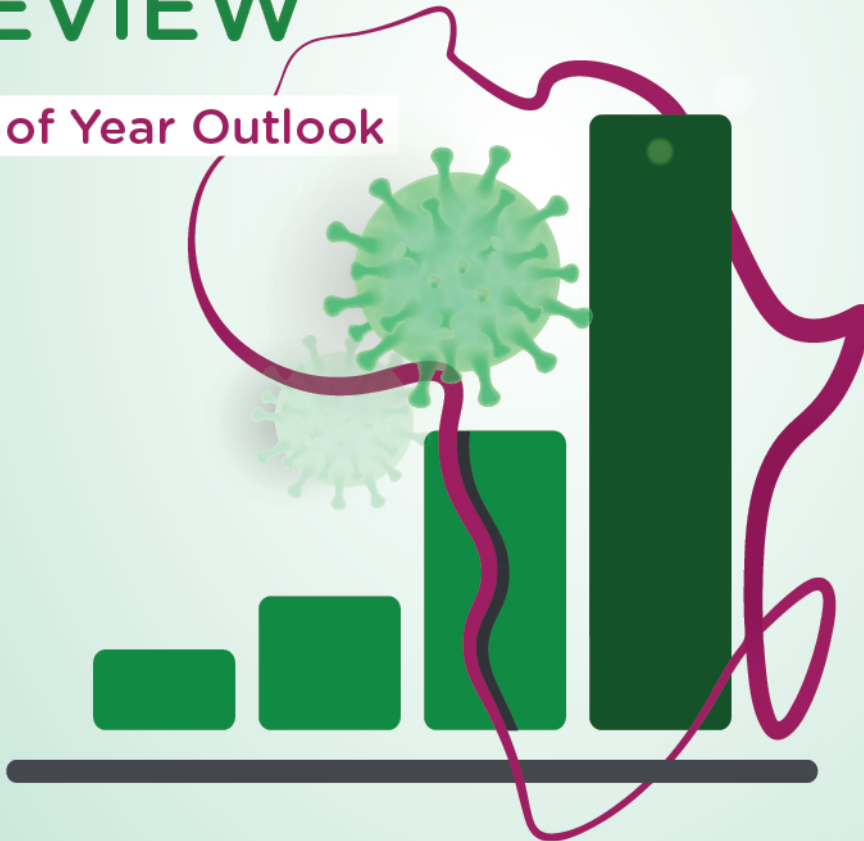




AFRICA SOVEREIGN CREDIT RATING REVIEW

End of Year Outlook



Second Edition

December 2020

COVID RATING NEXUS

ABOUT THIS REPORT

This report presents an indepth analysis of sovereign credit rating actions in Africa countries by three dominant international rating agencies -Moody's, Fitch and S&P Global - during the second half of 2020 (2020H2). The report is authored by the African Peer Review Mechanism (APRM), a specialised entity of the African Union, in collaboration with experts in the National Treasuries and Central Banks of Egypt and South Africa. The report

highlights experiences by different African governments with regards to rating actions during the 2020H2. It further makes recommendations on how countries can prepare for future rating reviews, establishing lines of communication with rating agencies, building capacity for liaising with rating agencies and, strategies that sovereigns assigned negative outlooks can pursue to avoid being downgraded.

FOREWORD

I present to you this second edition of the African Sovereign Credit Rating Review, an African Union - APRM bi-annual publication on the continental sovereign credit rating outlook. The first edition of the report outlined a summary of rating activities and drivers during the first half of 2020 (2020H1) when the first wave of Covid-19 swept through the continent. The severe economic impact of the Covid-19 pandemic was accompanied by a record number of rating downgrades as countries went into economic lockdown as part of the measures implemented by governments to contain the spread of Covid-19. The pandemic continued to extent severe strain on fiscal position of countries during the 2020H2. Against this background, the 2020H2 witnessed further negative rating actions and subsequent statements of discontent issued by governments in response their sovereign rating downgrades. The media statements by governments present prima facie evidence that there is information asymmetries between rating agencies and governments.



Prof. Eddy Maloka,
APRM CEO

This report follows APRM engagements with two of the three international rating agencies - Moody's and Fitch - in which they expressed interest to engage the APRM in an effort to bridge the information gap that exists between rating agencies and African governments. It is therefore vital for governments to develop sufficient capacities to engage with both investors and rating agencies to bridge the information gap, eliminate speculations and uncertainties. This report therefore helps rating agencies and investors who would otherwise rely on information available on public media as basis to make their decisions, appreciate the issues from an alternative a scientific perspective. And, this is critical in improving business confidence, market sentiments and investor risk perception. It is envisaged that the report will encourage governments to be more proactive in engaging investors and rating agencies with accurate and factual macroeconomic developments.



INTRODUCTION

As was the case in the first half of 2020 (2020H1), the second half (2020H2) was characterised by further rating downgrades of African countries by all the three leading international rating agencies. Notably, the Government of Zambia's Long-Term Foreign-Currency was downgraded to 'default' following the country's failure to settle bondholders' coupon payment on its USD1 billion Eurobond maturing in 2024. Zambia, the first African country to default on its debt since the outbreak of the coronavirus pandemic, was unable to make its coupon payment that was due on 14 October 2020 despite being granted a 30-day grace period. The country's proposal to defer bond repayments to March 2021

was rejected by investors. Sovereign bonds for Angola, Republic of Congo, Democratic Republic of Congo and Mali are now classified as 'Substantially risky' and 'extremely speculative'. These rating classifications indicate that these countries' speculative-grade or 'junk' bonds carry a higher risk of default, and are currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments. If business, financial and economic conditions are not favorable, the rating agencies expect the countries to default. Table 1 below presents a summary of all rating activities; rating downgrades, upgrades and changes in outlooks in 2020H2.

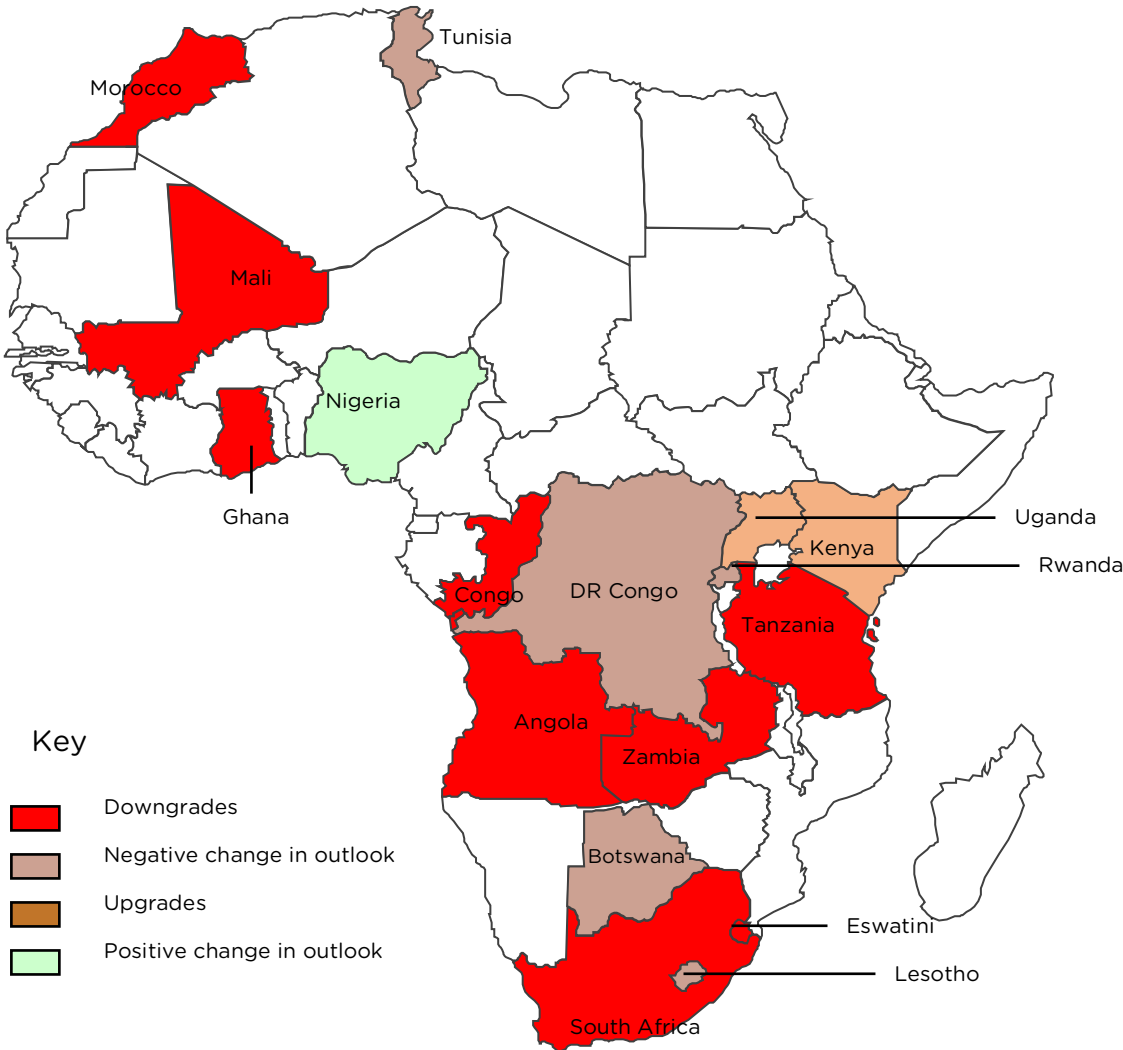
Table 1: Summary of sovereign credit rating actions (Jul - Dec 2020)

Country	Moody's		S&P		Fitch	
Angola	B3 (Stable)	Caa1 (Stable)			B- (Stable)	CCC (n/a)
Botswana			BBB+ (Stable)	BBB+ (Neg)		
Cape Verde			B (Stable)	B (Neg)		
Congo DR			CCC+ (Pos)	CCC+ (Stable)		
Congo Republic			B- (Neg)	CCC+ (Stable)		
Eswatini	B2 (Neg)	B3 (Stable)				
Ghana			B (Neg)	B- (Stable))		
Kenya					B+ (Stable)	B+ (Neg)
Lesotho					B (Stable)	B (Neg)
Mali	B3 (Stable)	Caa1 (Neg)				
Morocco			BBB- (Stable)	BBB- (Neg)	BBB- (Neg)	BB+ (Stable)
Nigeria					B (Neg)	B (stable)
Rwanda	B2 (Stable)	B2 (Neg)	B+ (Stable)	B+ (Neg)		
South Africa	Ba1 (Neg)	Ba2 (Neg)			BB (Neg)	BB- (Neg)
Tanzania	B1 (Neg)	B2 (Neg)				
Tunisia	B2 (Stable)	B2 (Neg)				
Uganda					B+ (Stable)	B+ (Neg)
Zambia	Ca1	SD			CC	RD

The 2020H2 saw a total of 9 countries being downgraded to lower ratings compared to 12 that were downgraded in 2020H1. A total of 9 countries also had their credit rating outlook negatively changed either from positive to stable or from stable to negative. This reflects a

high risk of further downgrades that may take place during the first half of 2021 (2021H1). Only Nigeria had a positive change in outlook by Fitch; from negative to stable. Figure 1 below shows the distribution of rating activities across the continent.

Figure 1: Distribution of rating activities in Africa



CREDIT RATING DRIVERS

The Covid-19 pandemic remains the primary credit rating driver in the period under review and its impact is expected to continue into 2021 as countries are battling to reverse the declining revenues and uncertainties surrounding the securing sufficient Covid-19 vaccine for their citizens. The

following were the key drivers in countries that experienced credit rating actions during the 2020H2 period;

- i. Constrained external liquidity, which was exacerbated by the economic shocks from the Covid-19 pandemic.

- ii. Decline in GDP due to low oil prices and production, and weak global trade.
- iii. Increase in budget deficits and rising public debt pressure as a result of low revenues coupled with high expenditure in health and social safety nets.
- iv. Slow progress in implementing fiscal consolidation, contributing to higher public debt trajectory and substantially widening fiscal.
- v. Depreciating currency that put pressure on the government foreign currency debt burden and offset the impact of the government's efforts on fiscal consolidation.
- vi. Uncertainty over the regulatory environment and government policy direction, which has long-term negative impact on economic growth potential and ability to attract foreign investment.

REVIEW OF THE RATING ACTIONS

The rating actions in 2020H2, which were predominantly negative, have significantly impacted several African countries. However, the following observations were noted;

- i. Duplication of rating actions - The rating agencies have downgraded countries twice since the beginning of the Covid-19 pandemic on the basis of largely the same rating drivers of economic contraction, expectation that fiscal deficit will widen and government debt will rise, for example, South Africa and Ghana. The risk factors had not significantly changed since the rating agencies had already acted on them with previous rating actions during the first wave Covid-19 peak period in 2020H1. It would therefore have been prudent for the rating agencies to grant governments some reprieve to implement their fiscal policies to stimulate economic growth, reduce spending, narrow the deficit and bring down the debt-growth trajectory.
- ii. Premature assessment of policy implementation - It was premature to assess the outcomes of the governments' proposed fiscal consolidation plans. Downgrades based on slow progress in implementing fiscal consolidation could have been deferred to 2021, for rating agencies to allow sufficient window for government

to implement their commitment to fiscal consolidation.

- iii. Compounded procyclical effects - Continuous rating downgrades immediately translated into high debt costs in these countries, making government debt unsustainable, deteriorating asset values and reduction in disposable income for citizens, exacerbating the deterioration of the countries' fiscal positions and, undermining the governments' fiscal consolidation efforts.
- iv. Inappropriate timing - The timing of the rating downgrades during the pandemic crisis continue to raise question on the procyclical approach of rating agencies - when bad news is piled on bad circumstances - putting a further strain on an economies that are already strained by the impact of the Covid-19 pandemic.
- v. One-sided calculus - Downgrading countries based on the expectation that fiscal position will deteriorate as government increase once-off fiscal expenditures is contestable, especially during crisis times when there is need to curb the impact on both the population and small

businesses. Based on economic theory, saving the economy from a crisis such as Covid-19 by increasing expenditure is not anything out of the ordinary. In both developed and developing countries, they have implemented these countercyclical fiscal policy measures to address the drag on an economy emerging from slower domestic activity and lower global demand. Under these conditions, debt should be of little to no concern. In addition, government expenditure on protecting jobs, creating employment and assisting business enterprises is classified as productive expenditure whose net economic output is beneficial to the government and the larger economy through tax revenue and social returns

Box 1: Government of Ghana disagrees with rating downgrade by S&P Global

The Government of Ghana's Ministry of Finance described as 'unfortunate' the downgrade of the country's credit rating from B to B- (negative) by the international ratings agency, S&P Global. It found it 'disturbing' that the rating agency would choose that path at a time when countries, including Ghana, were battling an unprecedented Covid-19 crisis. The downgrade was based on increased fiscal expenditure in response to some temporary fiscal and economic adjustments, one-off expenditure aimed at saving lives and livelihoods. These expenditures were resulting from government's intervention through subsidies on water and electricity to support vulnerable households during the lockdown period, credit for micro, small and medium enterprises (MSMEs) whose businesses were most impacted by the lockdown and investments in healthcare. In spite of the interventions, the government contend that the economic fundamentals remained strong and recovery prospects were high as reflected in the positive narrative on how Ghana has managed the economy under the pandemic. The Government of Ghana thus called on rating agencies to seriously consider freezing any rating actions during global pandemics such as the Covid-19.

Source: Ministry of Finance, Ghana, 14 September 2020

AFRICA SOVEREIGN BOND MARKET

There was very little activity on the sovereign debt market as countries were still priced out of the sovereign bond market due to high yield demand by investors. Nigeria announced that they will not be issuing Eurobonds in the near future due to the high costs, and was considering other options for raising capital to boost the country's economy in the face of a looming recession. Ivory Coast and Morocco are the only African country to issue sovereign bonds in 2020H2. And, Ivory Coast became the first in Sub-Saharan Africa to raise funds through sovereign debt issuance on financial

market since the beginning of the Covid-19 pandemic on the continent. The country's US\$1.19 billion sovereign bond raised to support its 2020 budget deficit was five times oversubscribed at a yield of 5 per cent per annum.

Morocco also issued a €1 billion sovereign bond on the international financial market in two tranches of 500 million whose notes sales reached €2.5 billion, a 2.5-time oversubscription. The first tranche with a maturity of 5.5 years sold at a discounted price of 99.374% with yield of 1.495%, while the second tranche

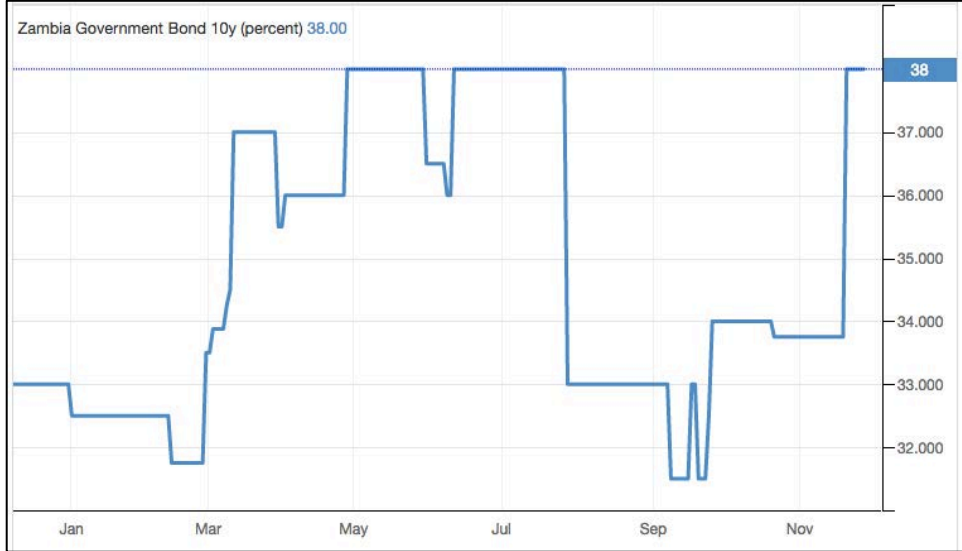
with a maturity of 10 years also sold at a discounted price of 98.434% with a yield of 2.176%. These bond issues, which took place in a difficult context, marked by uncertainties related to the evolution of the pandemic of Covid-19 and its impact on the credit quality of issuers, was a resounding success among international investors (Ministry of Finance, Morocco).

Zambia became the first African country to default on its debts since the pandemic, leading to fears of what analysts are calling a ‘debt tsunami’, that could engulf the other highly indebted nations as the financial impact of coronavirus hits. Zambia’s

sovereign bond yields spiked in response to the default, with the 10-year bond yield rising to 38 per cent, the level it attained during the Covid-19 first wave peak in 2020H1. However, the anticipated wave of defaults has not yet begun.



Figure 1: Zambia 10-year bond yield



Source: Tradingeconomics

SAVING NEGATIVE OUTLOOKS FROM DOWNGRADES

The APRM held an Africa Information Exchange on credit ratings on its newly established platform, the Continental Working Group on Information Exchange among countries. This followed a wave of sovereign downgrades in 2020H1 as the Covid-19 pandemic took its toll on economic fundamentals across the continent. From the analysis of rating drivers, the main driver of negative outlooks turning to downgrades is the failure by government to address specific risk factors cited by rating agencies in previous rating reviews. Based on the findings from the Continental Working Group, the following is the summary of challenges that majority of governments are facing with rating agencies;

- 1) Lack of National strategy - Some governments do not have a National Treasury/Central bank strategy for engaging with rating agencies to guide their responses to issues raised in previous reviews and how relevant department and agencies have addressed them.
- 2) No plans and mechanisms for monitoring actions - Failure by some governments to develop

focus areas and action plans to improve credit ratings through periodic monitoring of sovereign risk exposures.

- 3) Limited engagement with agencies - There is minimum participation by governments and the majority of them do not provide comments on the factual accuracy of the draft rating action reports of rating agencies for factual correctness. They also do not issue government response to rating actions to show their commitment in addressing the risk factors highlighted in rating reviews. Governments and their rating liaison teams have weak or no lines of communication with rating agencies, outside the review periods.
- 4) Poor information provision - Some governments are not providing rating agencies with up-to-date information on government policies, business and political developments to ensure that consistent and accurate credit ratings are assigned to the sovereign.
- 5) Persistent policy incoherence - There is often lack of coordination on policy efforts inside and outside governments, and no coherence in communicating government's position on policy matters to rating agencies and investors.



ESTABLISHING & MAINTAINING LINES OF COMMUNICATION

A number of countries - Ghana¹, Zambia², Namibia³, Tanzania⁴ and Nigeria⁵ - have issued post rating review statements in response to rating actions that they did not agree with. These governments commonly raised

objections that rating agencies did not adequately consult with government representatives during the review process to understand the sovereign risk exposures and the government's strategy in addressing the downside risk factors. Conversely, rating agencies contend that some government representatives have limited engagements with them during the rating process, especially on qualitative governance matters, leaving them with little choice but to make their rating decisions on the basis of alternative

¹ <https://www.mofep.gov.gh/press-release/2020-09-14/global-ratings-lowers-ghanas-long-term-rating-to-b-with-a-stable-outlook>

² <https://www.lusakatimes.com/2015/09/28/ignore-moodys-credit-downgrade-on-zambia-government-tells-investors-and-the-public/>

³ <https://www.reuters.com/article/namibia-ratings-idAFL5N1KZ0GD>

⁴ <https://www.reuters.com/article/tanzania-ratings/tanzania-criticises-moodys-for-negative-rating-outlook-idUSL5N1QN4U8>

⁵ <http://www.businesstimesafrica.net/index.php/details/item/2436-nigeria-govt-disagrees-with-moody-s-downgrading-of-nigeria-to-b2-stable-rating>

available credible data. In addition, analysts have raised the general problem of 'lack reliable and up-to-date' economic governance data in most African countries. Where the data is available, analysts have also questioned its accuracy.

There is therefore need to improve the two-way communication between governments and rating agencies through the following strategies. First, it is crucial for every government to designate group of experts as key contacts at a very senior level, who would be supported by a strong communication team both of who will engage with rating agencies to address information asymmetries. In cases where the Central Bank or National Treasury has inadequate support skills, they could explore the option of recruiting a sovereign advisor, who normally has a strong network and good connections, to engage rating agencies on behalf of government.

Second, it is important that at the beginning of the ratings calendar year, government representatives need to engage rating agencies on the dates of the sovereign rating review visits and confirm the dates with all interested parties under the Ministry of Finance. This should be followed by a clear main

theme of the rating review visits, discussion topics and industry experts that the rating agencies want to interview.

Third, in collaboration with other key government institutions such as the Central Bank, the National Treasury should develop a strategy for communication with rating agencies for the purpose of increasing the chances of a favourable credit review outcome. In addition, the National Treasury rating liaison team should participate on all meetings of rating agencies in the country, with public and private sector, and come up with a comprehensive outcomes report to be shared with responsible government officials as a basis for consistency and coherence in communicating government's position on policy matters to both investors and rating agencies. Fourth, it is crucial for governments to have on-going internal engagements in the National Treasury and Central Bank to deliberate on risk exposures highlighted by rating agencies and develop strategies to mitigate them. Fifth, it is vital for the government to maintain constant lines of communication with rating agencies and investors, verifying factual correctness on media queries that may impact investors' sentiments. It is

therefore to the government's advantage to initiate discussion topics with rating agencies to clarify and inform stakeholders on key risk areas such as budget reviews, policy proposals and other key macroeconomic events.

Lastly, it may be prudent here to add that governments can work with the AU consortium on Support to member States in the area of credit rating agencies so they can benefit from continent-wide experiences among others

RECOMMENDATIONS

The APRM makes the following recommendations to AU member states;

- 1) Sovereign bonds issued by African countries continue to be oversubscribed despite the impact of the Covid-19 pandemic, which is adequate proof that Africa's debt instruments remain attractive. It is an opportunity for countries to structure favourable terms on their sovereign bonds, medium to long-term tenor and low yields as developed markets such as Japan, Germany and China are issuing negative-yielding government bonds.
- 2) The role of rating agencies needs to be refocused to developing domestic markets, countries should thus stabilise their macroeconomic fundamentals to enable them to issue debt in their local currency on

domestic debt capital markets. This will promote the development of domestic debt markets, support short-term government liquidity demands and raise fiscal revenue from secondary market transaction taxes.

- 3) Governments should coordinate with representatives of key institutions in public and private sector for consistency and coherence in communicating government's position on policy matters to both investors and rating agencies.
- 4) It is critical for the National Treasury to respond to credit rating actions, issuing media statements highlighting their strategy in addressing the risk factors highlighted by rating agencies. This is crucial to minimise speculative actions by both public media and investors.

APRM Support to African countries

The following on-going support is being offered by the APRM to countries to address the challenges of weak credit ratings faced by countries;

- 1) Established a Continental Information Sharing Platform to serve as an information-sharing and peer-learning platform for countries to peer-learn on ways to minimize negative rating actions through information exchange as part of the AU-APRM support mechanism of research and advisory services as outlined in its Policy Framework.
- 2) Engaging rating agencies on the challenges being faced by African countries and ways to bridge the information gap that exists between

rating agencies and governments. This is a mechanism aimed at improving the two-way communication channel that will significantly assist in depoliticizing the work of rating agencies and averting the negative perception between rating agencies and governments.

- 3) Providing technical and operational support to National Treasuries credit rating liaison team for capacity building in preparing for upcoming credit rating reviews, the for developing strategies to engage rating agencies and implementing admissible rating recommendations.

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