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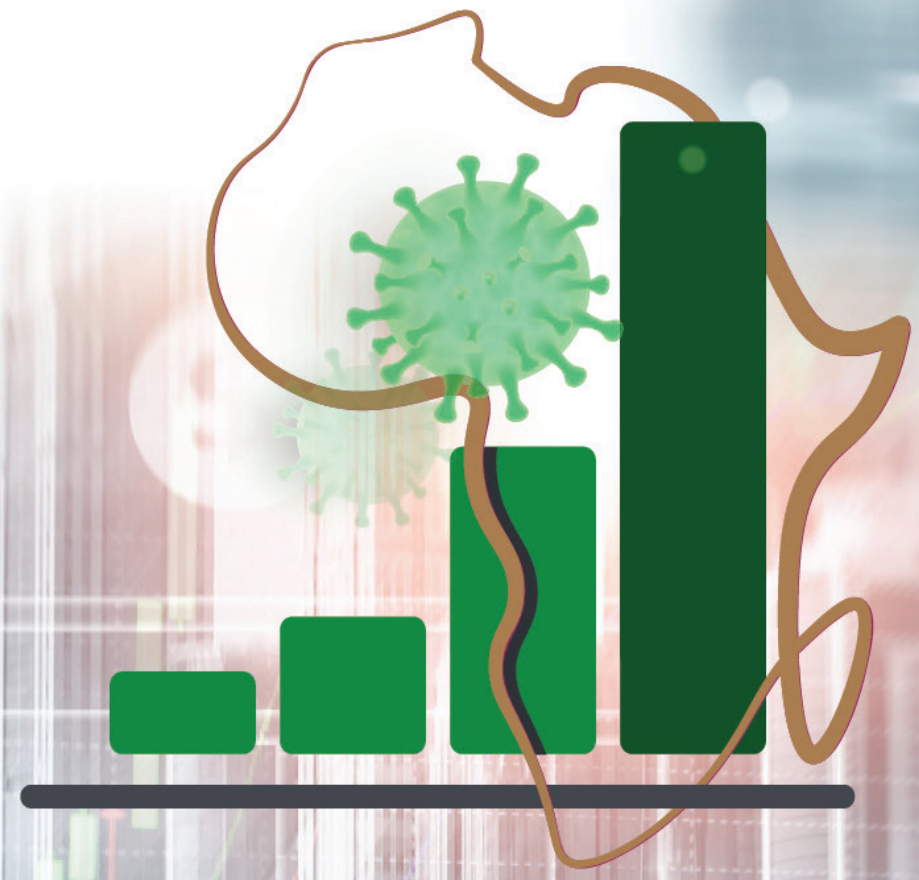
# AFRICA SOVEREIGN CREDIT RATING REVIEW



## 2021 MID-YEAR OUTLOOK

## 3RD EDITION

# AFRICA SOVEREIGN CREDIT RATING REVIEW

2021 MID-YEAR OUTLOOK

*3rd Edition*

**PUBLICATION OF AFRICAN PEER REVIEW MECHANISM**

Research, Methodology & Coordination Division

in Collaboration with the United Nations Economic Commission for Africa

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# APRM BI-ANNUALREPORT

*This is the 3rd edition of the African Union - African Peer Review Mechanism (APRM) authored bi-annual report on Africa credit ratings review. The report reviews long-term foreign currency sovereign credit rating actions in Africa by three dominant international rating agencies – Moody's, Fitch and S&P Global – during the first half of 2021 (2021H1) and makes recommendations to African countries on ways to minimise future negative rating actions.*


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# FOREWORD

The record number of sovereign rating downgrades of African countries since the outbreak of Covid-19 has indeed justified the rationale behind the African Union Assembly Decision for the APRM to provide support to countries in the area of credit ratings. The impact of these rating downgrades has been far-reaching and continues to threaten the sustainability of public debt due to high borrowing costs. On the other hand, a number of African countries have missed the opportunity to restructuring their debt through multilateral debt relief programs mainly because rating agencies would classify them as defaulters. These developments have magnified the impact of the Covid-19 pandemic, which continues to extend severe strain on fiscal position of countries. The direct consequence of the rating downgrades is the constrained capacity for governments to invest in health care services, vaccines and social protection programs when it is sorely needed. This is worsening the suffering and general welfare of citizens. I am optimistic with the work of the APRM through various interventions to support African countries in their engagements with international credit rating agencies.

**Prof. Eddy Maloka**
**CEO, APRM Continental Secretariat**


# 1. INTRODUCTION

The first half of 2021 (2021H1) was characterised predominantly by negative rating actions owing the continued economic challenges faced by countries as they deal with Covid-19 infection phases and waves, and at the same time, investing in recovering from the pandemic. In a typical procyclical trend, these low credit ratings are weighing on countries' economic recovery efforts to reverse the widened fiscal deficits, high debt levels and weaker debt affordability. A total of 7 countries – Botswana, Cape Verde, Ethiopia, Mauritius, Morocco, Kenya and Tunisia – were downgraded in the 2021H1, whilst 1 country – Zambia – had its credit rating outlook changed from stable to negative. Morocco, one of the three African countries that were still rated above 'junk' status, lost its investment grade by S&P, after Fitch had already downgraded it to 'junk' in the second half of 2020 (2020H2). Only 2 countries – Botswana and Mauritius are the remaining 'investment grade' countries on the continent. The negative outlook on Mauritius, however, is a strong signal that it is still at risk of being downgraded into junk status if its tourism sector fails to kick-start the economy and to curb the growing budget deficit in the post Covid-19 recovery period as expected by rating agencies.

Two countries –Benin and Mali had positive rating actions in 2021H1. Benin is the only African country to be upgraded during this period due to overall improvement in its public finance management as fiscal authorities made significant progress in implementing fiscal consolidation. Benin has successfully implemented structural reforms in both government revenues and expenditures, supported by the International Monetary Fund (IMF) through an extended Credit Facility (ECF) program. In Mali, before the military coup in May 2021 that disposed the transitional government, the country had its rating outlook changed from 'negative' to 'stable' due to stability of its political situation as the transitional government which had been established in September 2020 had been endorsed by regional partners and the international community.

*Table 1: Summary of sovereign credit rating actions (Jan – June 2021)*

| Country | Moody's | | S&P | | Fitch | |
|---|---|---|---|---|---|---|
| | Previous | Current | Previous | Current | Previous | Current |
| Benin | B2 (Pos) | B1 (Stable) | | | B (Stable) | B (Pos) |
| Botswana | A2 (Neg) | A3 (Stable) | | | | |
| Cape Verde | | | B (Neg) | B- (Stable) | | |
| Ethiopia | B2 (Neg) | Caa1 (UR) | B (Neg) | B- (Neg Watch) | B (Neg) | CCC (n/a) |
| Kenya | | | B+ (Neg) | B (Stable) | | |
| Mali | Caa1 (Neg) | Caa1 (Stable) | | | | |
| Mauritius | Baa1 (Neg) | Baa2 (Neg) | | | | |
| Morocco | Ba1 (Stable) | Ba1 (Neg) | BBB- (Neg) | BB+ (Stable) | | |
| Tunisia | B2 (Neg) | B3 (Neg) | | | | |
| Zambia | | | B (Stable) | B (Neg) | | |

*Source: Tradingeconomics, 2021*

# 2. CONTINENTAL RATING DRIVERS

**Within the context of the impact of the Covid-19 pandemic, the following are the key rating drivers in 2021H1;**

i. The upgrade in Benin was driven by the rising economic resilience, improved structure of debt, strong public finance management and robust economic growth prospects that is supported by ongoing structural reforms under the International Monetary Fund (IMF) Extended Credit Facility (ECF) program.

ii. The deterioration in fiscal strength as a result of shock from the Covid-19 pandemic led to the downgrade of Botswana and Mauritius as their capacity to absorb future shocks was significantly reduced due to erosion of governments' fiscal reserves.

iii. The tourism driven economy of Cape Verde was downgraded because it was severely affected by the Covid-19 pandemic. Another contributing key risk factor was the widening fiscal deficit, which has driven the country's gross general government debt to 154% of GDP by the end of 2020.

iv. Ethiopia was downgraded because of the rising risk to private creditors due to the government's commitment to participate in the Group of 20 (G20) Common Framework, signing a Memorandum of Understanding that requires it to engage with private creditors. The ongoing political conflict and ethnical tension, which rating agencies cite as undermining foreign direct investment critical for fiscal support in the near and medium term, also contributed to the negative rating action.

v. The downgrade of Kenya and Morocco was driven by the growing fiscal deficit and weak economic growth. Kenya's deficit, which is expected to reach 9% of GDP in the fiscal year ending June 2021, is due to poor revenue collection, averaging 15.5% of GDP, that has raised fears of the possibility of a debt distress, causing it to be downgraded in spite of reaching an IMF Staff-level Agreement of approximately US$2.4 billion financing package to mitigate credit pressures, boost international reserves and support the government's fiscal consolidation efforts.

vi. The upgrade of Mali before the second coup was based on the stability of the country's political situation, its post-pandemic economic recovery and the government's commitment to fiscal consolidation

vii. Tunisia was downgraded due to weakening governance and rising social constraints that is inhibiting the government's flexibility to implement fiscal adjustment and public sector reforms. This is making it challenging for the country to stabilize and consolidate the rising debt burden.

# 3. AFRICAN SOVEREIGN DEBT MARKET

Ethiopia's US$1billion 10-year sovereign bond maturing in December 2024 was the worst affected by the rating downgrades in 2021H1. The country's Eurobond suffered its biggest daily loss of 7.4% and its highest yield levels of 9.34% in more than a one year, following the rating downgrade. The downgrade of Ethiopia based on high risk of default from the G20 Common Framework caused panic on investors holding the country's sovereign bond.

*Figure 1: Ethiopia's Eurobond Yield*


*Source: Cbonds, June 2021*

On sovereign bond issuances, Benin became the first African country to borrow through the Eurobond market in 2021H1 by issuing €1billion in 11-year and 31-year bonds in January. In February, Côte d'Ivoire followed suit and issued its 10-year and 20-year bonds at the lowest ever rate since the country first issued a Eurobond. Egypt also issued a 40-year bond – one of the longest tenor African bonds. Notably, all the sovereign bond issuances in 2021H1 were oversubscribed by at least double the available issues, indicating the resilient high appetite for investment in Africa, despite all the challenges posed by the Covid-19 pandemic.

*Table 2: Eurobond issuance Jan – Jun 2021*

| Country | Issue date | Amount (US$B) | Purpose | Tenor | Coupon | Subscription |
|---|---|---|---|---|---|---|
| Benin | 15/01/2021 | 0.855<br>0.365 | Budget support & bond refinance | 11-year<br>31-year | 4.875%<br>6.875% | 3x |
| Côte d'Ivoire | 9/2/2021 | 0.727<br>0.303 | Budget support | 10-year<br>20-year | 4.30%<br>5.75% | 3.4x |
| Egypt | 8/2/2021 | 0.75<br>1.5<br>1.5 | Budget support | 5-year<br>10-year<br>40-year | 3.875%<br>5.875%<br>7.5% | 4x |
| Ghana | 30/03/2021 | 0.525<br>1<br>1<br>0.5 | Budget support | 4-year<br>7-year<br>12-year<br>20-year | 0%<br>7.75%<br>8.625%<br>8.875% | 2x |
| Kenya | 18/06/2021 | 1 | Budget support | 12-year | 6.3% | 5x |

*Source: World Government Bonds, June 2021*

**Box 1: Ghana is the first Africa country to borrow through a Zero-Coupon Eurobond**

The Government of Ghana issued a 4-year Zero-Coupon Eurobond worth US$525 million, the first time an African country has issued such a bond on the international capital market, which was two times oversubscribed. Ghana's issuance became the second by a Sub-Saharan African country since Covid-19 outbreak in March 2020 after Côte d'Ivoire, defying the concerns raised by international rating agencies on the country's Debt-to-GDP ratio that has increased to 76.1%, which according to rating agencies, is significantly higher than the generally acceptable emerging markets Debt Sustainability Ratio of 60%. Ghana's Zero-Coupon Bond means the country will not be liable to pay any interest over the 4-year bond tenor, allowing the government to borrow without having to worry about interest payments during the duration of the bond, which is crucially beneficial for the government to focus on implementation. Zero-Coupon Bonds are an innovative market oriented solution to address post Covid-19 challenges and improve the cash flow required for debt servicing, as the only debt obligation that the government will have to honour will be the face value of $525 million on maturity. Ghana's successful issuance of a Zero-Coupon Bond was supported by favourable market conditions, strong growth prospects, fiscal consolidation efforts and unavailability of other high-yield bond issuances.

# 4. RATINGS CHALLENGES

Despite the successes in sovereign bond issuances, African governments have raised concerns on the continuous negative credit rating actions that are derailing the economic recovery efforts. As countries make efforts to address the widening fiscal deficits, high debt levels and weaker debt affordability challenges as a result of the Covid-19 pandemic, low credit ratings and persistent rating downgrades have been cited as becoming a major impediment to recovery efforts.

The South African President, Cyril Ramaphosa raised concerns[1] about the role of international rating agencies in allowing African countries to access affordable capital, which is becoming a *'deterrent to countries who seek to take advantage of credible and transparent credit relief measures'*.

The United Nations[2] concurred and highlighted the enormous negative impact of credit rating announcements on the ability and capacity of States to respect, protect and fulfil their human rights obligations. The threats of credit ratings downgrades have stifled the flow of financial resources to Africa's emerging economies and overinflating the cost of servicing existing debts. It is preventing governments from pursuing sufficient fiscal space, entering into negotiations for debt restructuring with private creditors, even as part of multilateral programs aimed at providing debt relief. The following cases are some key examples;

- **The G20 Common Framework** – the three international rating agencies downgraded the Government of Ethiopia following its official announcement that it will seek debt assistance under the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI). The rationale was that the G20 Common Framework imposes a risk of losses on private sector creditors because the debtor country may seek favourable treatment from private creditors. Amongst the 25 African countries illegible for the G20 Common Framework, only Ethiopia, Chad and Zambia are participating in the initiative, as countries feared being downgraded, preventing them from restructuring their debts and stimulating their economies.

  This restrictive role of rating agencies is criticised as being speculative, as it does not reflect the rationale behind the G20 Common Framework initiative, which is *'to reduce debt burden'* and it was clear that it would not be imposed on private creditors. In addition, rating agencies have acted against G20 Common Framework participating countries despite themselves acknowledging that they were unclear on the magnitude of risk to private creditors under the initiative and that there are a number of potential outcomes that do not involve private creditors incurring losses, yet they proceed with the downgrades. In addition, the governments participating in the G20 Common Framework have made clear their commitment to comply with all of their contractual obligations to private sector creditors. The fact that the IMF and the World Bank issued a joint statement[3] supporting the G20 Common Framework should have been a sufficient basis for rating agencies not to speculate on the magnitude of the prospective risk and adjusting their risk inputs to allow participating countries to rework their debt under framework without being downgraded. The Common Framework offered the best chance for countries to make their debt burdens sustainable. Instead, the downgrades of G20 Common Framework participating countries increased their debt vulnerabilities and magnified the risk of debt distress, countering the efforts of international partners to support African countries to recover from the Covid-19 crisis.

- **Reputationally damaging comments** – Rating agencies have become known for being 'bearers of bad news' by making negative and reputationally damaging statements. In addition to the myriad of rating downgrades, ratings agencies make references and publish pessimistic reports. A good example is the reports on sentimental 'misery index', profiling and comparing emerging economies' assumed level of distress of their citizens. There is no necessity for rating agencies to throw their weight in portraying African countries as miserable nations with distinctively outstanding level of unemployment and inflation. Given the influential role of rating agencies in determining the dynamics of financial markets confidence, the announcements on such subjective indices add significant negative sentiments

1 https://www.gov.za/speeches/financing-african-economies-18-may-2021-0000
2 https://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/CreditRatingAgencies.aspx
3 https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/04/01/World-Bank-Group-And-International-Monetary-Fund-Support-For-Debt-Relief-Under-The-Common-50321

on African countries' business confidence. Such announcements have immediate impact on cost of public debt as investors react to negative news by increasing their bond interests. The direct result of this is shrinking fiscal space and financial resources that are necessary to support the development of private sector, industry and businesses, and provide for the public investments. As countries are emerging from the Covid-19 global pandemic, painting a gloomy outlook on the economy does not do justice to their citizens' welfare.

- **Overemphasis on government debt** – Although the average debt-to-GDP ratio recommended by the IMF and African Monetary Co-operation Program as prudent debt levels for developing countries is 60%, no country would have effectively responded to the Covid-19 pandemic without further accumulating debt. As countries are battling a large build-up in debt resulting from lower economic growth and higher budget deficits from social support and investments in the health sector during the Covid-19 crisis, rating agencies continue to cite government debt as their leading risk indicator in rating assessments. Countries that announced once-off fiscal expenditure to mitigate the adverse impact of the Covid-19 pandemic on the economy, support businesses, protect employment and the health sectors were downgraded because the expenditures would increase government debt burden. This has significantly undermined the effectiveness of governments' counter-cyclical policies. South Africa and Ghana are good examples, whose downgrades in 2020 were driven by once-off health and economic stimulus packages. Given that countries are emerging from the Covid-19 pandemic crisis, rating agencies should not be overemphasizing government debt in negative light. Default risk should be assessed more in terms of a country's strength of fiscal institutions, effectiveness of taxing authority and long-term productive capacity of a country's economy.

**Box 2: Downgrade of Ethiopia for participating in G20 Common Framework**

The Government of Ethiopia was downgraded in the 2021H1 by all the 3 dominant international rating agencies to a 'speculative grade', signalling that the country is at the brink of defaulting on its foreign debt. The leading risk driver in Ethiopia's downgrade, ahead of the armed ethnic conflict that may weaken the country's political and institutional framework, was the government's announcement on 19 January 2021 that it will seek to restructure its external debt under the G20 Common Framework relief program. The Government of Ethiopia made clear their commitment to comply with all of their contractual obligations to private sector creditors. It highlighted that the inclusion of private creditors in any debt restructuring deal was 'very unlikely' and that if there would be any potential adjustments, it would be 'minor'. In addition, Ethiopia only has one outstanding Eurobond that constitutes 1 percent of GDP and has wide number of options to service both the Eurobond and other commercial debt. Only 10% of its external debt is owed to private creditors and the bulk of the country's public external debt is official multilateral and bilateral debt. The downgrades were despite the joint World Bank–IMF Debt Sustainability Analysis (DSA)[4] , which showed that Ethiopia's debt is sustainable and its risk of falling into debt distress is minimal and insignificant.

*Source: Ministry of Finance, Ethiopia, May 2021.*

4 https://www.imf.org/en/Publications/CR/Issues/2020/05/06/The-Federal-Democratic-Republic-of-Ethiopia-Requests-for-Purchasing-under-the-Rapid-49396

# 5. RECOMMENDATIONS

The acknowledgement by the IMF [5] and the United Nations (UN) [6] that rating agencies are reinforcing the increase of perceived and real risk for investing in Africa is a step in the right direction. The United Nations Conference on Trade and Development (UNCTAD) [7] have also acknowledged that the swift downgrading of developing country debt by rating agencies contributed to the size and spread of the economic shocks from Covid-19 pandemic and that the dual-sized role of credit rating agencies' as both player and umpire in the markets needs to be revisited. Similarly, the call by the UN for the temporary suspension of credit ratings during a global crisis such as the Covid-19 pandemic has found support amongst heads [8] of states and governments [9] , academics and multilateral financial institutions given their role during the Covid-19 pandemic in which they worsened developing countries' debt positions. It is thus, time for all African countries to support the call to reform and regulation of rating agencies that lies at the centre of the global financial architecture to accurately integrate brightening realities and diverse circumstances of emerging economies into their models, to adopt a flexible methodology during global crises period to avert debt distress, and to support structural transformation that is key to fiscal and debt sustainability. In the medium term, regulators must take action to ensure that rating agencies are fulfilling their intended market-stabilising role.

5 https://www.imf.org/en/News/Articles/2021/05/14/sp051421-remarks-at-the-pontifical-academy-of-sciences
6 https://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=26833&LangID=E
7 https://unctad.org/system/files/official-document/tdr2020_en.pdf
8 https://www.gov.za/speeches/financing-african-economies-18-may-2021-0000
9 https://www.mofep.gov.gh/press-release/2020-09-14/global-ratings-lowers-ghanas-long-term-rating-to-b-with-a-stable-outlook

## 5.1 Recommendation for countries

The main challenge that governments are facing with international credit rating agencies is in the area of long-term foreign-currency sovereign credit ratings, and to a lesser extent, domestic currency sovereign ratings. On average, domestic currency ratings are one notch higher than foreign currency ratings. If countries were to borrow in domestic currency, their cost of borrowing would be much less as more countries are rated investment grade in local currency. This can be done through the following mechanisms;

i. **Support the development of domestic markets:** African countries should shift their focus from Eurobond to supporting domestic bond markets by borrowing in domestic currency to cushion themselves from exchange rate risk. This will be a cornerstone of the development of domestic financial markets, saving countries from the volatile exchange-rate movements, making economies more resilient to unexpected foreign capital flows movements. A well-developed domestic bond market is an important factor in making debt more sustainable as it becomes a stable and less risky source of funding. Domestic bond markets can easily form the basis of a robust financial system to support economic growth, the productive use and allocation of savings, non-inflationary financing of budget deficits, cutting taxes in difficult economic times and using counter-cyclical fiscal policy measures.

ii. **Reinforce the use of domestic and regional rating agencies:** Supporting the use of regional and local rating agencies is a key component in developing domestic capital markets. It is local and regional rating agencies that appreciate the quality of domestic debt instruments. The use of local rating agencies will support diversification into new debt instruments, support bond market depth and provide a platform for countries to borrow more on local financial markets.

iii. **Debt conversion:** Governments should consider debt conversion through entering into agreements with domestic institutions that have surplus foreign currency reserves to settle foreign currency debt in exchange for local currency debt to cushion against foreign currency fluctuations. A good example is the Government of Namibia, which converted its international debt to domestic debt through the Government Institutions Pension Fund (GIPF). The GIPF provided foreign currency to settle the government's 10-year Eurobond maturing this year in return for government owing GIPF a domestic currency debt.

iv. **Engage rating agencies:** In ongoing engagements with international credit rating agencies, the APRM-led initiative continues to note a

number of governments that neither fully participate in periodic credit rating reviews nor respond to information requests from rating agencies. It's critical to have a competent and engaging team of experts that are ready to provide information to both rating agencies and investors on material macroeconomic activities. The competence of the country's rating agency liaison team is critical, as their failures may cost the government significant fiscal resources when the country's rating is lowered. For example, on the DSSI and G20 Common Framework, if the participating countries had actively engaged rating agencies and issued public statements highlighting their commitment to their contractual obligations to private creditors and assuring interested stakeholders that private-sector creditors will not suffer risk of losses on the terms they would seek under the debt relief programs, it could have averted or at least delayed a number of negative rating actions.

## 5.2 APRM support to countries

Through a number of mechanisms, the APRM and collaborating partners continue to offer the following ongoing support to countries in the area of credit rating;

i. Conducting Institutional and Technical Capacity Building Interventions to offer technical support to the liaison teams to adequately prepare for future rating review exercises and to implement admissible rating recommendations.
ii. Engaging directly with international rating agencies and national regulators on specific rating events that are prejudicing countries' creditworthiness, encouraging rating agencies to equally emphasize the country's upside risk indicators and milestones, as they do downside events, and to stop reputational damaging comments that are not in line with their central role of providing information on creditworthiness of countries to investors.
iii. Engaging the UN and the Bretton Woods Committee on the drive to reform the work of rating agencies, whose announcements have become critical human rights concern.
iv. Engaging national regulatory authorities to improve regulatory efficiency, curb the procyclical nature of ratings and addresses unnecessary financial market distortions being caused by rating agencies at the expense of stability and recovery of governments' fiscal positions.
v. Facilitate the cross-border harmonized regulatory frameworks and continental supervisory framework.
vi. Supporting countries through other mechanisms such as its newly established Continental Information Exchange Platform and the APRM Continental Adhoc Committee of Experts.


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