AFRICA SOVEREIGN CREDIT RATING REVIEW

2021 END OF YEAR OUTLOOK

African Peer Review Mechanism

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4TH EDITION

ABOUT THIS REPORT

This 4th edition of the African Union - African Peer Review Mechanism (AU-APRM) end of year bi-annual sovereign credit rating review report presents an analysis of the long-term foreign currency sovereign credit rating actions in Africa by three dominant international credit rating agencies –Moody's, Fitch and S&P Global – during the second half of 2021 (2021H2) and makes recommendations to African countries on how to improve their ratings.

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1 GENERAL RATING OUTLOOK

The Second Half of 2021 (2021H2) witnessed a moderate improvement of creditworthiness across Africa with nine countries being assigned a positive sovereign credit rating action compared to only two in the First Half of 2021 (2021H1). This is eight times more positive sovereign credit rating in comparison to the same period in 2020 (2020H2), where only one country was assigned a positive rating outlook – Nigeria. The rating upgrades in 2021H2 were mainly driven by prospects of faster and stronger economic recovery as countries advance to contain the COVID-19 pandemic through mass vaccinations. Of the nine countries with positive rating actions in 2021H2, all of them had rolled out national vaccination programmes with an average national coverage of 14% being fully vaccinated. This saw the majority of African governments relaxing lockdown measures in favour of opening up their economies to allow more economic activities. There was thus optimism on prospects of gradually reversing the deterioration of the budget balances and stabilising government debts through improved fiscal discipline and implementation of reforms.

Five countries – Angola, Benin, Gabon, Côte d'Ivoire and Seychelles – had their credit ratings upgraded by one notch, although they all remain in sub-investment grade (junk status). The other four countries – Botswana, DRC, Nigeria and South Africa had their outlook upgraded from negative to stable with only the DRC being upgraded from stable to positive. The upgrade of Benin by Fitch followed Moody's upgrade in 2021H1. Botswana's outlook was also raised after S&P had kept it on negative for a year since September 2020. Gabon was upgraded 2 notches by Fitch from CCC to B- in August 2022, whilst three countries – Ethiopia, Rwanda, and Tunisia experienced negative rating actions. Ethiopia was downgraded twice by S&P during this period, from B- to CCC+ in September and further down to CCC in November.

Table 1: Summary of sovereign credit rating actions (Jul – Dec 2021)

Country	Moody's		S&P		Fitch	
	Previous	Current	Previous	Current	Previous	Current
Angola	Caa1 (Stable)	B3 (Stable)				
Benin					B (Pos)	B+ (Stable)
Botswana			BBB+ (Neg)	BBB+ (Sta-ble)		
DR. Congo	Caa1 (Stable)	Caa1 (Pos)	CCC+ (Sta-ble)	CCC+ (Pos)		
Ethiopia	Caa1 (UR)	Caa2 (Neg)	B- (Neg Watch)	CCC (Neg)		
Gabon					CCC	B- (Stable)
Cote D'lvoire					B+ (Pos)	BB- (Stable)
Nigeria	B2 (Neg)	B2 (Stable)				
Rwanda					B+ (Stable)	B+ (Neg)
Seychelles					B (Stable)	B+ (Stable)
South Africa					BB- (Neg)	BB- (Stable)
Tunisia	B3 (Neg)	Caa1 (Neg)			B (Neg)	B- (Neg)

Tradingeconomics, 2021

2 CONTINENTAL KEY RATING DRIVERS

The rating actions in 2021H2 were driven by the following key risk factors:

i. Angola was upgraded by Moody's on the basis of stronger legislative institutions and commitment of the executive to good governance, which would likely lead to improvement in fiscal metrics and the higher oil prices that would support fiscal consolidation efforts, structural improvement and a reduction in debt burden.

ii. The upgrade of Benin by Fitch was supported by the resilience of the country's economy to the pandemic, growing by an impressive 3.8% in 2020, which was amongst the highest in emerging economies globally in 2020. The GDP growth was a result of government's effort to strengthen and diversify the agricultural sector and boost foreign direct investment through the government's investment programme.

iii. The revision of Botswana's rating outlook from negative to stable by S&P was on account of the country's economic rebound, partially led by the diamond market recovery, which was anticipated to substantially improve the domestic fiscal and external sectors' performance over the next two years.

iv. Moody's and S&P Global changed the outlook of the Democratic Republic of the Congo from stable to positive because of the country's robust economic prospects, driven by the increased investments in the mining sector and structural reforms under the current IMF program.

v. Ethiopia was downgraded twice in 5 months by Moody's due to heightened political instability caused by the Tigray conflict, which derailed the government's transformative reform agenda and constrained access to international financing.

vi. Fitch upgraded Côte d'Ivoire and South Africa because of the prospects for faster and stronger economic recovery, with continued commitment and adherence to fiscal prudence and reforms by the country's authorities, which would gradually reverse the temporary deterioration of the budget balance and stabilise government debt. In Côte d'Ivoire in particular, normalisation of the political climate significantly decreases the political risk.

vii. The outlook of Nigeria and Gabon was upgraded due to improved liquidity, which was facilitated by higher oil prices and more support from International Financial Institutions. These were considered relevant for stabilizing the sovereigns' credit metrics and support their external position.

viii. Fitch lowered Rwanda's outlook due to weakening public finances and increasing public sector debt that was driven by high budget deficits associated with the COVID-19 pandemic.

ix. The upgrade of Seychelles reflected the rebound of the tourism sector since the country reopened its border to visitors in March 2020, leading to significant revenue growth and improvement in fiscal metrics.

x. Moody's downgrade of Tunisia was caused by weakening governance, political crisis and increasing uncertainty regarding the government's capacity to implement reforms necessary to access international funding.

3 AFRICAN SOVEREIGN DEBT MARKET

On Eurobond issuances, Cameroon was the first amongst the only four countries to borrow through the Eurobond market in 2021H2 by issuing $812 million in 11-year bonds in July 2021.The issuance by Cameroon was oversubscribed by three times and was sold at a significantly low coupon. In August, Rwanda also joined the Eurobond market to issue its $620 million 10-year bonds to refinance existing bonds and to fund priority projects. Nigeria and Egypt issued their Eurobond worth $4 billion and $3 billion, respectively, in September through bonds with tenures from 6 to 30 years. Like all other prior issuances, the sovereign bonds in 2021H2 were oversubscribed by at least three times, indicating a continued high appetite for African bonds in the COVID-19 pandemic recovery period.

Table 2: Eurobond issuance Jul – Dec 2021

Country	Issue date	Amount (US$B)	Purpose	Tenor	Coupon	Sub-scription
Cameroon	01/07/2021	0.812	Refinance existing bonds	11-year	5.95%	3x
Rwanda	02/08/2021	0.620	Priority Projects funding & bond refinance	10-year	5.5%	3x
Nigeria	21/09/2021	1.25 1.5 1.25	Budget finance & build external reserves	7-year 12-year 30-year	6.125% 7.375% 8.25%	4x
Egypt	23/09/2021	1.1 1.1 0.750	Finance fiscal budget	6-year 12-year 30-year	5.8% 7.3% 8.7%	3x

Source: World Government Bonds, Dec 2021

Despite the successes in issuing sovereign bonds on the international markets, countries are still facing a challenge of high interest rates, which are driving government debt burden to unsustainably high levels. On average, interest repayment is the highest expenditure portion and remains the fastest growing expenditure in the fiscal budgets of the majority of Africa's Eurobond holders. On the contrary, sovereign bonds issued by African countries continue to be oversubscribed by at least 3 times in 2021H2 despite the impact of the COVID-19 pandemic. This shows that Africa's debt instruments remain attractive to investors, who have confidence and high appetite for investing in the continent's high yield bonds. However, the continued oversubscription of Eurobond issuances shows mispricing of interest rates to the disadvantage of issuers and that countries are still borrowing at unnecessarily high costs to the fiscus, which could be reduced. An oversubscribed orderbook should be an opportunity for countries to renegotiate with bond issuing syndicate to restructure favourable terms on their sovereign bonds

Box 1: Egypt leveraged on oversubscription to bargain low interest rates

The Government of Egypt issued Eurobonds worth a total of US$3 billion with tenors from 6 to 30 years. The subscriptions on the bonds reaching a value of US$9 billion, which was three times the total value of the bonds on sale. Following this oversubscription, the Ministry of Finance of Egypt instructed the banks who were responsible for arranging the deal to decrease the interest rate to a minimum comparable to Eurobonds in other countries that have similar credit rating as Egypt. This resulted in interest rates being lowered by approximately 0.33% on the 6- and 12-year bonds, and by 0.13% for the 30-year bonds, which is an outstanding occurrence, especially in the height of the ongoing challenges caused by the COVID-19 pandemic.

Source: Ministry of Finance, Egypt, September 2021

4 RATINGS CHALLENGES

Despite the improvement in sovereign credit worthiness in the 2021H2, reflecting the optimism in the recovery of African economies, a number of challenges were highlighted;

i. ***Public debt concerns:*** The rating agencies have continued to cite *'increasing debt levels to above the 60% threshold for prudent debt-to-GDP ratio and failure to stabilise debt'* as one of the key risk factors weighing down foreign currency credit ratings in the majority of African countries. This is despite that the bulk of sovereign debt is either in domestic currency or in the form of low-cost loans from international institutions such as the African Development Bank and IMF.

ii. ***Timing of positive rating actions:*** There are some countries that had outstanding economic performance throughout the COVID-19 pandemic to which rating agencies have also acknowledged, but this has not been translated to positive rating action. Given the impact and procyclicality of ratings on bond interest rates and investor sentiments, a rating upgrade or positive change in outlook will go a long way in reducing the cost of servicing public debt, which has a ripple effect on other fundamental risk factors.

According to the rating agencies' definitions, *"an outlook assesses the potential direction of a long-term credit rating over the intermediate term, which is generally up to one year for speculative grade and generally up to two years for investment grade".* The rating agencies have not been sticking to their own definitions, they have kept a number of countries in the same speculative grade with a negative outlook for more than one year. For example, Fitch kept South Africa at BB- (negative) since 03 April 2020 before it changed the outlook to stable on 15 December 2021

Box 2: Moody's and S&P affirmed sovereign credit rating of Egypt

The APRM issued a statement in October 2021 following the rating review of Egypt by S&P Global in which the international rating agency affirmed the country's long-term foreign currency sovereign credit rating at B with a stable outlook for the fourth time since Egypt registered its first COVID-19 case in February 2020. Affirming a rating means the country's current rating remains unchanged and this has been so since May 2018. Fitch Ratings and Moody's last upgraded Egypt's rating to B2 and B+ in March and April 2019, respectively. The international credit rating agencies however acknowledge the country's strong, resilient, and balanced policies adopted in the face of the pandemic, along with the resumption of economic, financial, and restructuring reforms which helped provide a strong and diversified domestic financial base in Egypt and a high balance of foreign exchange reserves. On the basis of the risk factors in the sovereign credit rating methodology, the fundamentals in Egypt call for the country's long-term foreign currency sovereign credit rating or outlook to be upgraded. This will translate into a significant decline in the cost of servicing government debt and further stimulate the economic fundamentals in Egypt.

Source: APRM Statement on credit ratings action on the Arab Republic of Egypt, October 2021.

iii. ***Limited availability of data:*** A report published by Fitch Ratings in September notes that Nigeria is one of the African countries *"that do not publish consolidated fiscal data on a general government basis, which 'complicates' its assessment of the country's fiscal performance".* The rating agency therefore produces its own estimates that may not be anywhere closer to the actual general government fiscal metrics and most likely would not be providing sufficient information. From previous objective assessments, the APRM notes that estimations of fiscal performance by rating agencies are usually pessimistic due to analyst biases and their general approach to 'err on the side of caution'. The outcome of these estimations thus tends to disadvantage the underrated country.

5 RECOMMENDATIONS

Governments and rating agencies should cooperate regularly during the sovereign credit rating review process. Strengthening their relationship and ensuring that each consistently, accurately and objectively play their part will be beneficial for the overall rating assessment exercise. With regard to its review of the rating actions in 2021H2, the APRM makes the following recommendations.

i. **Improving fiscal metrics:** As economies recover from the impact of COVID-19, fiscal and monetary policies should generally be inclined towards fiscal consolidation to address the rising debt burden and maintain the debt-to-GDP ratio at levels agreed to by Regional Economic Communities (RECs).

ii. **Increase data integrity and transparency:** There is need to timely publish consolidated fiscal data on a general government basis to allow both investors and rating agencies to objectively assess the countries' fiscal performance.

iii. **Bargain for favourable terms on bonds:** Governments should coordinate with bond issuing syndicates to leverage on oversubscriptions of bond orderbooks and bargain for a decrease in interest rates comparable to other countries that have similar credit ratings.

iv. **Specialised functions and upgrading expertise:** Governments need to develop expert capacity both in the National Treasury and Central Bank to support the constant engagements between rating agencies and government. This can be achieved primarily by attracting internationally competitive expertise on special contract terms and by creating dedicated fit-for-purpose offices.

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