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SUB-SAHARAN AFRICA: MACRO UPDATE

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THE RECOVERY

Economies that will be quick to recover are those with

1) sizeable agriculture sectors. i.e. Kenya, Ethiopia;
2) low exposure to tourism, i.e. Cote d'Ivoire;
3) fiscal buffers, i.e. Tanzania; and
4) household buffers, i.e. Cote d'Ivoire, Ethiopia.

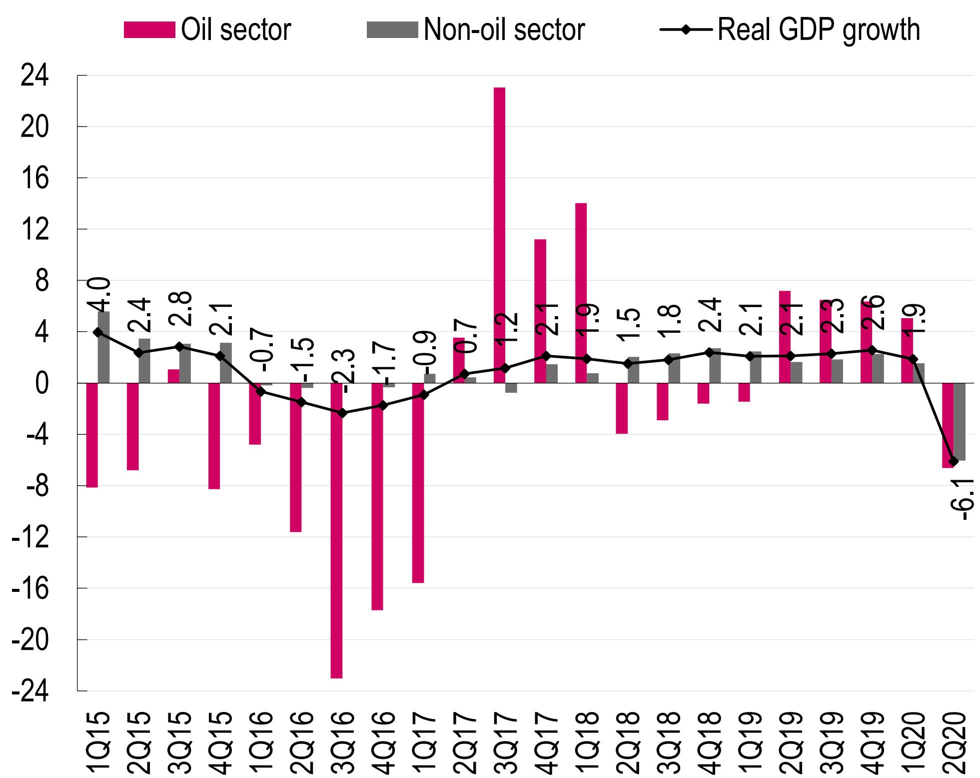
Risks to the short-term outlook:

1) Political, i.e. Ethiopia, Zambia
2) Debt sustainability, i.e. Angola, and access to external financing.

Nigeria

Nigeria: lack of household buffers implies protracted recovery

Figure 1: Nigeria – real GDP growth



- **The outlook – upside**. We think there is potential upside for growth in 2H20, in large part due to the easing of lockdown restrictions. We also do not expect the stringent lockdown restrictions imposed in April to be reinstated, because the government and the economy cannot afford it.
- Second quarter GDP numbers revealed the depth of the decline brought on by “the great lockdown”.
- Nigeria’s economy contracted by 6.1% YoY in 2Q20, vs growth of 2.1% YoY in 2Q19. The magnitude of the decline was equivalent across the oil and non-oil sectors.
- Consumption (as indicated by wholesale and retail trade’s decline), was the biggest drag on growth.
- We maintain our growth forecasts of -2.9% and 1.0% for 2020 and 2021, respectively.

We expect a shallower decline in 2H20 owing to the easing of restrictions. However, we think a run-down consumer implies a protracted recovery.

Nigeria: consumption collapses

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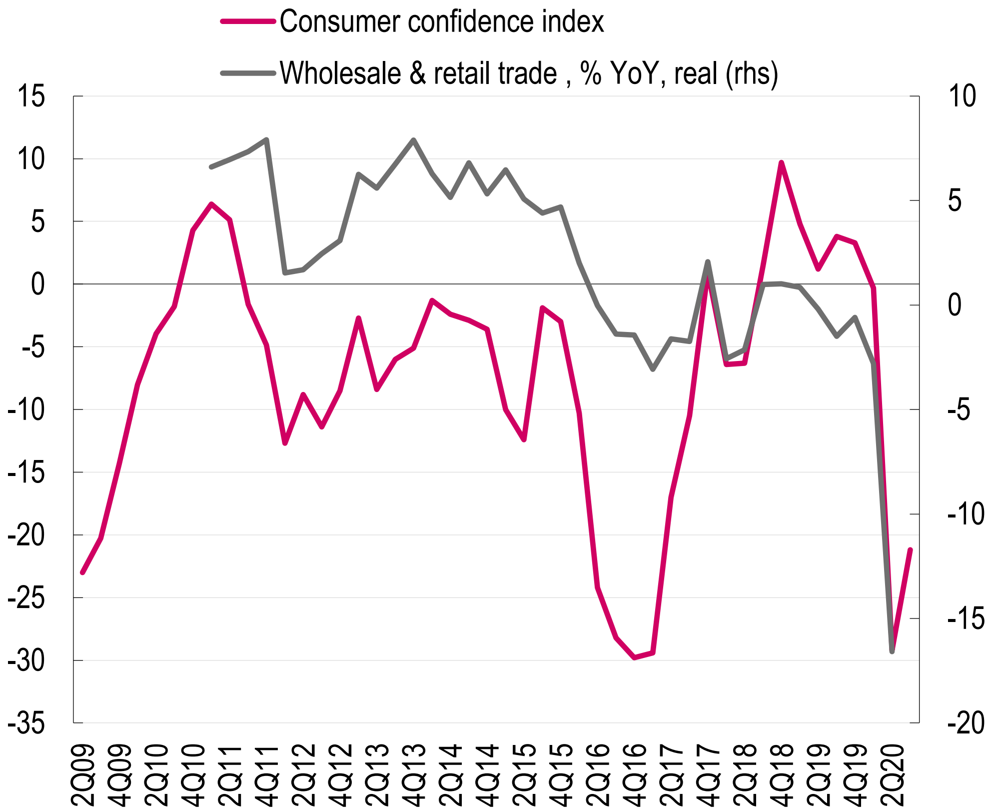
Figure 2: Nigeria – consumer confidence index vs wholesale & retail trade, % YoY



- Wholesale and retail trade – the second biggest economic sector and our proxy for the consumer – contracted for the four quarters preceding 2Q20, implying the consumer was already in recession before the COVID-19 pandemic hit.
- The sector's decline deepened to -17% YoY in 2Q20, vs -0.2% YoY growth in 2Q19. This corresponded with a sharp fall in Nigeria's Consumer Confidence Index to -29.2, vs 1.2 over the same period.
- The last time consumer confidence was this low was in 2H16, when the naira was sharply devalued against the dollar to NGN315/$1, from NGN199/$1 previously.
- The 3Q20 consumer confidence index improved to -21, from -29 in 2Q20. This suggests the decline in consumption continued, but at a moderately slower rate. The depth of the negative index leads us to believe the economy contracted again in that quarter.

Nigeria's struggling consumer was further hurt in 2Q20 by restrictions on movement, closure of markets and falling real incomes due to rising inflation.

Nigeria: flat oil production in 2021 implies limited upside for GDP, CA

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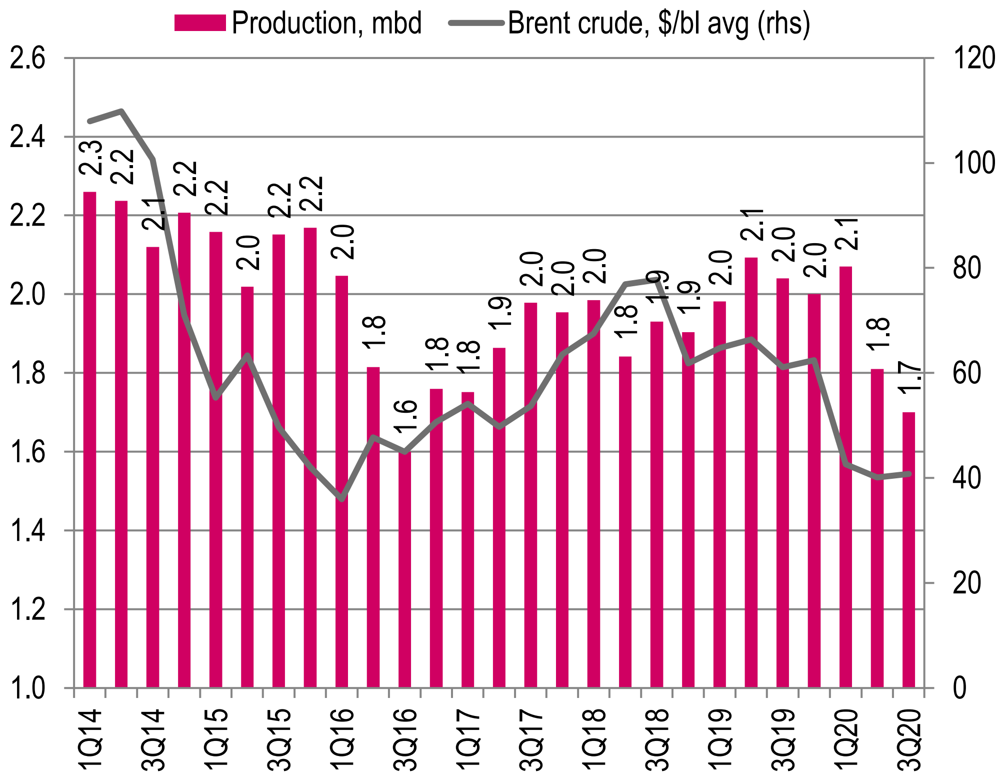
Figure 3: Nigeria – oil production and price



- Four consecutive quarters of growth ended for the oil & gas sector in 2Q20, when it declined by 6.6% YoY, vs 7.2% YoY growth in 2Q19. This was due to a fall in oil production to 1.8mbd, from 2.0mbd over the same period.
- Our oil & gas analyst, Nikolas Stefanou, expects oil production (incl. condensates) of 1.65-1.70mbd in 4Q20. This implies 1.8mbd production for 2020, which is a 10% YoY decline.
- We project oil production of c.1.8mbd in 2021, which means limited upside for GDP and the trade balance from the oil sector.

Flat oil production in 2021 means little upside for growth and the trade balance.

Nigeria: CA deficit narrowed in 1H20

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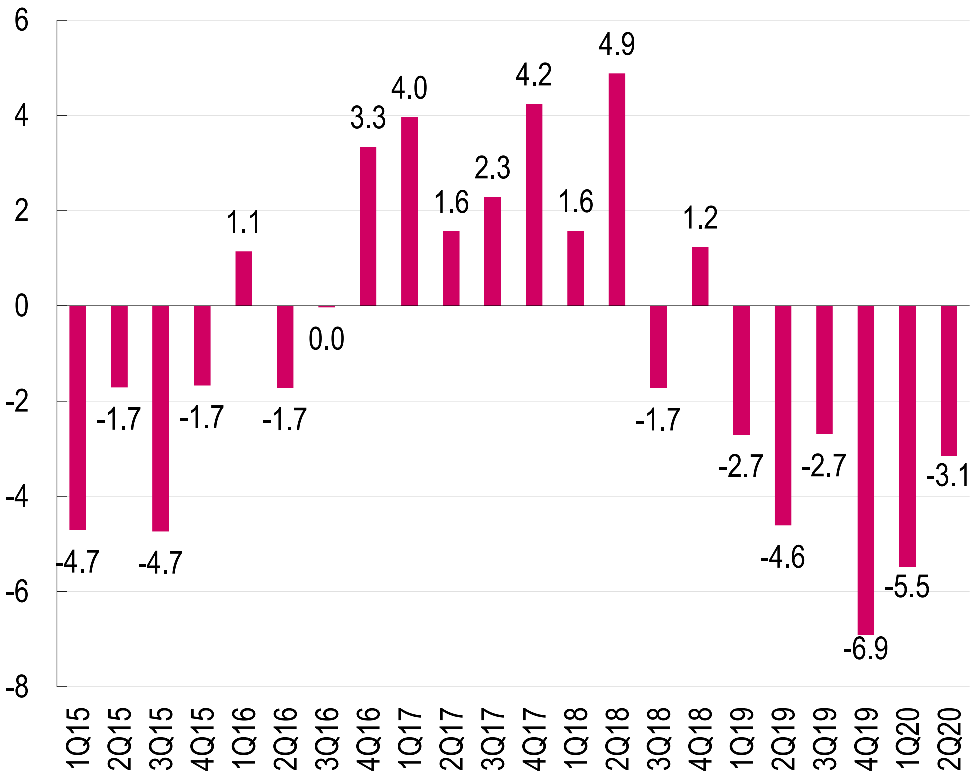
Figure 4: Nigeria – current account, % of GDP (annualised)



- Deterioration of the trade balance to -3.6% of GDP, vs 0.8% a year earlier (due to a drop in oil exports) was mitigated by a sharp fall in outflows of income and services payments from Nigeria.
- Nigeria's current account (CA) deficit narrowed to 3.1% of GDP in 2Q20, during the height of the pandemic-related restrictions, from 4.6% a year earlier, on our estimates.
- This was due to a c. 70% fall in net services and income payments.

Widening of trade deficit was offset by a fall in outflows of income and services payments.

Nigerian naira: is this as strong as it gets?

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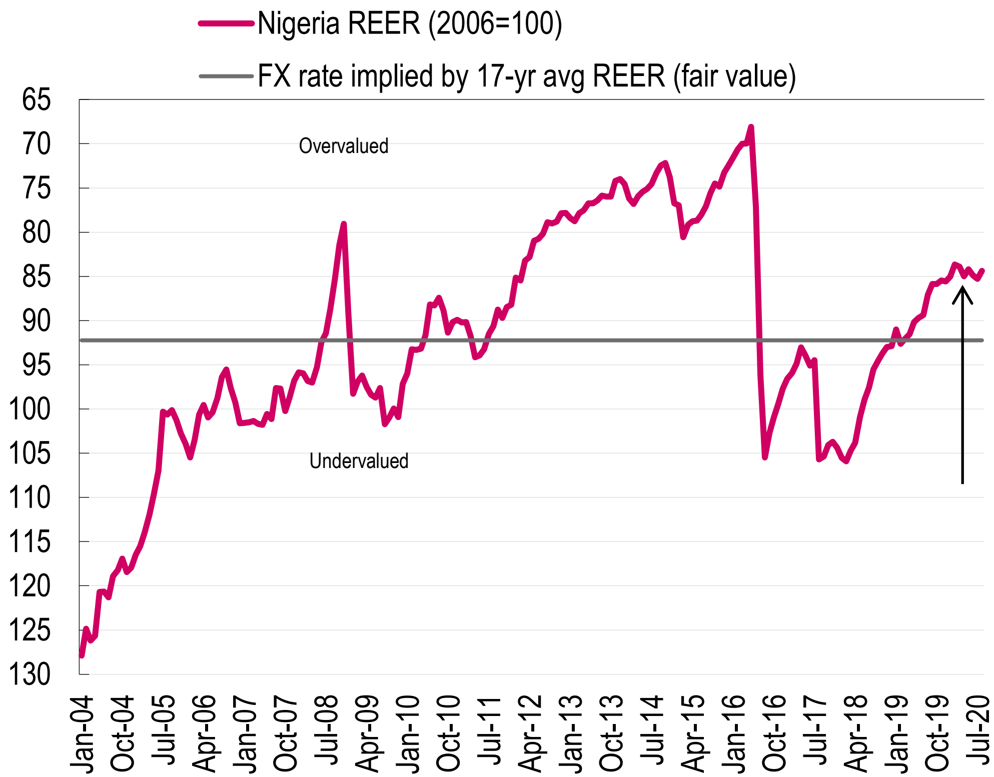
Figure 5: REER vs fair value



- We estimate the naira's fair value to be NGN421/$1, implying it is 9% overvalued, on our real effective exchange rate model.
- Contrary to 2015-16, the naira has not become increasingly overvalued (which culminated in a sharp 60%-naira devaluation, vs the US dollar, to NGN315/$1 in August 2016).
- This time around the naira is slightly less misaligned since the crisis emerged early this year.

If oil production has bottomed and the price picks up in 2021, then this may be as strong as the naira gets.

Nigeria: upside risk to inflation

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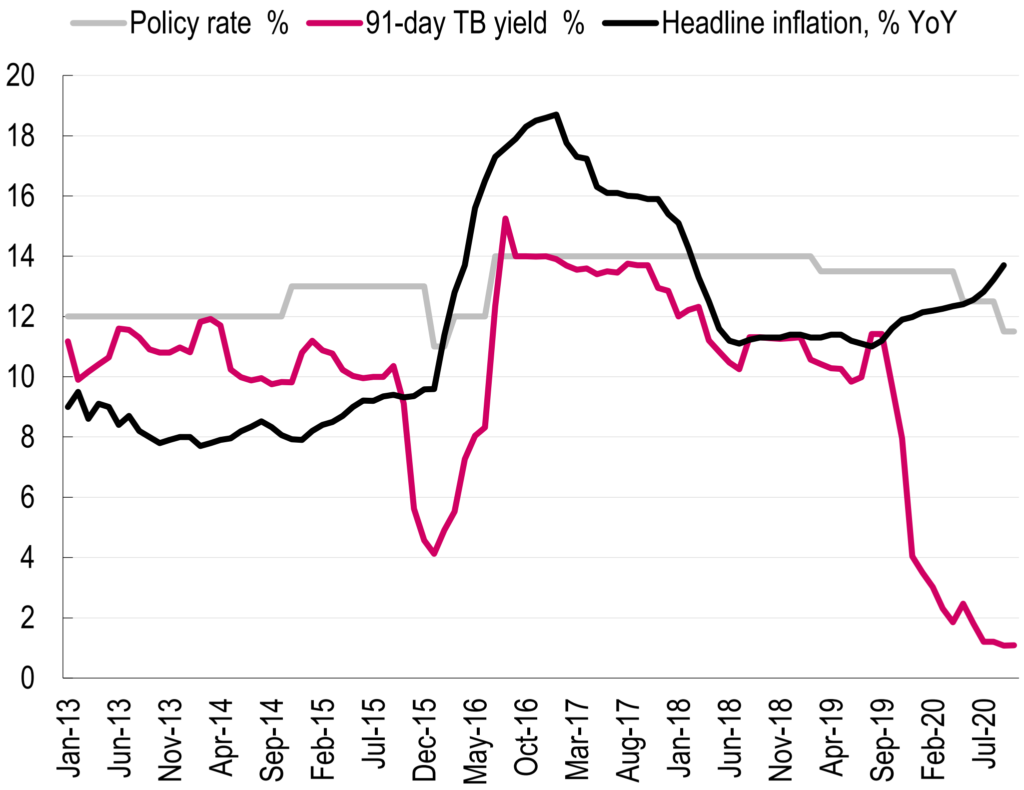
Figure 6: Inflation vs interest rates



- Nigeria's YoY inflation increased to 13.7% in September, from 11.2% a year earlier.
- Food inflation rose to 16.7% YoY, vs 13.5% YoY over the same period. The closure of the land borders in August 2019 partly explains the pickup in food inflation over the past year.
- Core inflation (ex. farm produce) edged up to 10.6% YoY, from 9.4% YoY. The non-food items with the highest YoY inflation rates are healthcare (12.6%) and transport (11.6%).
- **Floods that have reportedly washed away at least 450k hectares of rice farmland implies upside risk for food prices,** and by implication headline inflation, in the short term. The ban on dollar access (from official sources) for food imports is likely to add to food inflationary pressures.
- Our YE20 inflation forecast is 15.2%., and for inflation to remain in the mid-teens in 2021.
- We expect Nigeria's MPC to keep the policy interest rate at 11.5% at its 24 November meeting. We expect no change to the monetary policy stance over the short term. However, naira depreciation pressures and growing inflationary pressures imply upside risk to interest rates.

Naira depreciation pressures and growing inflationary pressures imply this years policy interest rate cuts may (partially) be reversed.

Nigeria: abnormally low fiscal revenue

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Figure 7: Nigeria – federal government budgets

	FY21 proj.		FY20 target		6M FY20
	NGNbn	% of GDP	NGNbn	% of GDP*	
Total revenue	7,866		5,366		1,650
Oil revenue	2,010		1,014		820
Non-oil tax revenue	1,490		1,625		581
VAT			284		85
Company income tax			822		301
Customs			451		184
Special levies			68		10
Independent revenue			933		178
Transfers			1,794		71
Total expenditure	13,080		10,811		4,457
Personnel costs	3,760		3,046		1,427
Debt servicing costs	3,124		2,679		1,105
Capital expenditure			2,686		445
Statutory transfers	485		428		280
Budget deficit	5,200	3.6	-4,976	3.6	-2,806
Total financing	4,280		4,976		
Net external financing			1,985		
Net domestic financing			2,214		1,420
Other financing	915		777		
Assumptions:					
Benchmark oil price, $/bl	40		28		
Oil production, mn b/d	1.86		1.80		
FX rate, NGN/$1	379		360		

*Annualised

- In 1H FY20 the federal government of Nigeria's (FGN) revenue came in 43% below target. As a result, spending was 18% below target, with capex being the biggest casualty.
- On 8 October, President Muhammadu Buhari proposed a NGN13.1trn budget (a 21% YoY increase), which will be funded largely by a one-third increase in revenue.
- We see upside in oil revenue from a higher oil price, small increase in production and moderately weaker naira. However, we think weak growth may keep the FGN from meeting its non-oil revenue target. This implies downside risk to the deficit target of 3.6% of GDP (flat vs FY20E target).
- Low single-digit yields on local debt will help contain funding costs.

As there are limits to Nigeria's concessional financing options, we think a eurobond issuance in FY21 is probable, in part to refinance existing debt.

Kenya

Kenya: sharper than expected economic decline

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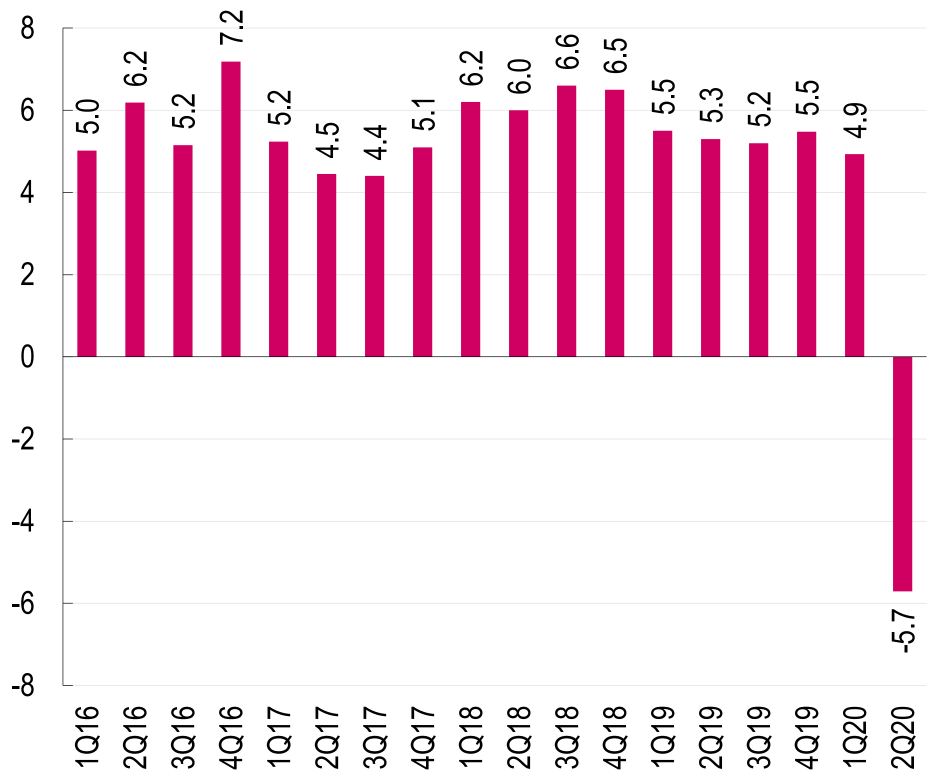
Figure 8: Kenya – real GDP growth



- Kenya's economy contracted by 5.7% YoY in 2Q20, vs 5.3% YoY growth in 2Q19. This was a deeper decline than the -2.3% YoY consensus estimate from a Bloomberg poll of analysts.
- The decline was largely due to education, which cut 4 ppts off real GDP growth, and offset the pick-up in agriculture's growth.
- **We think the economy remains on track to grow by 1.5% in 2020, due to agriculture's strong growth** and the easing of COVID-19 restrictions in 2H20.
- We believe significantly lighter restrictions and the unlikely re-imposition of lockdown support a pickup in growth to 4.2% in 2021.

Education drags down growth.

Kenya: agriculture, the biggest contributor to growth

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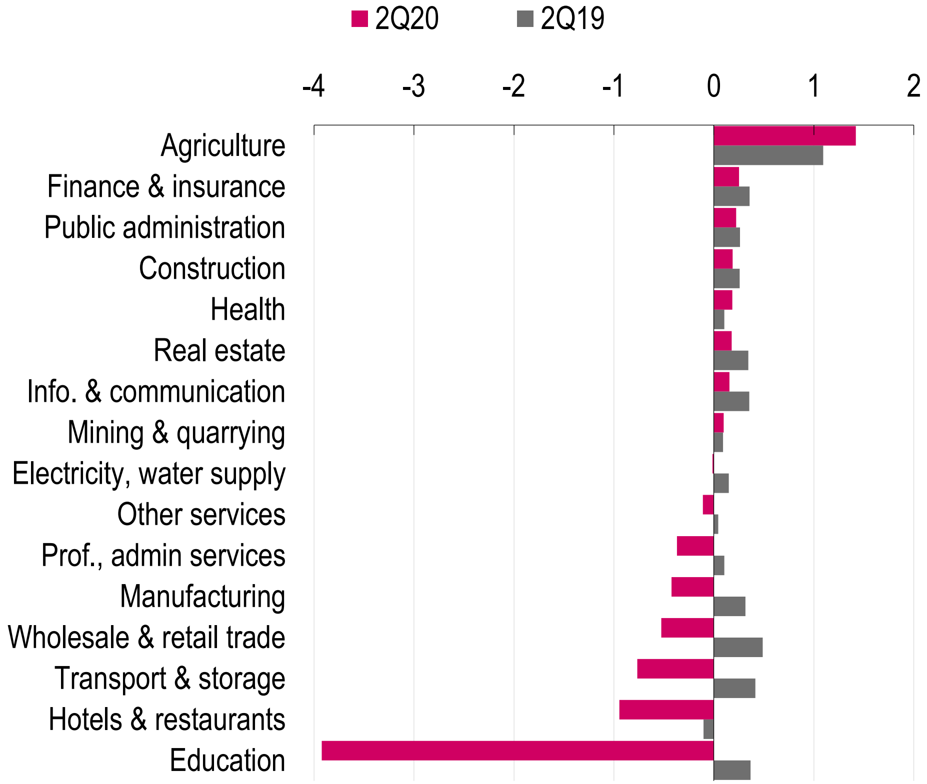
Figure 9: Kenya – contribution to real GDP growth, ppts



- We have argued this year that the agriculture sector, particular the smallholder farmers that are not growing cash crops (i.e. cocoa, coffee, cotton, sugarcane or tobacco), will be one of the sectors most insulated from the economic impact of the COVID-19 crisis. This because it is the least integrated with global supply chains and the banking system.
- So, if a country has good rains and agriculture is a sizeable sector, that economy should see growth in 2020 despite the COVID-19 pandemic.
- Kenya affirms our argument. Kenya's agriculture sector saw its YoY growth strengthen to 6.4% YoY in 2Q20, from 2.1% YoY a year earlier, which explains its 1.4 ppts contribution to real GDP growth

Agriculture, the biggest contributor to growth by far.

Kenya: tourism, hardest hit sector

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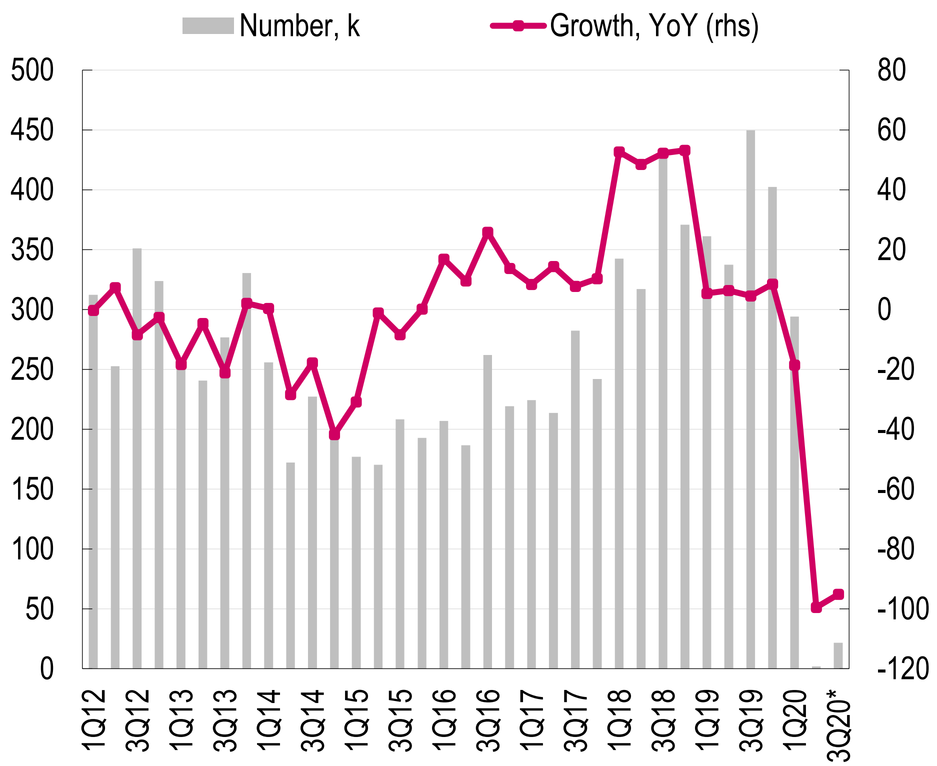
Figure 10: Kenya – tourist arrivals at airports



- The hotels and restaurants sector recorded the sharpest decline of all the sectors; -83% YoY in 2Q20, vs 12% YoY growth a year earlier.
- This corresponds with the 99% YoY decline in tourist arrivals in 2Q20 to 1,777

Re-imposition of lockdown in Europe, which is a significant source of Kenya's tourists delays the recovery of the country's tourism sector.

Kenya: PMI suggests V-shaped recovery

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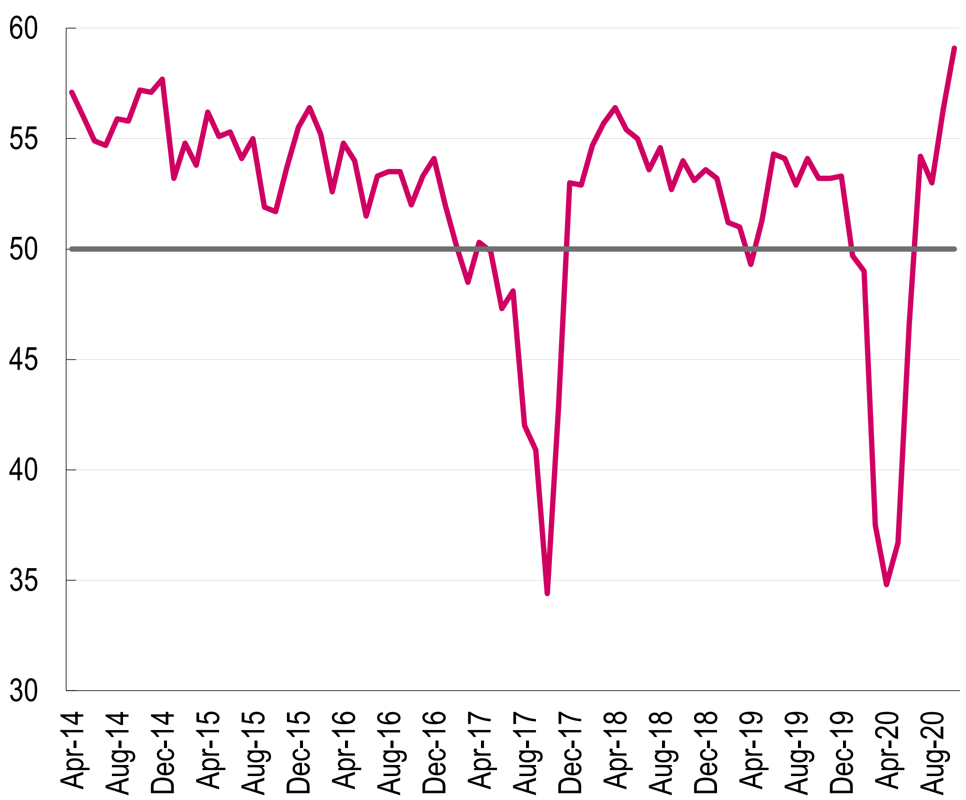
Figure 11: Kenya – purchasing managers index



- Kenya's PMI suggests that growth resumed from July, when the index climbed back over 50, implying expanding economic activity. In October, the PMI increased to 59.1, which is a record high since the series was introduced in April 2014.
- We believe the economy is on track to grow by 1.5% in 2020. First, the hardest-hit sector during the height of restrictions, education, should see a recovery from 4Q20, on the back of the phased re-opening of schools from October.
- Second, 89% of hotels surveyed in September by the CBK were open, vs 35% in May. The resumption of international flights explains the pick-up in tourist arrivals in August to 14k, which is 20-fold July's arrivals. However, this is still 90% down YoY the pick-up in the hospitality sector is likely to be muted.
- Third, the lifting of the ban on movement in and out of Kenya's major cities in July is supporting a pick-up in transport and trade activity in 2H20.
- Fourth, we expect agriculture's momentum to be sustained in 2H20.

The downside risks to the recovery in 2021 are: 1) below average October-December, and March-May 2021 rains; 2) lockdowns in countries that are sources of tourists.

Kenya: inflation is ticking up

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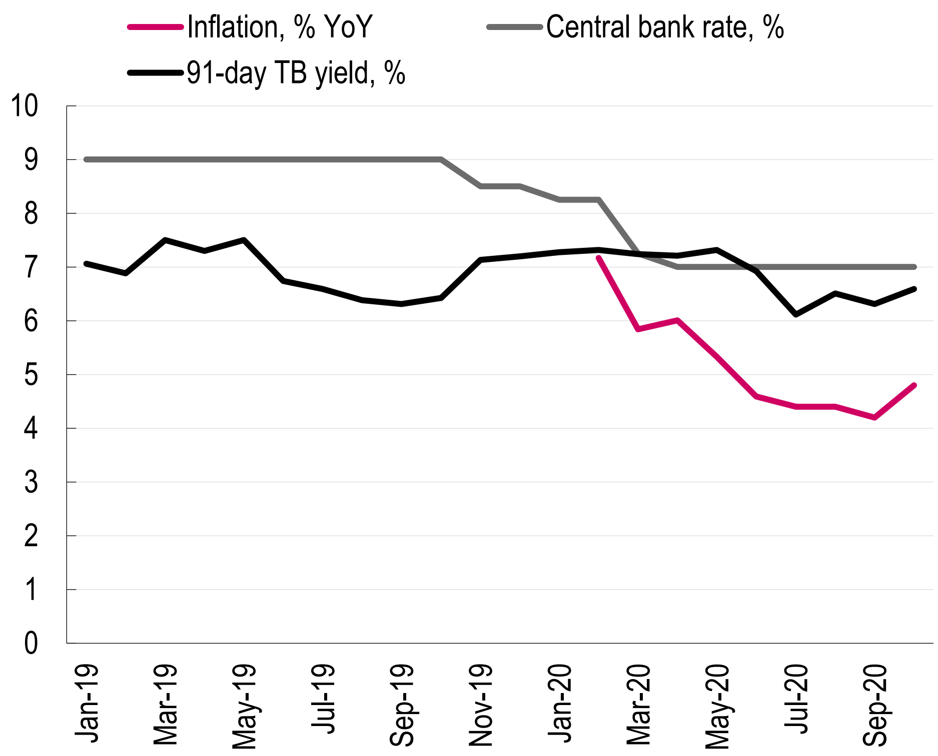
Figure 12: Kenya – inflation vs interest rates



- Kenya's YoY inflation ticked up to 4.8% in October, from 4.2% in September, after slowing for five months.
- Food inflation edged up to 5.8% YoY, from 5.2% YoY over the same period, after slowing for five months on the back of a good food harvest that followed a good rains.
- Transport price inflation was the outlier; it surged to 13.5% YoY in October, from 5.5% YoY in February.
- We expect inflation to remain in the low single digits in the short term, in large part due to favourable food prices.
- We believe this will enable the MPC to maintain its accommodative policy stance in this period. We expect the central bank rate to be kept at 7.0% at the MPC's 26 November meeting.

Inflation appears to have bottomed.

Kenya: strong shilling succumbs to depreciation pressure

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Figure 13: Kenya – official FX reserves

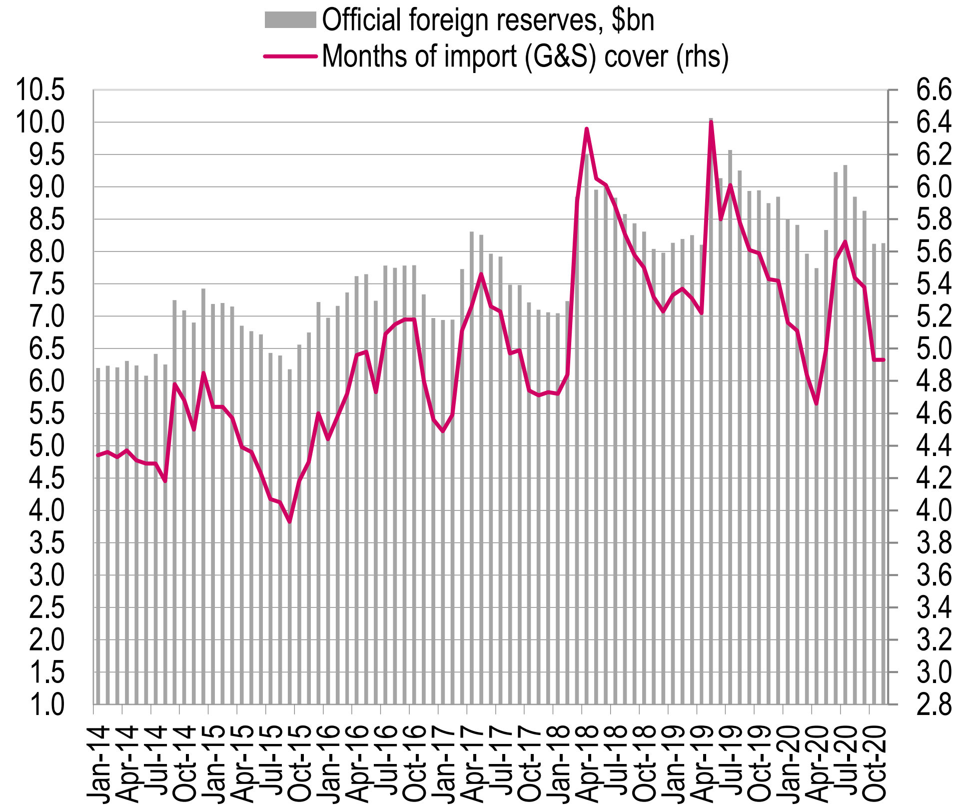
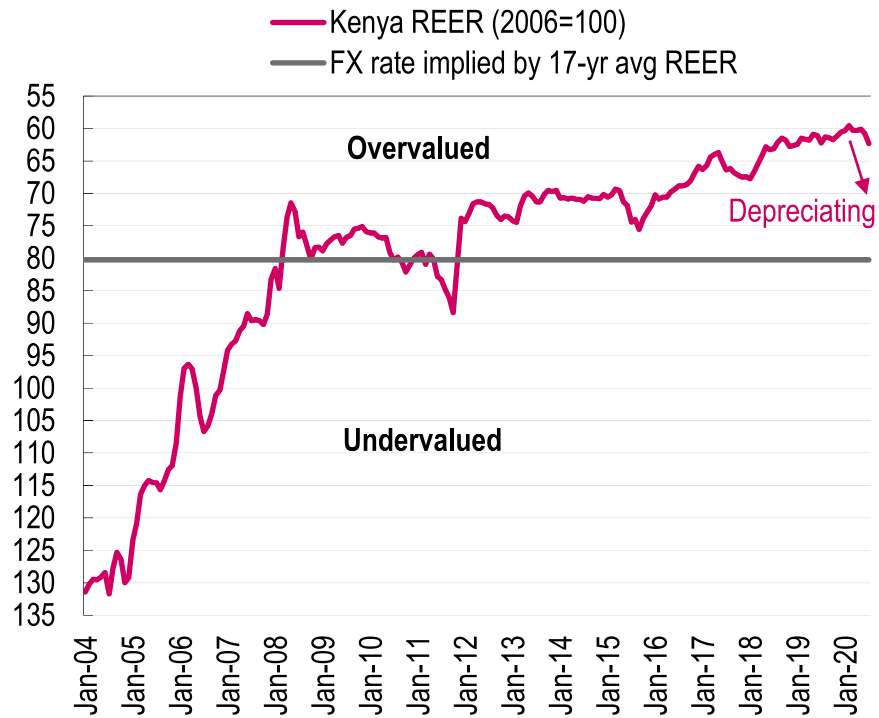


Figure 14: Kenya – REER vs fair value



The overvalued Kenyan shilling comes under pressure to depreciate.

Rest of SSA

Ghana: an unexpected soft landing

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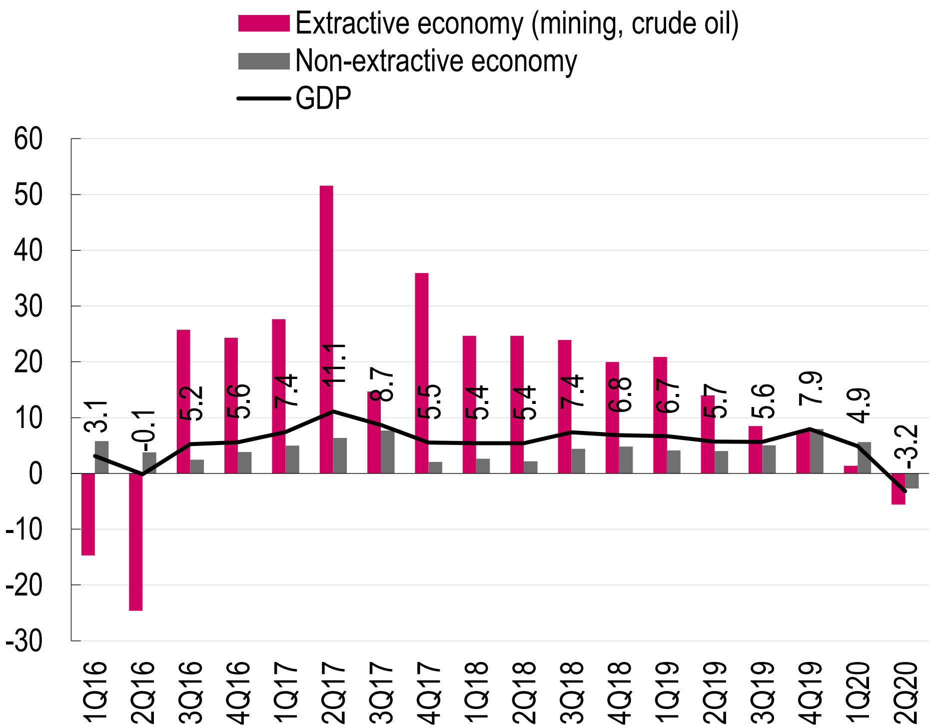
Figure 15: Ghana – real GDP growth



- Ghana's economy contracted by 3.2% YoY in 2Q20, vs 5.7% YoY growth a year earlier, and vs the Bloomberg consensus projection of -3.8% YoY.
- We think Ghana is turning out to have a softer landing than our Resilience score note suggested.
- Most sectors grew, only a handful – hospitality, trade, manufacturing and extractive – declined.
- We think Ghana's shallower-than-expected decline affirms our view that the economy will grow in 2020.
- Our growth forecasts are 2.0% in 2020 and 4.3% in 2021, respectively.
- We think the downside risk to the growth outlook is a stalling of the recovery in 4Q20 due to the 7 December general elections.

Ghana's soft landing may also be explained by the brief lockdown and measures taken by the authorities to mitigate the impact of the pandemic.

Rwanda: steep fall

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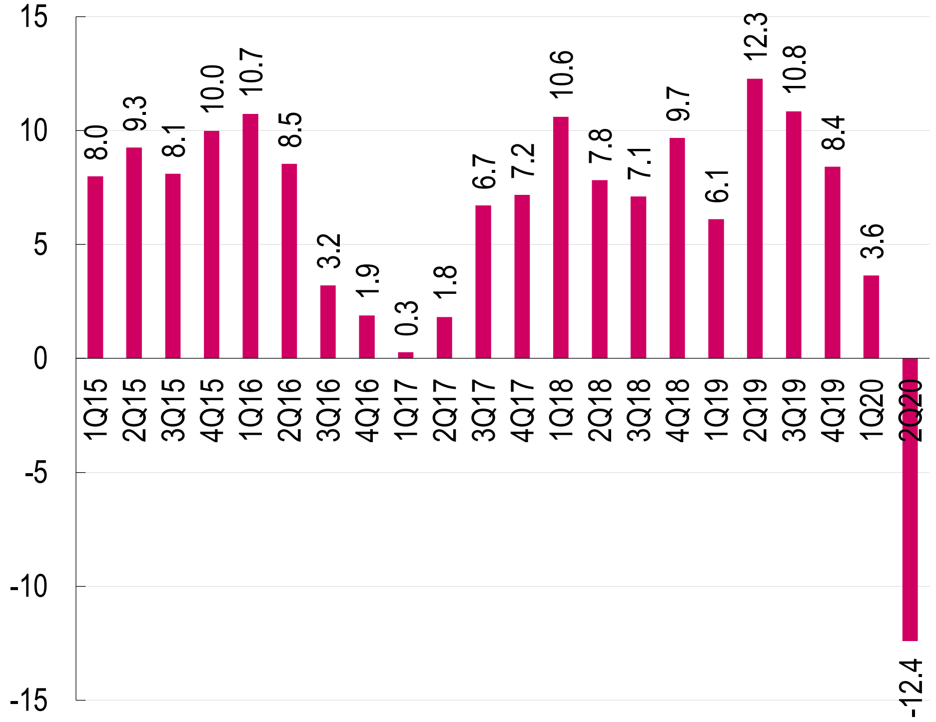
Figure 16: Rwanda – real GDP growth



- Rwanda's economy contracted by 12.4% YoY in 2Q20, vs 12.23% YoY growth in 2Q19. It is among a minority of SSA countries to record a double-digit fall in GDP in 2Q20. The other is South Africa. This is probably because both countries imposed arguably the most stringent lockdowns in SSA.
- Only a handful of sectors grew. Due to a sharper-than-expected decline, we revise down our 2020 and 2021 growth forecasts to -0.3% and 5.0% respectively, from 2.5% and 6.0% previously.
- Economic activity has started to show signs of recovery, according to the IMF, following a virtual mission to Rwanda in October. However downside risks are high.

We expect Rwanda be the exceptional East Africa economy that contracts in 2020, albeit modestly.

Zambia: economic downturn preceded COVID-19

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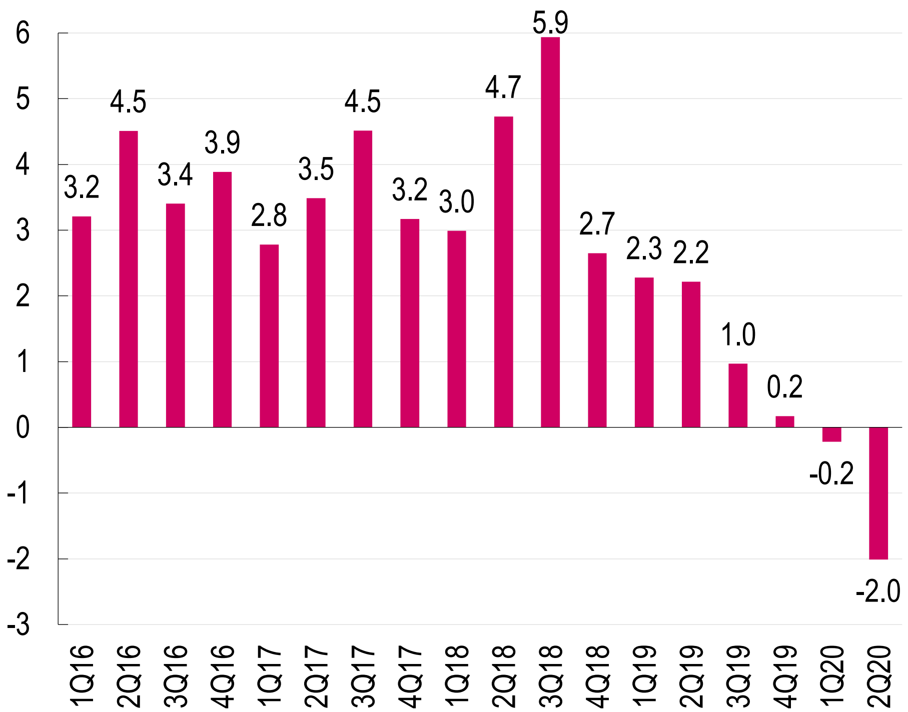
Figure 17: Zambia – real GDP growth



- Zambia's economy was on a downturn before the COVID-19 pandemic hit. The country's most recent GDP data reveal that the economy contracted by 2.0% YoY in 2Q20, vs growth of 2.2% YoY year earlier.
- The contraction was largely due to deep double-digit YoY declines in the wholesale and retail trade, construction, and accommodation and food services sectors.
- This was mitigated by growth in the mining, agriculture, communications, financial services, and transport sectors. Zambia's PMI suggests the economic downturn bottomed in May at 34.8 (below 50 indicates an economic decline).
- A nascent recovery began in June when the PMI rose to 42.3, and thereafter picked up to 46.6 in September, only slightly higher than March's PMI of 44.7. This suggests the economy was still in decline in 3Q20 .
- The government forecasts growth of at least 1.8% in 2021 (we estimate 2.3%).

A bad year for agriculture due to poor rains could delay a recovery, subdue government revenue, and put the FY21 deficit target at risk.

Inflation driven by supply disruptions

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Figure 18: Inflation, % YoY

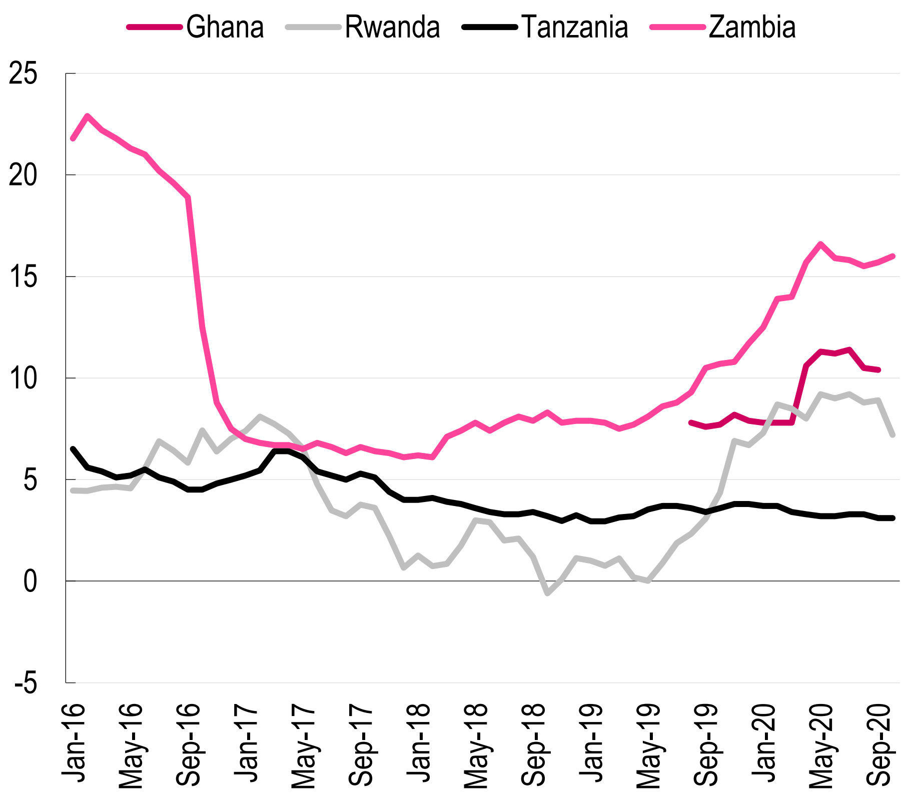
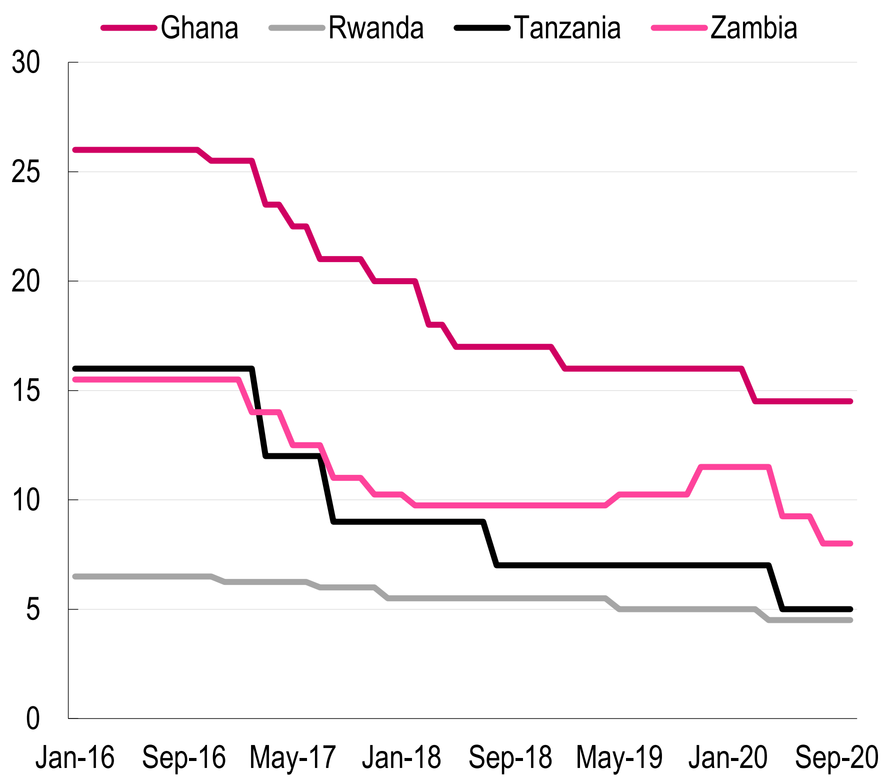


Figure 19: Policy interest rates, %



Monetary policy stances become more accommodative, despite inflationary pressures in Rwanda and Zambia.

FX – we like East African currencies, ex. KES

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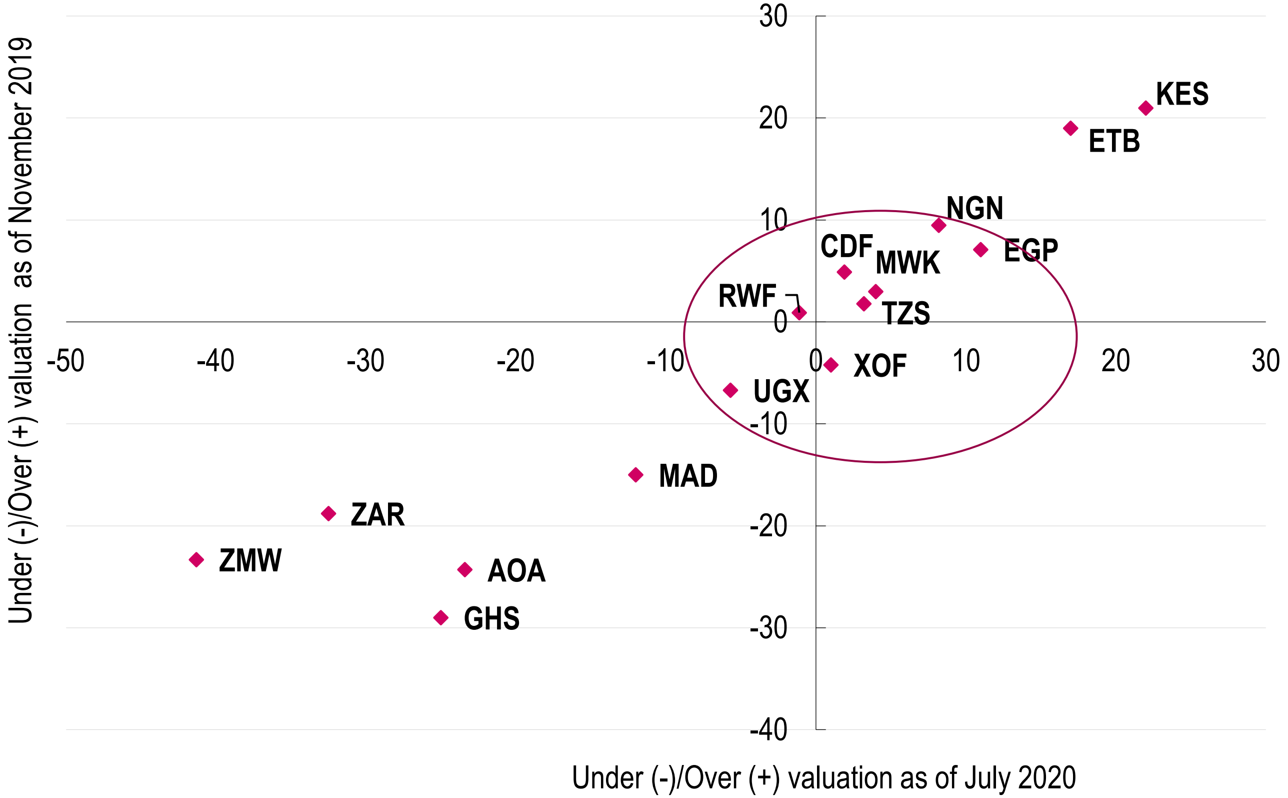
Figure 20: SSA – misalignment of currencies, % under(-) or over (+) valued



RenCap FX forecasts

	YE20	YE21
KES/$1*	106.0	112.2
TZS/$1	2,393	2,501
RWF/$1	1,000	1,053
NGN/$1	449	508
GHS/$1	6.14	6.61
ZMW/$1	22.50	24.76

*under review

East African currencies – RWF, TZS, UGX trade close to their fair values, which implies they have limited volatility

CONCLUSION

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SSA countries with sizeable agriculture sectors, low exposure to tourism and sizeable fiscal and household buffers will be see a swifter recovery.

1) Nigeria – the economy's recovery will be weighed down by weak consumption due to negative per capita income growth (real); and its low government revenue which implies limited fiscal space to stimulate growth.

2) Kenya – growth from the sizeable agriculture sector will counter the downturn in other sectors, including the hospitality sector, and support real GDP growth in 2020, and a swifter recovery in 2021.

3) Ghana – the government's high debt and wide budget deficit will weigh on growth.

4) Rwanda – the country's sizeable agriculture sector and decent per capita income growth in recent years supported a soft landing from the crisis. However, a stringent lockdown undermined growth.

5) Zambia – the country's relatively small agriculture sector, large budget deficit, high government debt and negative per capita income growth suggest a protracted recovery.

6) Tanzania – the sizeable agriculture sector, small budget deficit and low public debt support imply a soft landing and swift recovery.

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