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Africa from the Inside:
Spotlight on Risk in Africa

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Forecasting Risk in Africa in 2017

Africa had its own Lehmann shock moment in July 2014. From mid-2014, the oil price began its steep decline. From a high of US$142 per barrel in mid-July 2008, as the price of oil reduced, so did the growth prospects of a large number of African economies.

This has had major developmental implications for many African economies as well for many companies that have invested in their economies.

Seemingly, the blanket "Africa Rising" narrative led to a general lack of inability to foresee and mitigate risk on the part of many multinationals in the region. Intra-regional multinationals in Africa must now adapt to "Africa 3.0" – the emerging post-crisis African economy.

The global economy remains in an almost-daily "risk-on, risk-off" state of mind. Our own region – Southern Africa – is no different, and due to the overall lack of economic diversification is very vulnerable to external factors and shocks.

There is thus a heightened sensitivity to risk, but what then is the real risk environment facing investors in Africa in the year ahead?

A rising debt crisis

Many African states are experiencing a fiscal blowout – they have taken on too much public sector debt and are unable to service it. In total, African states owe just more than US$35bn in Eurobond debt. Debt-to-GDP ratios are rising across the continent with several countries in the red zone of unsustainable debt.

For frontier-type markets, any figure approaching 60% is considered unsustainable and governments need to reduce budgetary expenditure as a result.

Debt-to-GDP in SSA, % (2013-2016)

Source: IMF, 2016; World Bank, 2016

South Africa currently stands at 51.3%. The worst regional performer is Mozambique with a debt-to-GDP figure of 130% (and likely to shortly face sovereign default).

The general trend in 2017 indicates increased involvement of the

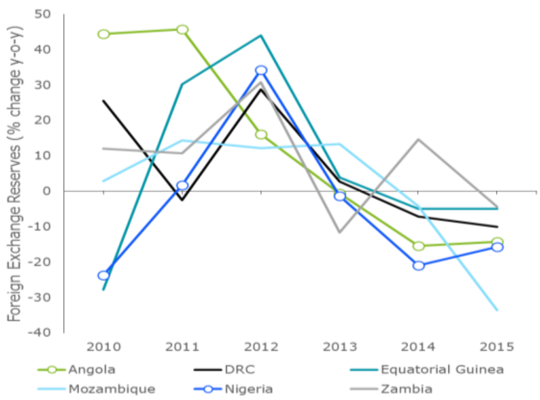
International Monetary Fund (IMF) in specific African states, the necessity of structural reform and an overall reduction in state spending.

Captured capital

Many African states are rapidly imposing capital controls in order to shore up their foreign exchange reserves. As a result of dwindling forex reserves – often compounded by authorities trying to defend currencies haemorrhaging in value – many invested corporates are finding themselves in situations where sudden foreign exchange restrictions are imposed on them. As a result they cannot repatriate their dividends, invested capital, and have limited access to forex.

Countries where this is currently prevalent include Angola, Nigeria and Zimbabwe. The question for investors in Africa will increasingly be how to mitigate currency risk and repatriate or re-invest what could be termed "captured capital".

Falling foreign reserves



Source: BMI, 2016

Rising regulatory risk

Regulatory action in some African states can be described as being somewhat "aggressive" over the past year as they seek to extract large sums from invested firms for regulatory infractions.

Key examples include MTN's (reduced) US$1.7bn fine in Nigeria and ExxonMobil's extraordinary fine of US$75bn in Chad. Companies need to tread very carefully going forward in light of states' need to increasingly extract rents.

Corporate fines across Africa in 2015-2016

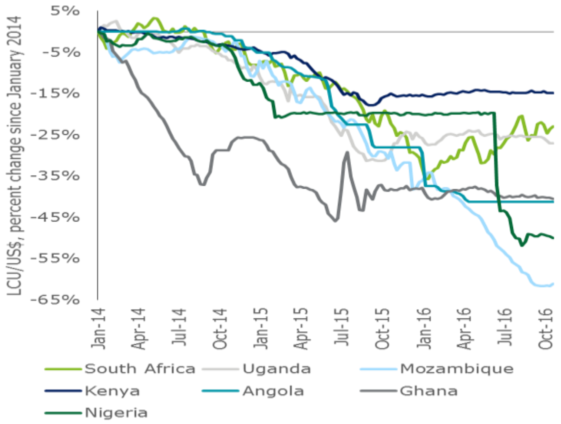
Country	Company (sector)	Amount	Month settled
Nigeria	MTN (telecoms)	US$1.7bn	June
Chad	ExxonMobil (mining/oil)	US$75bn	-
South Africa	Arcelor Mittal (mining)	US$110m	-
Tanzania	Standard Bank (financial)	US$4.2m	February
Zimbabwe	Barclays (financial)	US$ 2.5m	February

Source: Deloitte research, 2016

Currency risks

With the commodity price collapse over the past three years, currency volatility for many emerging and frontier economies has been a severe buffeting force to contend with. Currencies worst affected include the Mozambican metical, the Nigerian naira and the Angolan kwanza.

Plummeting currencies



Source: Oanda, 2016

Devalued currencies – often compounded by errant monetary policies – have deterred foreign investment and impacted negatively on the fiscal state of all African resource-driven economies. Currency risk will continue to be front of mind in 2017, mostly for oil-propelled countries.

Possibility of bank failures

The rapidly declining health of many African economies is likely to result in many banks going out of business this coming year. Many African countries simply have too many undercapitalised banks. Economies at risk include Nigeria, Ghana, Mozambique, Angola, the DRC and Kenya.

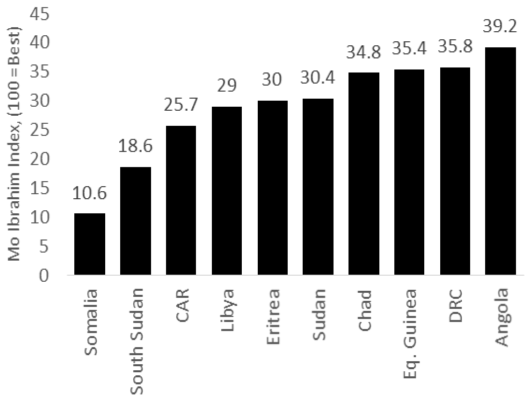
Quoted by Bloomberg last month, Ronak Gadhia from Exotix Partners LLP in London stated that "…smaller Kenyan banks are facing a potentially dangerous cocktail of declining margins, declining liquidity and deteriorating asset quality, which could at best force consolidation within the sector, or at worst precipitate a full-blown banking crisis."

How governments react to prevent or manage banking failures will determine their future economic trajectory over the longer term. A not dissimilar situation was experienced in Southeast Asia and Korea following the Asian financial crisis of 1997. Lessons can be drawn from these countries' experiences.

Political & governance risk

Ultimately the emerging market story is nothing more than a governance story. In many countries in the region there is an obvious need for a shift in approach toward political and economic governance. Some countries are able to de-risk political transitions (for example Ghana) whilst others are characterised by instability. Recent examples from this past year include Gabon and Gambia.

10 worst-governed African states



Source: World Bank WGCI, 2016

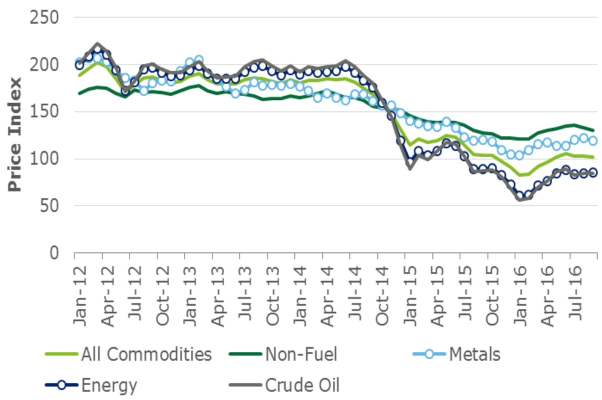
Countries that may present political shocks in 2017 include Angola, Kenya and the DRC. Even the leadership succession in South Africa's ruling ANC late next year and policy uncertainty resulting from it has the potential to negatively impact the economy.

Lower for longer commodity prices

Of continued concern for Africa's growth outlook are persistently low commodity prices, in particular oil. It appears that the new ceiling for oil is US$60 per barrel indicating prolonged sub-trend growth of oil-propelled economies compared to recent years.

There is no resource that raises such high hopes of development but ultimately results in such little return as oil. This is especially true of the continent's West African economies. Commodity-driven economies have little resilience to weather commodity price declines and are thus facing pressures from lower GDP growth.

Commodity price indecies 2012-2016 (2005=100)



Source: IMF, 2016

China's rebalancing as a risk

Inextricably linked to commodity prices is China's growth outlook. The country's growth model has been incredibly commodity intensive, driven by rapid urbanisation and substantial infrastructure investment. This has underpinned commodity exporting economies. There is also no clear consensus on how China's economic story is going to unfold.

An economic crisis – a so-called "hard-landing" in the Chinese economy – would result in a severe negative knock-on effect in Africa.

The supercharged days of double digit growth in China are clearly over. The economy is now "rebalancing" from one driven by over-investment toward a services-driven economy.

As China's growth recalibrates and its resource-intensive growth model subsides, the implications for resource-exporting economies are being dramatically felt in Africa.

Key take-away

We are now rising from the bottom of the commodity cycle but the global economy still faces systemic risk. Frontier economies are characterised as having a high risk operating environment.

Whilst a gradual recovery is imminent for Central and West African economies later this year, companies must continue to be able to identify emerging risks and mitigate the impact on their business.

The strategy of "fortitude" will continue in 2017 with investors in the region having to review their risk mitigation strategies to match the changing and diverse set of territories across the African continent.

Contacts

Dr Martyn Davies
Managing Director: Emerging Markets & Africa
Deloitte Africa
mdavies@deloitte.com

Hannah Edinger
Associate Director: Africa Services Group
Deloitte Africa
hedinger@deloitte.com