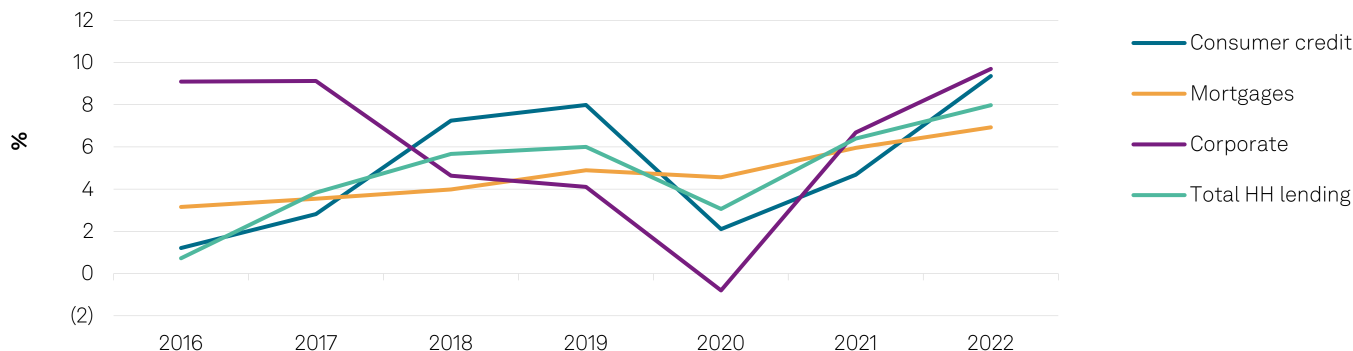
South African Banks Defy Economic Challenges

South Africa's energy crisis and infrastructure woes are hindering industrial production capacity and pose a risk to the banking sector. We forecast an economic slowdown, with real GDP growth falling to 0.7% in 2023, from 2% in 2022, and averaging 2% per annum over 2024-2026. Real GDP growth per capita will contract by almost 1% in 2023, which in turn will exacerbate inequalities and unemployment. We forecast South Africa's GDP per capita at $6,400 in 2023, down from $7,700 in 2011. Lingering power shortages and infrastructure bottlenecks are also undermining South Africa's export capacity and could lead to higher reliance on portfolio flows to finance the current account deficit, which is forecast to average 2% of GDP through 2026. The removal of limits on private-sector power generation should help renewable electricity generation to tackle the shortages.

Credit conditions will remain constrained in 2023, although inflation is likely start moderating later this year, following an improvement to 6.8% in April 2023, from 7.8% in July 2022. We expect inflation to retreat to within the SARB's 3%-6% target range in 2023 and average 5% through to the end of 2026. We forecast that growth in credit to the private sector will moderate to 5% in 2023, after a rebound in 2022.

Chart 21

Corporate lending momentum could continue in 2023



HH--Household. Source: S&P Global Ratings.

Households' disposable income will come under pressure because of the additional costs of implementing alternative power solutions and higher interest rates. Electricity shortages will weigh more on small-to-midsize enterprises (SMEs) than large corporates. Larger corporates in the industrial sectors face a reduction in the amount of power available, which will likely reduce their output and increase costs. We expect they will transfer these additional costs to customers. The retail property sector's income-producing assets were resilient throughout the pandemic and recovered more quickly than we expected. However, office space continues to struggle, with the vacancy rate higher than 15% in 2022.

Although inflation is moderating, the SARB raised its benchmark rate 10 times consecutively from November 2021 to May 2023, increasing the rate by a cumulative 475 bps to 8.25%. Banks will continue to extend credit to the renewables sector, although capacity constraints have delayed the implementation of some projects in 2022. We forecast that private sector credit to GDP will remain stable, at about 75% of GDP but growth in credit to the retail and households' sector will slow down because of affordability constraints. Households' disposable income will come under pressure because of the elevated prime lending rate now at 11.75%, despite moderating inflation. The private sector's debt-absorption capacity is limited by moderate wealth, rising unemployment, and wide income disparities.

The new higher interest rate cycle will lead to the credit loss ratio settling at higher than the historical low of 0.75%, likely averaging 1.1% of total loans through 2024. Nonperforming loans will likely average 4.0% of systemwide loans in 2023, which is higher than pre pandemic level, but better than the 5.4% recorded in 2021.

We anticipate that the sector will maintain adequate average risk-adjusted returns of 15%-16%. This, in turn, will support banks' internal capital generation over 2023-2024. Higher interest rates will underpin earning assets in the short-term. A prolonged period of higher interest rates could lead to a more rapid rise of credit losses, offsetting gains on interest income. Banks' earnings capacity is supported by their diversified business model and their ability to generate a consistent share of noninterest income. Earnings recovered quickly following the 2020 pandemic shock.

We expect that large banks, which account for about 90% of the system assets will continue to grow earnings in 2023, as higher interest rates support growth in investment income and net interest margins. South African banks' exposure to the rest of Africa is limited, ranging between 10-15% of their total assets, though some banks are more geared towards Africa, where operational and credit risks are elevated.

Recent credit events in Ghana do not pose material risk to banks' creditworthiness. Assets in Ghana accounted for less than 1% of group assets on average and banks have impaired their exposure to Ghana sovereign debt at an average of about 50%. That impairment is well beyond market expectation and was made in anticipation of the debt restructuring. We expect banks to record modest levels of impairment losses on their government securities held at amortized cost. Government exposures accounted for about 15% of total banking assets in 2022.

South African banks' regulatory capital has strengthened over time, and we expect banks will continue to maintain robust buffers compared to the minimum requirements. They hold an average minimum of 400 bps above their minimum Common Equity Tier 1 ratio. The Prudential Authority is an early adopter of global best practices. It reinstated, in January 2022, the Pillar 2A capital requirement suspended in 2020 and banks resumed dividends in 2021, following the 2020 suspension of payouts, including payment of extraordinary dividend.

South African banks started implementing Basel III capital ratios in 2013 and have embarked on the reform of Basel III. The SARB provided a roadmap to implement a revised minimum capital

requirement to withstand market and credit risks. The replacement of the 35% Amount of Stable Funding (ASF) factor, with 0% by the end of 2028, for short-term wholesale funding of less than 6 months is another sign of full commitment to the Basel standards. Banks are expecting to replace this source of funding with customer deposits or capital markets funding.

Chart 22

South African banks' regulatory capital is underpinned by good profitability

Top -tier South African Banks' capitalization as at Dec. 31, 2022

Source: S&P Global Ratings.

South African banks are largely funded by customer deposits and domestic wholesale short-term deposits. Professional money managers tend to dominate the management of contractual savings. The confidence-sensitive nature of wholesale funding is mitigated by the mature asset management industry, whose funding is denominated in local currency. Furthermore, exchange controls ensure that rand liquidity remains in the country. Major banks are not exposed to large-scale refinancing risk or a downturn in investor sentiment because they do not rely on international funding. We expect details on the calibration of the financial loss-absorbing capability, or additional loss-absorbing capacity (ALAC), of instruments issued by domestic systemically important banks to be clarified in 2023. At this stage, we do not apply extraordinary support for ALAC to our issuer credit ratings on South African banks.

Top-tier South African banks' issuer credit ratings are constrained by the 'BB-' long-term foreign currency sovereign rating. We do not rate financial institutions in South Africa above the long-term foreign currency sovereign rating given the direct and indirect impact that sovereign distress would have on domestic banks' operations. The stronger standalone credit profile reflects our expectation that banks' earnings will be resilient throughout the cycle. South African banks boast a long track record of sound asset quality and robust regulatory capital buffers to withstand weakening economic prospects.

We have a stable outlook on all banks, which reflects the outlook on South Africa. Bank ratings will move in tandem with the sovereign rating, but an upgrade is unlikely in the next 12 months. A negative rating action would occur if economic and governance reforms do not progress as planned, resulting in further deterioration in economic growth, or higher fiscal financing needs than we expect.

Nigerian Banks Resilient To Lingering Economic Setbacks

We forecast that the Nigerian economy will grow by 3.3% in 2023, after expanding 2.8% in 2022. Nigeria is among the world's top 15 hydrocarbon exporters (close to 90% of its exports receipts are from crude oil and gas exports). Nonetheless, we project only very small current account surpluses for 2023-2024 due to uncertainty regarding oil production volumes. Production in 2022 was marred by oil theft, pipeline leaks, and terminal shutdowns. We expect production volumes will remain below the OPEC quota in 2023, undermining foreign currency revenues.

The large private oil refinery in Nigeria, Dangote, is scheduled to commence production sometime in 2023 but ramp up of refining capacity to the full 650,000 barrels per day will go beyond 2023. Still, the increased capacity will preserve FX reserves.

The Central Bank of Nigeria (CBN) introduced the RT200 FX program to stimulate FX inflows. Under the program, non-oil exporters can remit their FX at the official CBN rate--or NAFEX plus Nigerian naira (NGN) 65. Despite the CBN adopting the Nigerian Autonomous Foreign Exchange Fixing Mechanism (NAFEX) rate as its official rate, the spread between the NAFEX rate (NGN460/$1) and the parallel rate (above NGN700/$1) widened further in 2022. The intervention in the NAFEX window to stabilize the naira led to a $3 billion reduction in FX reserves in 2022. In addition, we deducted about $10 billion of forwards and swaps in our measure of international reserves, which led to our forecast of usable FX reserves of about $28 billion in 2023.

Despite a prolonged period of foreign-currency shortages, largely affecting manufacturing and services such as airlines, we expect that non-oil sectors will support economic growth, which in turn should present some lending opportunities to banks. We forecast that loan growth will average 18% per year over the next two years.

The start of operations at Dangote refinery is likely to provide lending opportunities to the oil and gas sector but also exacerbate industry concentration. Nigerian banks have rebalanced their exposures to oil and gas, favoring upstream operations, but the implementation of the Petroleum Industry Act (PIA) and the state-owned Nigerian National Petroleum Co. (NNPC)'s restructuring may in time rebalance exposures toward the downstream sector.

Nigeria's household and corporate leverage metrics are at the lower end of Nigeria's peer group. Banks essentially serve large and established corporations. Lending to small-to-midsize enterprises remains marginal in banks' loan portfolios, at less than 5% of total loans and will be further stifled by the high interest rates environment and inflation. Low wealth levels per capita ($2,000 in 2022) and a large informal economy contribute to the country's modest financial intermediation (loans to the private sector averaged 13% of GDP per annum over the past 5 years).

Despite large fiscal and external imbalances, the Nigerian banking sector performance has been strong. The banking system's dollarization has moderated as banks continue to de-risk their credit portfolios, with foreign currency loans estimated to be an average 40% of total loans. Still, credit risks stemming from sensitivity to currency depreciation, single-name concentration, and energy transition risks persist. This is because loans to the hydrocarbon sector still represent about 30% of total loans.

Economic challenges and volatility typically exacerbate single-name concentration risks, which tends to crystalize in nonperforming assets. The 20 largest loans average approximately 30%-40% of the sector's gross lending. The sector nonperforming loan ratio fell below the 5% regulatory limit in 2022, when it reached 4.2%, down from 5.0% in 2021, on the back of recoveries and lending growth. That said, pressure on asset quality will likely re-emerge amid high inflation and interest rates.

The gap between inflation and the CBN's benchmark rate persists following the interest rate hike to a record high of 18.5% in May 2023 (amid higher headline inflation that rose to 22%). This could lead to further rate hikes in 2023 and put pressure on borrowers as banks have the capacity and latitude to reprice their assets. Banks' credit losses outperformed our normalized loss estimates in 2022, at about 1.5% of total loans for rated banks. Some banks de-risked their balance sheets after the sudden drop in oil prices in 2016 and converted a fair share of foreign-currency loans into local currency. However, we expect that credit losses will inch higher to reach 2% of total loans in 2023. This level remains below the average 3.5% credit loss ratio that the sector recorded in 2016 on the back of the oil price shock.

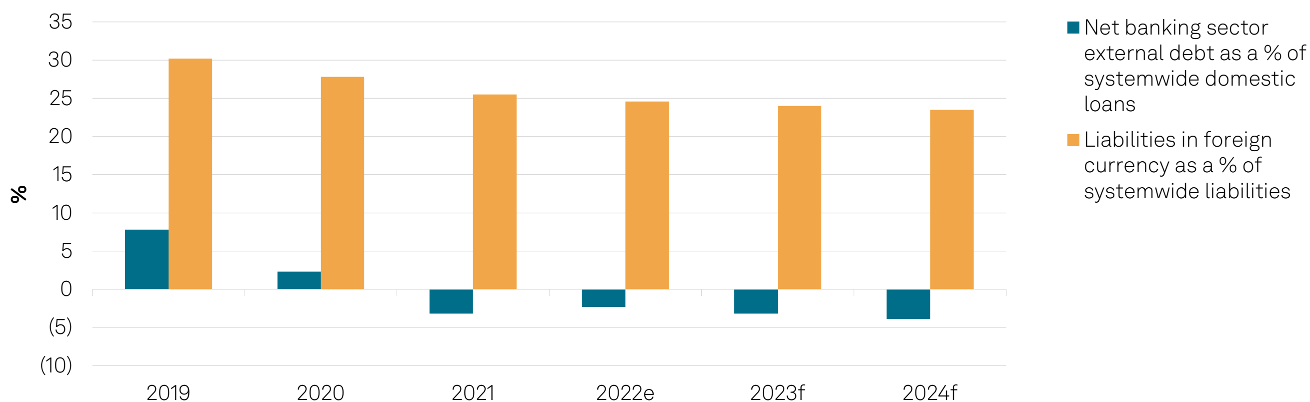
Nigerian banks are largely funded by non-interest-bearing customer deposits. Top-tier banks' low cost of funding underpins their consistent risk-adjusted returns. The adoption of digital channels has supported banks' efficiency and service delivery and shielded their earnings from volatility. However, the additional increase in mandatory reserves, and discretionary debits above the statutory minimum of 32.5%, will likely undermine banks' net interest margins and lending opportunities.

A challenging operating environment and infrastructure gaps tend to exacerbate banks' operating costs in Nigeria. The Asset Management Corporation of Nigeria (AMCON) levy (accounting for 20%-30% of operating costs) continues to weigh on banks' efficiency metrics. AMCON was created in 2010 for a period of 10 years to stabilize and clean up the sector's nonperforming assets. In exchange, commercial banks must pay a levy of 0.5% of their total on- and off-balance sheet assets.

Despite persistent U.S dollar shortages, foreign currency deposits have been stable over time at about 22% of total deposits and serve as a hedging mechanism to depositors. While Nigerian banks have historically been exposed to external refinancing risk, the sector recorded a net external asset position in 2021. Taking advantage of their subsidiaries in the U.K and the U.S., Nigerian banks increased their foreign assets by 30%, while their external liabilities declined by 2%. We expect the banking sector's external asset position to stabilize through 2024. The recent grey listing of Nigeria by the international anti-money laundering association Financial Action Task Force (FATF) should lead to increased due diligence costs but we expect most banks will maintain their correspondent banking relationships.

Chart 23

Foreign currency liabilities are more manageable



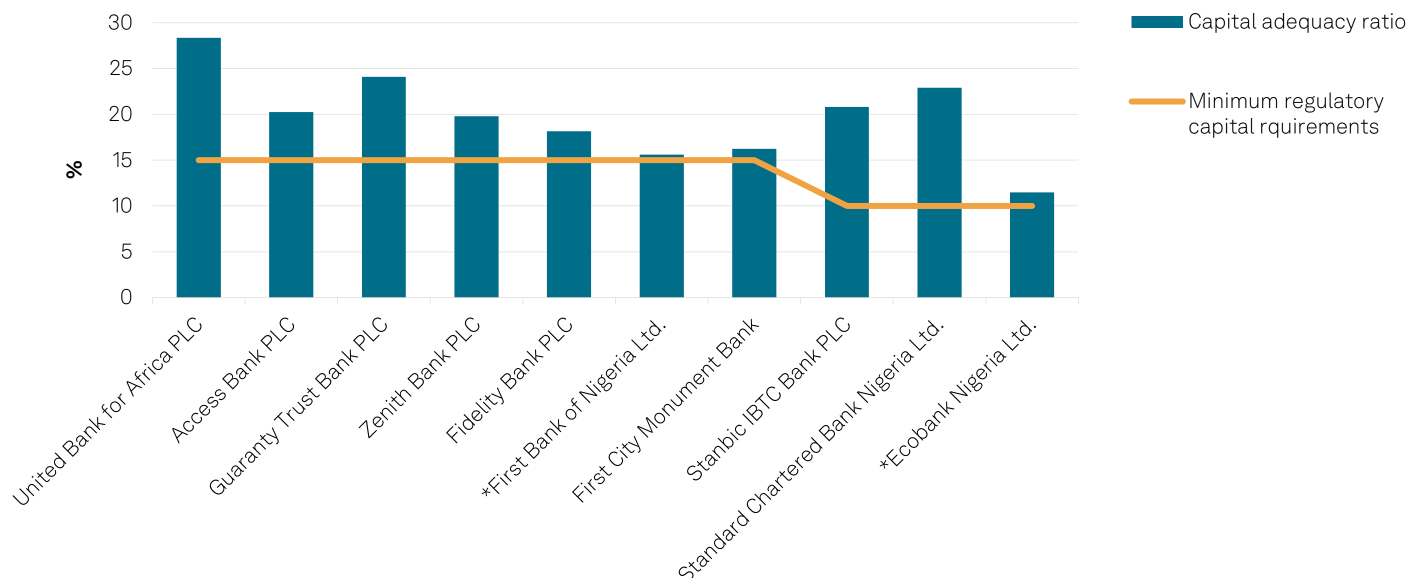
f--Forecast. Source: S&P Global Ratings.

We expect the sector will maintain adequate levels of risk-adjusted returns in line with past trends, over the next two years, despite high inflation and interest rates. We expect return on equity will average 16% in 2023, in line with 2022's strong performance. Bank balance sheets are long U.S. dollar, and a naira devaluation will lead to additional earnings. At the same time, a FX devaluation will result in higher risk weighted assets and capitalization. Most banks have U.S dollar denominated instruments in their capital stack, which provide a hedging against currency risk.

Following the start of the parallel run of Basel III guidelines in November 2021, the implementation of the new capital buffers remains challenging. Domestic systemically important banks (DSIBs) and banks with an international banking license are subject to a minimum 15% capital adequacy ratio, while all other banks must meet a 10% minimum. Under Basel III, DSIBs will need to adhere to additional capital buffers. We believe that the implementation of the new capital buffers hinges on the clarification of the FX regime and unification of rates by the central bank.

Chart 24

Most rated banks operate with ample regulatory capital buffers



*First Bank of Nigeria Ltd. data as at end of Sept. 2022 and Ecobank Nigeria Ltd. data as at end Dec 2021. Data as at December 2022. Source: S&P Global Ratings.

We assess most rated banks' stand-alone credit profiles (SACPs) one or two notches higher than the sovereign's creditworthiness because of the banks' resilient performance through the cycle. While some banking groups have exposure outside Nigeria, they remain predominantly exposed to credit risk in the country. Assets in Ghana accounted for less than 5% of group assets, on average, and banks have impaired their exposure to Ghana sovereign debt at around 25% on average, which is short of the 30% announced haircut on the Eurobonds. As a result, we anticipate some banks will have to make additional impairments in 2023 on these exposures. That should not weigh on most Nigerian banks' creditworthiness. However, currency risk could lead to pressure on our measure of capitalization for some banks, which in turn could affect their SACPs.

We do not rate financial institutions in Nigeria above the foreign-currency sovereign ratings, due to the direct and indirect effects that sovereign stress would have on banks' operations and creditworthiness. A lower sovereign credit rating could put pressure on banks' SACPs. We have a

negative outlook on the ratings on all the banks we rate in Nigeria, which largely reflects the negative outlook on the sovereign ratings.

Despite Kenyan Bank's Strong Profitability, Credit Risk Will Remain Elevated In 2023

Credit conditions tightened in Kenya in 2022 due to increased inflationary pressures in the second half of 2022. CPI growth [for 2022] averaged 7.7%, above the upper bound of the Central Bank of Kenya's (CBK) target range (2.5%-7%). The CBK incrementally raised its benchmark rate to 8.75%. Private sector credit grew 11.5% in 2022, broadly in line with 2021's growth. Loans to households, trade, manufacturing, and real estate sectors, accounted for three quarters of total bank lending. We forecast that annual loan growth will average 10% over the next two years, leaving the loans to the private sector ratio broadly stable at an average 27% of GDP. Loan growth is below the historical norm and is constrained by banks' roll-out of their risk-based pricing framework.

Loans to SMEs account for about 20% of bank lending, and information on these credits remains a structural weakness for the sector. CBK's recent decision to suspend information sharing on digital borrowers affected by the pandemic is unhelpful. We expect the sector to continue operating with a high nonperforming loans (NPL) ratio of about 12.5%, down from the about 14% average of 2020-2022. The trade, manufacturing, real estate, and households' sectors account for the bulk of NPLs, which are largely due to loose lending practices and public and private sector borrowers payment delays that have been exacerbated by the pandemic. We expect the sector's credit losses to normalize at 2% in 2023, down from 3.8% in 2020, as inflation and higher interest rates will weigh households' already low incomes and disposable incomes. Loans to households accounted for 27% of total loans in 2022.

Given weak credit expansion, banks have been investing heavily in government securities, which contributed around 30% of their total assets by the end of 2022, up from less than 20% at year-end 2017. Banks' exposure to the government was also boosted by the state's higher financing needs, underpinned by budget deficits and rising financing costs. This benefited banks' net interest margins and earnings in 2022 in a context of rising interest rates. Banks' return on average assets was 3.7% in 2022, up from 2% in 2020. Return on equity also rose to 26.3% in 2022, exceeding the 23% average recorded between 2015-2019.

The Kenyan banking sector is well capitalized, and banks maintained an average core capital buffer of 560 bps in 2022. That said, resilience could be tested by inherent risks associated with large exposures to government securities (about 200% of banks' total equity in 2022, versus 150% in 2019) and moderate NPL provisions, below 50% in 2022.

Banks are predominantly funded by short-term customer deposits and lack long-term funding sources. Lower-tier banks are more confidence sensitive than top-tier banks due to a greater reliance on wholesale funding. We forecast the deposit to loan ratio will remain above 90% in 2023 supported by deposit growth that is in line with loan growth. The Kenyan banking sector's external assets declined 26% in 2021, leading to a net external debt ratio of 3.5% of system loans in 2021 and 7.5% in 2022. We expect external refinancing risk will moderate as the sectors' external assets grow. Foreign currency liabilities have been stable over recent years and account for about 18% of bank deposits. Foreign and regional banks hold about -third of the banking sector's assets following recent acquisitions and licenses granted to foreign banks. We expect consolidation to continue in the next two years, largely among small-and-midsized banks.

Kenya's Anti Money Laundering and Combatting the Financing of Terrorism (AML/CFT) framework is under scrutiny after gaps were noted to have emerged in the last regional peer review, conducted in 2021-2022. Deficiencies in the financial sector's ability to identify terrorism financing risks, beneficial

ownership, customer due diligence, among other factors must be addressed. The next review is scheduled for February 2024.

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