S&P Global Ratings

Emerging Markets:

Sub-Saharan Africa's Still Down But Not Out

June 8, 2022

Key Takeaways

- **Sub-Saharan Africa (SSA) is struggling to return to prepandemic economic growth.** Commodity-fueled exports and investments should help reduce external imbalances and boost activity in commodity rich countries, notably Nigeria, Angola, and to a lesser degree South Africa. However, the rising cost of goods and services will hurt households across the region, especially in fuel and food-importing countries. The authorities and regulators will likely look to balance providing subsidies and other support measures against permitting price rises, while dealing with large fiscal deficits and sizable public-sector debt.
- **Rising global interest rates are pertinent risks for highly indebted sovereigns.** Increasing commodity prices are benefiting many key countries, but high debt burdens, elevated cost of debt, and limited fiscal flexibility remain a drag on sovereigns' credit quality, while rising food and energy prices, alongside a busy election cycle, will delay fiscal consolidation.
- **Sustained high commodity prices will keep most rated corporates resilient.** So far, the effect of the Russia-Ukraine conflict and China's slower economy has been moderate for most rated SSA corporates, largely because--as exporters--they benefit from the higher commodity prices, can offset rising costs, and have limited need to tap capital markets at present. Although country risk continues to weigh on credit quality, companies are showing solid deleveraging, with debt to EBITDA below the average for emerging markets.
- **Sound capitalization and profitability should shield banks in Nigeria and South Africa against adverse economic conditions.** Higher interest rates should lead to stronger net interest margins. That said, an extended period of high inflation could undermine asset quality.

This report does not constitute a rating action.

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(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of rating committees exercising their analytical judgment in accordance with publicly available ratings criteria.)

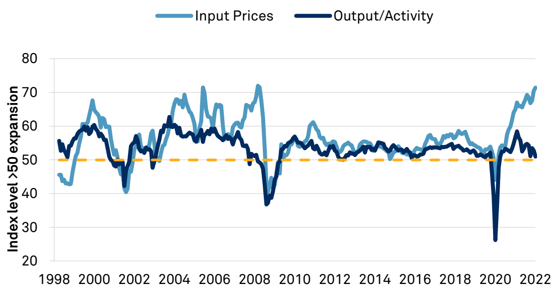
- SSA's recovery from the pandemic is lagging that in other regions, and the current global economic environment does little to change its course.
- Growth in many of the region's key countries (Angola, D.R. Congo, Ethiopia, Ghana, Kenya, Nigeria, and South Africa) remains short of pre-pandemic trends, and projected GDP growth rates appear insufficient to bring the economies back to their former trajectories (except for Kenya).
- High prices for primary energy and metals will help stoke investments and help reduce external imbalances, support currencies, and boost economic growth, notably in Angola, and to a lesser degree South Africa.
- Consumers across the region will start to feel the pinch of higher food and energy costs (net crude exporters have insufficient refinery capacity).
- High inflation will force regulators to walk a fine line between providing subsidies and other support measures, and raising prices at the pump, while the threat of rising interest rates amid the slow economic recovery could exacerbate the financing of sizable public debt.

The global economic environment is less conducive to growth today than just three months ago. What seemed to be promising growth momentum that held up despite a fourth wave of COVID-19 at the end of the year, faces a new shock from the Russia-Ukraine conflict. Combined with recent lockdowns in China, global business confidence has deteriorated, and existing supply chain issues and inflation trends have worsened (see chart 1). Furthermore, global financial conditions have tightened rapidly since the U.S. Federal Reserve pivoted to a "whatever it takes" hawkish stance to rein in inflationary pressures, which could further destabilize global growth.

Global shocks have compounded the challenges for the region's exports. Exports constitute a sizeable 28% of SSA's GDP (weighted average in our sample) of sub-Saharan economies (see chart 2). As of 2021 year-end, domestic demand had returned to its pre-pandemic level but export volumes continued to lag behind, for both goods and services (of which a sizable part is tourism).

Chart 1

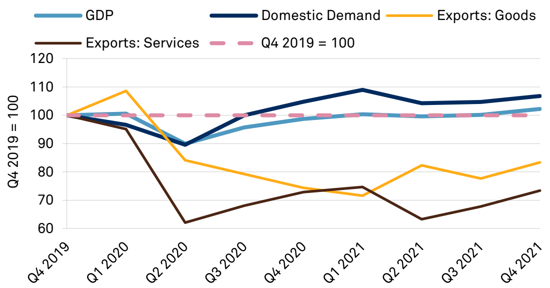
Global PMI: Firm Output Slows While Input Prices Rise



Source: S&P Global Market Intelligence, S&P Global Economics, Data through April 2022 Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

Chart 2

Local Demand's Recovered But Exports Still Fall Short

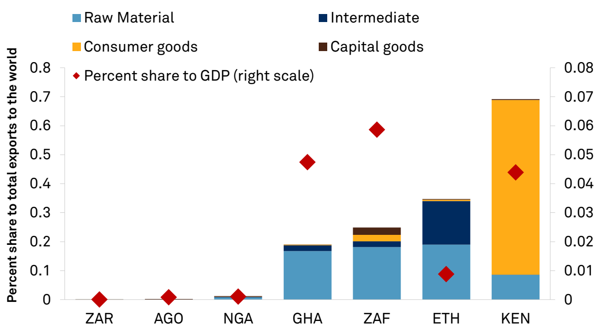


Source: Oxford Economics, S&P Global Ratings Calculations. Note: Representative sample includes South Africa, Kenya, Nigeria, and Ghana. Copyright © 2022 by Standard & Poor's Financial Services LLC. All rights reserved.

Although the fallout of the Russia-Ukraine conflict will boost commodity producers in a handful of economies--notably Angola and Nigeria--it will also cause economic pain to consumers across the region. While the region's direct trade linkages to Russia and Ukraine are limited (see charts 3 and 4), the conflict has prompted a surge in commodity prices by disrupting energy and food exports from Russia and Ukraine, key exporters of commodities ranging from cereals, energy, and fertilizers, to edible oil and metals. Even before the conflict, commodity prices had been on the rise (chart 5), and terms of trade improved last year in resource-intensive (according to the IMF's classification) countries (chart 6). With the ongoing conflict, they have climbed even higher, resulting in a windfall gain for some large crude oil exporters (Nigeria, Angola) and metal exporters (South Africa, Ghana, and DR Congo) but putting significant pressure on commodity importers.

Chart 3

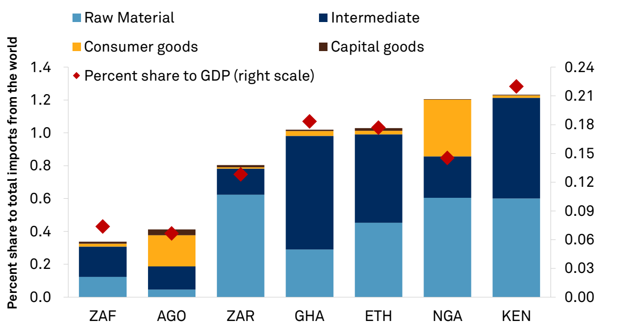
SSA Has Low Export Exposure To Russia And Ukraine



Sources: World Bank (WITS), Oxford Economics, S&P Global Economics; Note (1) Average of the annual ratios from 2017-2020

Chart 4

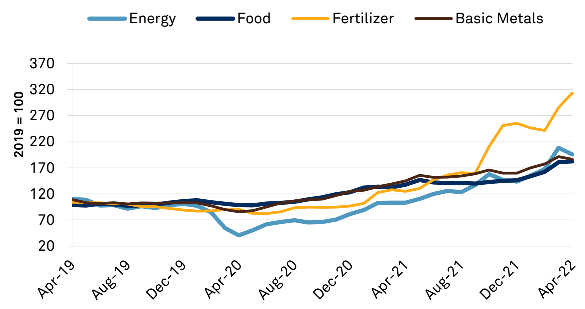
Direct Imports Exposure To Russia And Ukraine Is Relatively Low



Source: WITS (World Bank), S&P Global Economics; Note (1) Average of the annual ratios from 2017-2020

Chart 5

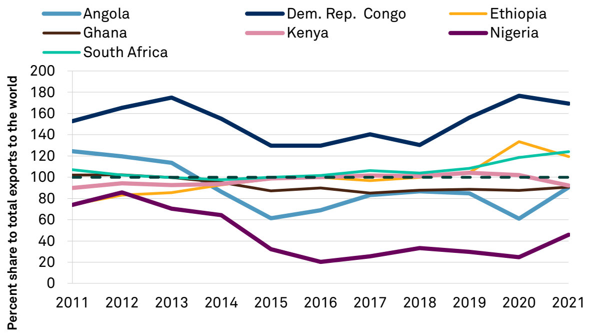
Commodity Prices Are Soaring



Sources: World Bank, S&P Global Economics

Chart 6

Terms Of Trade Picked Up Amid Commodity Price Boom



Sources: Oxford Economics, S&P Global Economics

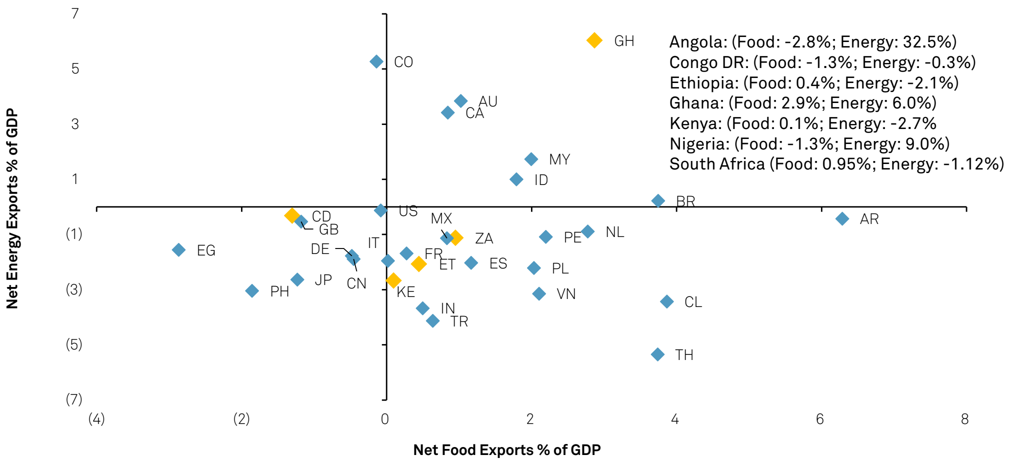
That said, problems with energy and transport infrastructure persist, preventing production and exports companies from fully capturing the potential windfall. Take South Africa, for example, where the key exports are coal, platinum group metals (PGM), gold, and iron ore (almost half of the country's merchandise exports) and global prices for them are elevated. Although mining export values increased by more than 45% in 2021, total volumes declined by about 2%. Stagnant real fixed investment by mining companies in recent years suggests that prospects for the sector's growth are limited in the near term. Angola and Nigeria are also struggling to increase oil export volumes, plagued by technical and other difficulties.

At the same time, higher food prices will hit consumers' wallets more acutely in SSA than in other regions. Commodities such as cocoa, coffee, tea, and cotton generally lead agricultural exports from economies in the region, keeping pace with agricultural imports (chart 7). However, SSA's top agri-imports are mainly staples such as wheat, maize, rice, soybeans, and other oilseeds, for which prices have risen due to tighter global supply stemming from the Russia-Ukraine conflict. Households in the region spend a greater share of their income on food. The median in SSA is about 43.5% of consumption (chart 8), which is substantially larger than in a typical advanced economy (15%) or major emerging markets (25%). Fertilizer prices have skyrocketed since the conflict started, which means food production costs have increased as well, possibly affecting upcoming planting seasons. Fuel is another major expenditure item (transportation services in chart 8). Add this to the equation, and SSA looks set to be hard hit by the recent surge in food and fuel prices. But the impact will extend far beyond headline consumer price inflation (CPI). Calls for subsidies will either be heeded, putting pressure on government budgets; or disregarded, resulting in social discontent.

While the cost of essentials has increased, unemployment in many SSA countries including South Africa, Nigeria, and Kenya are currently much higher than before the pandemic. Labor-intensive sectors such as tourism are trailing others in the recovery, and many small restaurants and retail businesses have been shuttered. This creates an environment vulnerable to unrest as fewer incomes are available to pay for more expensive essentials. South Africa and Ghana have already seen social unrest, and the threat of it looms in Kenya and Nigeria where elections are to take place in the next 12 months. Nigeria has delayed plans to scrap food and fuel subsidies, Kenya has extended fuel subsidies, and South Africa has temporarily cut fuel levies and extended pandemic-era grants.

Chart 7

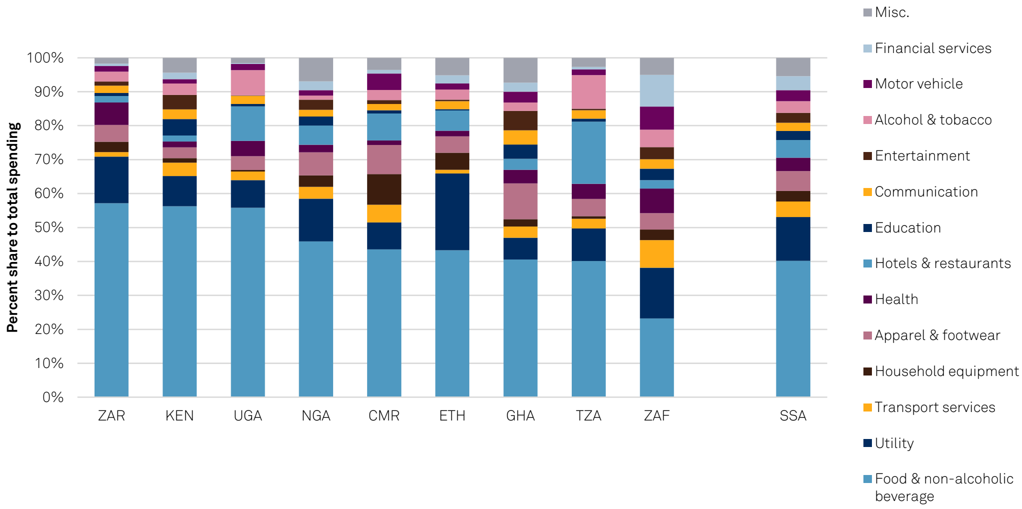
Food And Energy Trade Imbalance (% Of GDP) Appears Manageable For Net Importers



Source: ITC Trademap, WTO, Oxford Economics, S&P Global Economics; Note (1) The reference period is average of 2017-2020); (2) Angola and Nigeria are outliers that do not fit in the chart.

Chart 8

Food And Fuel Take Up A Large Share Of Consumer Baskets In Many Sub-Saharan Countries



Sources: S&P Global Market Intelligence, S&P Global Economics.

Real GDP growth in the seven key Sub-Saharan countries (we rate 18 in the region) is forecast to soften to 3.2% on aggregate for 2022-2024 following estimated 4.5% growth in 2021 (table 1). The weaker growth should be viewed in a global context, where world real GDP growth is expected to be almost half as much in 2022 as in 2021, with all major trading partners--the euro area and China--experiencing major downward revisions to their economic outlook. Consumer price index inflation is going to stay elevated and above central bank targets over the next three years, peaking in 2022 in most countries before gradually sliding back toward the targets.

Table 1

GDP Growth and Consumer Price Inflation Forecasts

	Real GDP Growth (%)						CPI Inflation (%)						Inflation Target (%)
	2017-2019	2020	2021	2022f	2023f	2024f	2017-2019	2020	2021	2022f	2023f	2024f	(mid-point)
Angola	(0.9)	(5.4)	0.7	2.3	2.5	2.8	**22.2**	22.3	25.8	23.0	15.0	12.0	
D.R. Congo	**4.6**	1.7	5.7	6.0	6.5	6.5	**23.9**	11.4	6.0	9.0	5.0	5.0	**7.0**
Ethiopia	**8.9**	6.1	6.3	5.0	6.5	6.5	**11.5**	19.9	20.2	26.0	22.0	16.0	
Ghana	**6.9**	0.4	5.0	4.9	5.1	5.1	**10.2**	8.7	10.0	16.0	12.0	9.0	**8.0**
Kenya	**4.8**	(0.3)	7.3	5.0	5.4	5.6	**6.0**	5.4	6.1	6.0	5.8	5.4	**5.0**
Nigeria	**1.6**	(1.8)	3.7	2.9	2.7	2.6	**13.3**	13.3	17.0	13.3	11.0	10.0	**7.5**
South Africa	**0.9**	(6.4)	4.9	1.8	1.6	1.7	**4.6**	3.3	4.5	5.8	4.4	4.8	**4.5**
Average for the seven countries	**2.5**	(2.3)	4.5	3.1	3.2	3.2	**10.8**	10.6	12.6	12.4	9.8	8.6	
Resource-intensive countries*	1.7	(3.4)	4.0	2.7	2.6	2.6	11.2	10.1	12.4	11.6	8.9	8.1	
Non-resource intensive countries	6.9	3.0	6.8	5.0	6.0	6.1	8.9	13.0	13.5	16.5	14.3	10.9	
Select Others													
U.S.	**2.5**	(3.4)	5.7	2.4	2.0	2.1	**2.1**	1.2	4.7	6.7	2.6	1.8	**2.0**
Eurozone	**2.1**	(6.5)	5.2	2.7	2.2	2.1	**1.5**	0.3	2.6	6.4	3.0	2.2	**2.0**
China	**6.5**	2.2	8.1	4.2	5.3	5.1	**2.2**	2.5	0.9	2.4	2.5	2.2	**3.0**
India	**5.7**	(6.6)	8.9	7.3	6.5	6.7	**3.9**	6.2	5.5	6.3	4.8	4.5	**4.0**

Source: S&P Global Ratings Forecasts, IMF. Note: (1) Aggregate growth is based on PPP weighted GDP share, (2) India GDP (fiscal year), (3) Ethiopia GDP (fiscal year July-June); (f) S&P Global Ratings Q1 2021 forecasts. Resource intensive countries are Angola, D.R. Congo, Ghana, Nigeria, and South Africa as per IMF classification.

Source: S&P Global Ratings Forecasts, IMF. Note: (1) Aggregate growth is based on PPP weighted GDP share, (2) India GDP (fiscal year), (3) Ethiopia GDP (Fiscal year July-Junr); (f) S&P Global Ratings Q1 2021 forecasts,

D.R. Congo is poised to be the growth leader with a 6% rise in GDP forecast for 2022 and 6.5% on average over the next two years. Angola, Kenya, Nigeria, and South Africa will all see growth well above their pre-pandemic averages. Growth expectations for major oil exporters (Nigeria and Angola) in 2022 have been revised up compared with the April and October 2021 forecasts, although security challenges and the technical complexity of oil blocks constrain oil supply.

Structural constraints, including energy shortages and a weak pace of economic reforms, will continue to constrain medium-term economic growth in the region. South Africa, which is already a major exporter of platinum group metals (PGMs), including rhodium and palladium--one of the rarest metals on earth--used in auto production, is attempting to increase its investments and exports to cover some of the sudden void of such metals from Russian supply either due to sanctions imposed on Russia or sourcing companies' purchasing decisions.

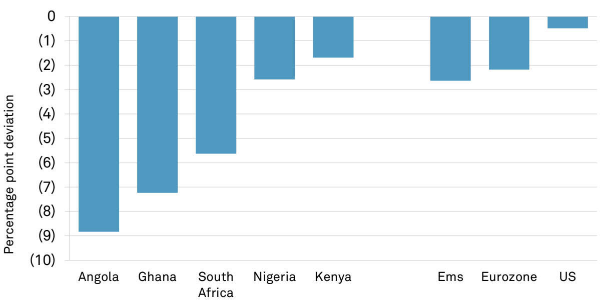
On per capita basis, resource-intensive countries Angola, Nigeria, and South Africa will show annual growth in 2022-2024, a welcome respite following contractions during 2016-2020. Meanwhile, Ghana and Ethiopia would likely disappoint relative to their pre-pandemic averages, albeit clocking in relatively higher growth rates than their regional peers. Growth should be at a sustainable pace of 2.6% and 6.0% respectively on average for resource intensive and non-resource intensive countries. We see more downside than upside potential for our baseline scenario however.

The recovery has so far been stronger than expected but will likely fall short of pre-pandemic trends. Growth in 2021 came in stronger than we anticipated last April for all seven countries in our sample, standing out were Ethiopia (despite shocks from the pandemic, conflict, and locust infestation) and South Africa (multiple COVID-19 waves and social unrest in the second half of the year). Kenya's was also much better than expected, but this was partly an artifact of the rebased economy, to reflect its size and structure more accurately (which led to other sectors diluting the contribution of the agricultural sector). Nigeria saw stronger-than-expected manufacturing and agriculture sectors, as well as favorable oil prices.

Still, growth in the region remains behind the pre-pandemic trend (chart 9), and projected growth rates are not high enough to return the economies to their former trajectory (chart 10). The seven key SSA economies will be 7.8% smaller by the end of 2024 than indicated by the long-run trend before the pandemic. Kenya will continue to close the gap to the pre-pandemic (2011-2019) trend in the coming quarters, perhaps even avoiding permanent loss. D.R. Congo is also expected to start catching up but is still about 4 percentage points below trend. Shortfalls from pre-pandemic trend in South Africa, Nigeria, and Angola are poised to stay generally the same, while Ethiopia and Ghana will likely see theirs widen in the next two years.

Chart 9

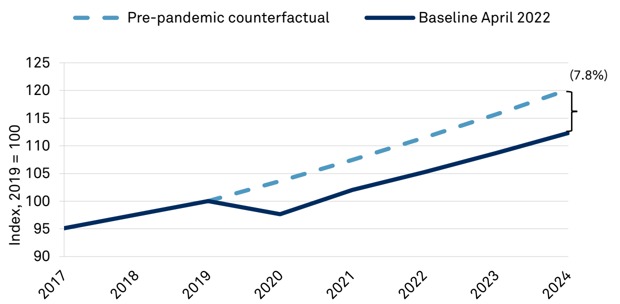
Real GDP Growth Deviated From Trend In Q4 2021



Source: Oxford Economics, S&P Global Economics.

Chart 10

Sub-Saharan Africa's Real GDP Will Lag Prepandemic Trend



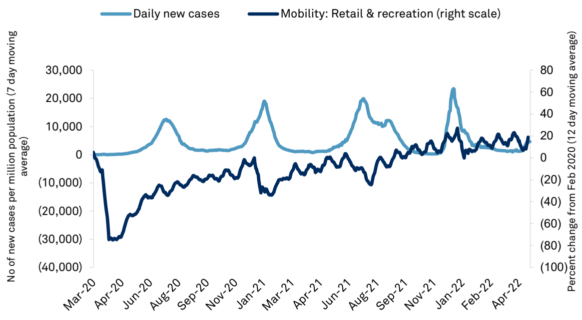
Sources: S&P Global Ratings, Oxford Economics, S&P Global Economics; Note (1) Aggregate GDP is based on GDP PPP Weights; (2) Counterfactual GDP is calculated based on average of real and potential GDP growth between 2011-2019.

COVID And Disruptions To Global Activity Cloud Our Baseline Forecasts

We assume the economic cost of further COVID-19 waves will keep falling, although the risk of new variants cast a shadow over our base case. The omicron variant has proved less severe than anticipated, with fewer deaths and hospitalizations. More importantly, it had only limited impact on the region's economy (chart 11). That said, although the COVID-19 vaccination campaign has accelerated in the last six months, the vaccinated population remains well below the 70% target proposed by the World Health Organization, and far from vaccination rates in the rest of the world (chart 12). Against this backdrop, we remain wary that new variants could thwart SSA's economic prospects.

Chart 11

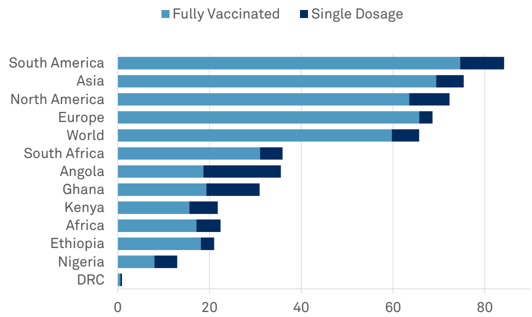
SSA COVID-19 Cases And Mobility



Source: Ourworldindata.org, S&P Global Economics, Data as of May 18, 2022.

Chart 12

COVID-19 Vaccination Per Hundred People (May 18, 2022)

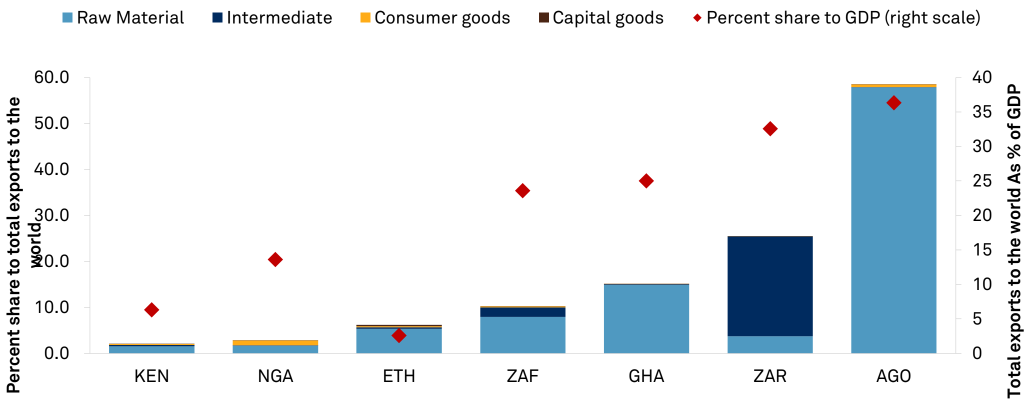


Source: Ourworldindata.Org, S&P Global Economics.

A sharper-than-expected slowdown in China's industrial sector from new COVID-19 lockdowns is a key risk to our growth forecasts in the near term. This is especially salient for raw materials exporters, either because of the direct impact of lower demand from China (chart 13) or indirectly through weakened commodity prices. Given China's current COVID-19 stance, a broader spread of omicron could lead to more lockdowns and consequently pose risks to demand from Chinese consumers, industrial production, and global supply chains. Apart from this, a persistent slowdown in the world's second-largest economy (beyond the near term from lockdowns) would also mean lower global growth. If the pandemic has taught us anything, it is that interdependent and complex supply chains globally mean that small disruptions in one region can amplify problems elsewhere, and a significant supply shock can lead to an even greater demand shock.

Chart 13

Sub-Saharan Africa's Exports Exposure To China By Product



Source: WITS (World Bank), S&P Global Economics; Note (1) Average of the annual ratios from 2017-2020

S&P Global Ratings

Sovereigns

Key Selected SSA Sovereign Profiles

- Rating trends are mixed for key selected countries, namely Angola, Democratic Republic of Congo (D.R. Congo), Ethiopia, Ghana, Kenya, Nigeria, and South Africa, reflecting the delayed impact of COVID-19 on metrics and, more recently, commodity price rises and inflationary pressure linked to the conflict in Ukraine.
- Angola and D.R. Congo were both upgraded this year (see table 2), while we revised the outlook on our rating on South Africa to positive in view of reform momentum and fiscal consolidation, albeit supported by commodity exports.
- Ethiopia, Kenya, Nigeria, and Ghana were all downgraded during the pandemic reflecting fiscal and external pressures, toughening financing conditions, or political instability.
- We expect most of the seven countries will continue facing fiscal pressure made worse by spillover from the pandemic, rising food and energy prices, and the worsening external and fiscal-financing environment tied to the war in Ukraine, with global interest rates increasing. Large commodity exporters and those on a fiscal reform path are likely to fare better.

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Table 2

Sovereign Ratings Mixed Performance

Country (FC Rating)	12/31/2019	12/31/2020	12/31/2021	As of June 2022
Angola	B-/Negative/B	CCC+/Stable/C	CCC+/Stable/C	B-/Stable/B
D. R. of Congo	CCC+/Positive/C	CCC+/Stable/C	CCC+/Positive/C	B-/Stable/B
Ethiopia	B/Stable/B	B/Negative/B	CCC/Negative/C	CCC/Negative/C
Ghana	B/Stable/B	B-/Stable/B	B-/Stable/B	B-/Stable/B
Kenya	B+/Stable/B	B+/Negative/B	B/Stable/B	B/Stable/B
Nigeria	B/Stable/B	B-/Stable/B	B-/Stable/B	B-/Stable/B
South Africa	BB/Negative/B	BB-/Stable/B	BB-/Stable/B	BB-/Positive/B

Source: S&P Global Ratings

Angola (B-/Stable/B)

The government's reform program, higher oil prices, and debt relief on some official debt are reducing Angola's immediate liquidity risks. We expect that economic recovery and lower currency depreciation relative to 2018-2020 will support a continued decline of government debt.

The upgrade on Feb. 4, 2022, reflected our assessment that risks to Angola's debt repayment have decreased in light of better-than-expected improvement in debt metrics, a track record and expectation of fiscal prudence, and a more supportive external environment. As effects of the COVID-19 pandemic abate, the country is seeing the gains of difficult reforms implemented in previous years and under the IMF program over 2018-2021, including exchange rate liberalization, the introduction of the value-added tax, and spending rationalization. Angola has delivered primary surpluses averaging 6.5% of GDP over the past four years, and we expect they will average 4% over 2022-2025. Government debt fell sharply to an estimated 75% of GDP in 2021, down more than 55 percentage points from 2020. The dramatic decrease was helped by an 18% year-on-year appreciation in the exchange rate as of year-end 2021, along with a substantial rise in nominal GDP and oil revenue thanks to higher oil prices. This reverses much of the 67 percentage point increase in debt over 2017-2020 that was largely the result of currency depreciation of nearly 75%.

We expect that ongoing fiscal reforms and lower exchange-rate depreciation will help government debt gradually moderate to 64% of GDP by 2025. Still, debt could stop declining or reduce by less than we expect if socioeconomic pressure, elections in August 2022, or the end of the IMF program (ended in 2021), lead to slippages or delays in planned fiscal measures. The recovery of oil prices in 2021 benefited Angola, given its reliance on the sector. Oil plays a dominant role in the country's economy, contributing more than 25% of GDP, 95% of exports, and 50% of fiscal revenue.

The pandemic and long-standing declines in oil production continue to weigh on Angola's economic performance. Oil production is about 750,000 barrels per day or 40% below peak oil production in 2008, and 20% below the 2019 pre-pandemic level. Over the past several years, multinational investors in the oil sector have taken profits on their past investments via dividends, leading to additional external pressure. Our ratings on Angola remain constrained by the government's high external debt-servicing burden over our forecast horizon through 2025. External interest and principal payments will average more than $6 billion annually (5%-6% of GDP) over 2023-2025. Angola's restructuring of bilateral debt with Chinese lenders over 2020-2022, and G-20 members as part of the Debt Service Suspension Initiative in 2020-2021, provided room to service commercial debt during a time of multiple external shocks.

Democratic Republic of Congo (B-/Stable/B)

D. R. Congo's balance of payments vulnerabilities have moderated, notably due to strong copper and cobalt mining sector performance and sizable funding from the IMF. Continued mining sector production expansion, a favorable terms of trade outlook, and ongoing and announced reforms by the government also underpin stronger economic growth prospects. Despite a notable improvement over the past year, we consider that the country's domestic political and security situation remains fragile, particularly in the context of the upcoming 2023 election.

The upgrade on Jan. 28, 2022, primarily reflected what we view as D.R. Congo's moderating external imbalances, with foreign currency reserves increasing more than expected to an estimated $3.5 billion at year-end 2021 from less than $800 million a year previously, underpinned by higher prices for copper and cobalt as well as funding from the IMF. In our view, D.R. Congo's economic prospects are also stronger, on the back of expected expansion in mining output and relatively high commodity prices. The government's announced focus on structural reforms and the recently approved IMF program, which should catalyze extra donor support, should bolster economic performance.

Although they have moderated, we still view D.R. Congo's economic and external vulnerabilities as elevated, which constrains the sovereign ratings. Of all sovereigns we rate, D.R. Congo has the second-lowest GDP per capita, behind only Mozambique. Its economy remains narrow and concentrated on the mining sector, leaving it vulnerable to swings in the terms of trade and global pandemic developments.

We continue to see a number of risks to domestic political stability. The current governing coalition contains 24 parties with frequently different positions, complicating consensus policymaking. D.R. Congo is heading toward presidential elections in 2023, which could generate additional uncertainty, as was the case during the disputed 2018 election. The domestic security situation remains a concern, with increasing armed attacks on civilians in eastern D.R. Congo, some of which have involved foreign militias such as the Allied Democratic Forces.

Ethiopia (CCC/Negative/C)

Parliament's recent lifting of the nationwide state of emergency and declaration of a unilateral truce with the Tigrayan forces signals a relative easing of civil tensions. Even so, the current focus on security issues has come at the cost of further delays on the delivery of reforms, and other prior actions required for the IMF to agree to a new Extended Credit Facility (ECF). Without a new ECF, progress on the restructuring of Ethiopia's official debt under the Common Framework appears to be at a standstill. Meanwhile, the country is facing a terms-of-trade shock via rising energy and food prices alongside its recent loss of duty-free export access under the U.S.' African Growth and Opportunity Act, further straining the government's ability to service its commercial debt obligations. The authorities' decision to finance rising fiscal deficits via the domestic bond market at negative real interest rates appears to be heightening currency and inflationary pressure.

Ethiopia's parliament voted to lift the nationwide state of emergency two months early, in February 2022, and declared a unilateral truce with the Tigrayan forces to permit food aid into the northern region in March 2022, signaling a relative easing of tensions and the government's political willingness to initiate mediation talks with the rebels. This truce follows the rapid intensification and geographic spread of the conflict in November 2021, which saw the Tigray People's Liberation Front and a coalition of opposition forces capture strategic towns in the Afar and Amhara regions and attempt to descend toward the capital of Addis Ababa. While recent reconciliation attempts mark a major turning point in the 16-month conflict, in our base-case scenario, we assume the economic, fiscal, and external situation will remain fragile until the conditions for a political resolution become more apparent.

The Ethiopian government approved a supplementary budget of 122 billion birr (2.5% of GDP) in January 2022 to address higher-than-budgeted humanitarian, security, and rehabilitation needs triggered by the conflict. While the government expects the total impact on the deficit will be partially neutralized through a reprioritization of capital expenditure, we project this additional spending pressure and existing revenue shortfalls will contribute to the fiscal deficit widening to 4.0% of GDP from a budgeted 2.7% for the fiscal year ending July 7, 2022 (fiscal 2022). Similarly, we assume ongoing disruptions to the government's reform agenda, including the recent suspension of the bidding process for the second telecoms license and the sale of a minority stake in Ethio Telecom, will continue to present domestic debt-servicing issues for state-owned enterprises (SOEs). We understand that the Liability and Asset Management Corp., the administrator of SOEs' government-guaranteed domestic debt, has recently missed payments owed by the railways, sugar, and electric power corporations to the Commercial Bank of Ethiopia, which, if they remain unpaid, could pose additional contingent liability risks to the government.

We project Ethiopia's external vulnerabilities will mount because the country has lost its duty-free access to the U.S. market under the African Growth and Opportunity Act and is experiencing the impact of rising commodity prices due to the Russia-Ukraine conflict. Ethiopia sources about 16% of its imports from Ukraine, primarily wheat, capital goods, and metal products; and remains a net importer of energy and cereals (30% of total exports). In the face of this external stress, the government is likely to cut nondiscretionary imports (such as nonmilitary capital goods) to preserve rapidly depleting FX reserves, which cover less than two months of imports.

Separate from the conflict, Ethiopia approached bilateral lenders for debt relief via the G-20 Common Framework in February 2021 to restructure some of its official bilateral debt. While a 12-country external creditor committee co-chaired by China and France convened to discuss the terms of the debt restructuring in September 2021, we understand that negotiations have stalled until Ethiopia signs a new ECF with the IMF. The new ECF program, which will replace the country's original $2.9 billion joint ECF-Extended Fund Facility arrangement, of which the ECF portion lapsed in September 2021, will dictate the parameters of the final debt restructuring agreement. It remains unclear as to when this process will be finalized, and whether private creditors, including Eurobond holders, will be expected to participate in accordance with the Common Framework's comparability of treatment clause.

Our sovereign credit ratings reflect our view of a sovereign's capacity and willingness to service its scheduled commercial obligations. Therefore, we would consider private sector participation under the Common Framework a default event under our sovereign criteria (see "Beyond DSSI: S&P's

Perspective On The G20 Common Framework For Debt Relief," published Feb. 17, 2021, on RatingsDirect).

Ghana (B-/Stable/B)

Ghana is trying to consolidate its large fiscal deficits. In January 2022, the authorities announced a 20% cut to spending, excluding interest and wages, likely creating fiscal savings this year of at least 1% of GDP. We project that government revenue including grants will increase to 17.2% of GDP by year-end 2022 versus 14% before the pandemic, reflecting the introduction of new taxes, including this year's pending electronic transactions levy. Fiscal tightening will lead to slightly slower GDP growth of about 4.2% in 2022 versus 5.0% in 2021, before accelerating again and averaging just under 5% in 2021-2024. If the planned fiscal measures bear fruit, we project that net general government debt will stabilize at 77% of GDP this year, before gradually declining to 75% in 2025.

Our ratings are supported by Ghana's solid growth prospects--with real GDP growth projected to average close to 5% per year over 2022-2025--as well as its relatively transparent and responsive political institutions and largely market-oriented economy. Since 2005, per capita GDP in dollar terms has more than doubled, reaching a still low $2,373 in 2021, with growth per person over the past 15 years averaging 3.5%. Ghana is one of the most open economies in Africa, with exports equal to one-third of GDP. The largest two sectors, mining and hydrocarbons, account for about 70% of all exports. Because of Ghana's relatively diversified commodity base of gold, oil, and cocoa, its terms of trade have remained fairly stable, with a 10-year average standard deviation of 3.4%. We expect these offsetting trends could continue over the medium term.

Our sovereign ratings on Ghana remain constrained by weak public finances, although recent commitments by the governing party to impose a 20% cut to discretionary spending will, under our projections, reduce expenditure by over 1% of GDP during 2022. This implies a 2.8 percentage point narrowing of the headline cash general government deficit to 9.4% of GDP in 2022, including arrears payments of 0.4% of GDP and energy sector transfers of 1% of GDP (versus the government's projection of 7.9% of GDP for the overall cash deficit). From the second quarter of 2022, the authorities began collecting a new electronic transactions tax, which will apply to mobile money payments, bank transfers, merchant payments, and remittances. It is difficult to project precise revenue linked to a new tax, but financial transaction taxes have proved reliable sources of revenue in other emerging markets, particularly in Latin America.

However, Ghana's debt ratio remains acutely vulnerable to exchange rate movements, as well as growth, or terms of trade shocks. External general government debt, including nonresident holdings of domestic debt, is equivalent to 44% of GDP, according to our estimates.

An even greater concern is the cost of financing debt, at an estimated 47% of government revenue (the government's estimate is lower at 38%), the second highest level of interest spending globally after Sri Lanka. Cutting the cost of debt is likely to require a decade of fiscal tightening, in combination with reforms to boost domestic savings and attract more nondebt sources of external financing. Fiscal tightening remains challenging from a political perspective, given Ghana's short election cycles and the narrowness of the current administration's parliamentary majority.

Kenya (B/Stable/B)

Kenya's already high government debt-service burden and external debt metrics have been exacerbated by the pandemic and we expect external financing requirements to remain substantial. Nevertheless, we expect fiscal consolidation, aided by an IMF program, to result in slower accumulation of government debt over the forecast period.

The COVID-19-related economic shock led to a widening of Kenya's fiscal deficits in the 2021 and 2022 fiscal years (ending June 30) and increased general government debt by 12 percentage points between 2019 and 2022 to 62% of GDP. Supported by a $2.4 billion 38-month IMF program signed in April 2021, we expect a slow reduction of Kenya's fiscal deficits and a stabilization of debt levels. We project that the general government deficit will stand at 8.1% of GDP in fiscal 2022, before falling to 6.8% in fiscal year 2023 and 5.8% in fiscal year 2024. We forecast that general government debt, net of liquid assets, will average 64% in fiscal years 2022-2025.

Our ratings on Kenya are constrained by the country's low GDP per capita, relatively high fiscal deficits and debt, and a history of strong ethnic loyalties, sometimes leading to tensions. The ratings are supported by Kenya's dynamic private sector and diversified economic base, including its large diversified agricultural and services sectors relative to peers, which should help cushion its economy and support a rebound. Kenya also benefits from flexible monetary settings, supported by its relatively deep and dynamic domestic capital markets, with the market capitalization of its local currency debt at over 25% of GDP, and a relatively developed institutional framework compared to peers.

Elections are set to be held on Aug. 9, 2022, during which the incumbent president, Uhuru Kenyatta, will have to step down after completing the maximum two terms permitted under the constitution. Mr. Kenyatta has thrown his support behind long-standing opposition leader Raila Odinga, who will face tough opposition from current deputy president William Ruto. Nevertheless, the economic policy positions of both leading candidates are not so different, with both pledging to maintain Kenya's private-sector-led economic structure, while continuing to attempt to contain fiscal deficits and invest in infrastructure. Mr. Kenyatta had last year tried to enact significant constitutional reform proposals under the "Building Bridges Initiative" (BBI). The BBI aimed at switching from a winner-takes-all constitutional system to a more balanced share of power, with the creation of the post of prime minister; the creation of more constituencies; further devolution (with the associated fiscal costs of larger transfers to counties); and a greater role for the opposition leader. However, the proposals were struck down as unconstitutional by both the High Court in May 2021 and then by the Court of Appeal in August, and therefore the election will go ahead under the existing constitutional rules. Kenya's institutions benefit from stronger checks and balances than many other African peers, but ethnic loyalties remain strong, and at times have led to tensions. Judicial reforms implemented over the last decade have substantially enhanced the independence and strength of the judiciary, which even ordered a rerun of the 2017 election.

Nigeria (B-/Stable/B)

Higher oil prices and a rebound across most non-oil sectors are supporting an economic recovery. However, structural bottlenecks, foreign exchange (FX) shortages, and security issues remain significant, while elections loom in February 2023. Campaigning has begun in the run-up to the spring 2023 elections, during which current president Mohammadu Buhari will stand down since he has completed the maximum-permitted two terms. Nigeria's now-established democratic and federal system helps distribute finite resources and assimilates differing views and cultures into the political structure, but makes reform implementation and tax collection more difficult. The launch of a large 650,000 barrel per day refinery in 2022 should support GDP growth and the government's fiscal and balance-of-payments positions, while the implementation of the long-awaited Petroleum Industry Act, passed in 2021, should, over time, support investments in the oil sector, but Nigeria will still struggle to raise oil production levels.

FX shortages, a policy of import substitution, very low revenue, and a consequently high debt service as a share of revenue will continue to curb fiscal and external flexibility over the next few

years. The still-tightly-managed exchange rate will also constrain growth prospects. Fiscal flexibility is limited by low revenue as a percentage of GDP--even by regional standards--and the resultant high interest bill as a percentage of general government revenue. Postponing the removal of petroleum subsidies and other significant fiscal consolidation efforts until 2023 will affect 2022 fiscal metrics but consolidation should begin after the 2023 elections.

A still-tightly-managed exchange-rate regime and high inflation constrain growth and limit the effectiveness of monetary policy transmission, while the banking sector remains vulnerable to asset quality problems. Improving current account receipts, recent special drawing rights allocations from the IMF, and the $4 billion Eurobond issued last year all supported Nigeria's FX reserves in 2021 and we expect reserves to rise slightly during 2022-2025. Continued (albeit reducing) uncertainties, OPEC+ oil production quotas, and security issues will continue to pose risks to Nigeria's GDP growth and fiscal and external metrics. Instability, kidnappings, and banditry across many regions have been rife in the past few years, weighing on economic activity, but increased security-related expenditure in recent budgets should lead to fewer incidents.

A recovery of GDP growth and the ongoing expansion of the non-oil tax base leads us to forecast the consolidated general government (center and states) fiscal deficit to fall slightly to 5.7% in 2022, from 6.1% in 2021, before averaging 4.6% in 2023-2025. Nevertheless, an extension of fuel subsidies until the end of 2022 will hit the fiscal 2022 out-turn, postponing meaningful consolidation until after the elections in 2023. Relatively high oil prices will likely see the current account surplus average 1.2% in 2022-2025. External financing gaps could emerge if oil price dynamics weaken or if funding from official lenders or commercial sources is not as forthcoming as anticipated. That said, a deep domestic market should support fiscal financing.

Nigeria's heavy reliance on oil revenue and exports makes it susceptible to volume volatility (operational and security issues or OPEC production quotas can limit production) or a drop in oil prices. Security incidents (across both the oil-producing Niger Delta and the wider non-oil sectors of the economy) along with technical and maintenance issues in the hydrocarbon sector have previously weighed on Nigeria's growth and investment outlook. Uncertainties related to the outcome of the Spring 2023 general elections could lead to investment being postponed and further dampen investor sentiment.

South Africa (BB-/Positive/B)

Recent favorable terms of trade in South Africa have improved the external and fiscal trajectory, while the country's reasonably large net external asset position, flexible currency, and deep domestic capital markets provide strong buffers against shifts in external financing. We expect South Africa to post a current account surplus in 2022 (though smaller than in 2021) for the third consecutive year, as prices for key metals and mining exports have risen significantly since the start of the Russia-Ukraine conflict. Higher-than-expected tax revenue, particularly from mining companies, will help reduce the fiscal deficit and debt as a proportion of GDP relative to our previous expectations. However, supply and logistical constraints, along with growth slowdown in China and higher oil prices, could limit the upside to growth and fiscal position to some extent. Fiscal risks emanating from ongoing wage negotiations, further extensions of the Social Relief of Distress (SRD) grant, and materialization of contingent liabilities could increase the government's fiscal imbalances.

Structural constraints, including energy shortages and infrastructural bottlenecks will continue to limit medium-term economic growth. We expect the government will make some progress at tackling structural issues, as well as governance issues at government-related entities (GREs). However, social pressure will remain high, given growing public discontent over high unemployment and inequality and weak delivery of basic services, in our view.

Nevertheless, higher commodity prices are allowing some immediate fiscal headroom. In May 2022, we revised up our fiscal forecasts through 2025 to reflect higher revenue growth, although spending could exceed our projections and overall debt continues to rise. South Africa is a net external creditor, and we expect it will post current account surpluses again this year and next. We consider South Africa's monetary flexibility, freely floating exchange rate, and deep financial markets to be significant credit strengths.

Fiscal consolidation efforts are centered on containing growth in spending, including through cuts in public-sector wages via a planned freeze of public-sector pay and limiting additional support to GREs. The government projects stabilization of debt at 75.1% of GDP by fiscal 2024. Our forecasts are more conservative than the authorities' because we incorporate some slippage on spending. The recent floods will also likely have some fiscal impact in terms of higher reconstruction costs and lost revenue. We estimate a fiscal deficit of 6.2% of GDP in fiscal 2022, falling to an average deficit of 5.2% over fiscal 2023-2025.

Risks to the fiscal outlook are on four fronts: settling at higher wages than currently provisioned, an extension or a permanent inclusion of the SRD grant, increased support to weak GREs, and higher-than-projected borrowing costs. In the context of rising costs and a wage freeze in base salaries since 2020, it is unlikely that public unions will accept below-inflation increase in wages, in our view. There is rising political pressure for the government to introduce a basic income grant to replace the SRD, with demands to also increase the grant closer to the food poverty line. We estimate that these measures could add about 0.8-1.2 percentage points of GDP to spending. However, the National Treasury has emphasized that any permanent increase in spending will be accompanied by revenue measures.

Another key fiscal challenge is that interest expenditure is structurally high, limiting fiscal flexibility, while also cementing large interest payment outflows to non-residents abroad. We could see pressure building on debt yields given the current risk-off sentiment toward emerging markets amid monetary tightening by the U.S. Federal Reserve, geopolitical tensions in Europe, and a spike in domestic debt maturities from 2022. We forecast that interest payments will average above 18% of government revenue over the next four years. We expect that general government debt as a percentage of GDP will rise to 77% in 2025, from 69% in 2021. That said, recent improvements in the fiscal deficit and increased cash balances have helped reduce the need for treasury bill issuances in the domestic market. Government debt denominated in foreign currency remains lower than 10% of total debt, limiting the sensitivity of debt levels to changes in currency values.

Corporate Sector

SSA Corporates' Fate Links To Global Risks

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- As for most global economies, the key factors influencing prospects for corporate entities in SSA include: persistent albeit moderating COVID-19 effects, exposure to the impact of geopolitical risks, inflationary pressures, and global capital markets' current risk-averse stance.
- Notably, given the diversity of economies and companies in the region, the extent of each factor's influence reflects regional, local, and industry specifics.
- On balance, we expect the GDP of the seven SSA countries featured in this report will be a significant 7.8% smaller than the pre-pandemic long-run trend by the end of 2024, indicating a tougher environment for corporates.

Normalized mobility data reflects governments' limited ability to provide transfers in SSA during the pandemic. High poverty, unemployment, and informal economy in the region, combined with limited government safety nets, increase the motivation to return to business as usual compared with wealthier regions, where government support can compensate for a lack of earnings. As such, most economically active people in SSA have returned to work, consumer spending is recovering, and lockdown restrictions have largely been removed. That said, the pandemic still poses risks to SSA corporates, in particular those with large capital expenditure programs and workforces (such as in the mining, chemicals, telecommunications, utilities, and infrastructure sectors). Elevated absenteeism rates, constrained local and global supply chains (especially for bulk commodities), and persistent strain on discretionary incomes continue to depress corporate earnings to an extent.

Direct geopolitical risks from the Russia-Ukraine conflict and China's zero-COVID policy are more muted in SSA than elsewhere, but indirect effects are hitting the region. The impact of higher commodity prices, food and fuel shortages, and reduced Chinese demand feed through to Sub-Saharan countries in various ways. Positively, we believe that if the Chinese government hikes infrastructure spending in response to COVID-19-related weakness, emerging markets that supply metals to China, including South Africa, would likely benefit. Moreover, SSA's dependence on Russia and Ukraine for fuel, and to a lesser extent food, is limited. However, higher food and fuel prices would in particular pressure lower-income households, pushing down consumption. That said, SSA economies are, on average, tilted toward the export of hard and soft commodities, which are in short supply. As such, exporters stand to benefit from price windfalls in the current environment. Furthermore, although SSA countries typically have large exposure to Chinese exports and imports, global supply shortages and higher prices for many commodities have reduced the risk of slower Chinese growth in the short term.

Higher inflation since 2021 will both help and hurt, depending on the economic sector. Inflation kicked into high gear after dislocations in commodity markets due to war and sanctions, given Russia's large contribution to global oil, gas, and precious metals supply, and Ukraine's dominant position in certain agriculture products. For mining and other commodity exporters, higher prices and global demand for agricultural products, fuel, and metals is providing a welcome cash windfall, enabling them to absorb higher input costs and supply chain inefficiencies. Tourism activity is starting to recover, but rising costs could strain the affordability of consumer-focused service industries such as retail and domestic utilities.

Limited debt-issuance needs offset the impact of the current risk-off stance in capital markets, for now. Many SSA corporates raised debt in the global capital markets over the past two years, mainly to take advantage of low interest rates and demand for speculative-grade instruments. Most of the issuance was to refinance existing debt or fund acquisitions (of operating assets), contributing to improved leverage metrics and lower-risk capital structures (longer maturity profiles). Consequently, investors' aversion to risk since March 2022 will likely not constrain the development of corporates in the region for the next one-to-two years. Notably, South Africa's deep domestic markets remain largely supportive of new issuance, and capacity in the Nigerian and Kenyan debt capital markets is increasing.

Deleveraging Brings Debt To EBITDA Below The Emerging Market Average

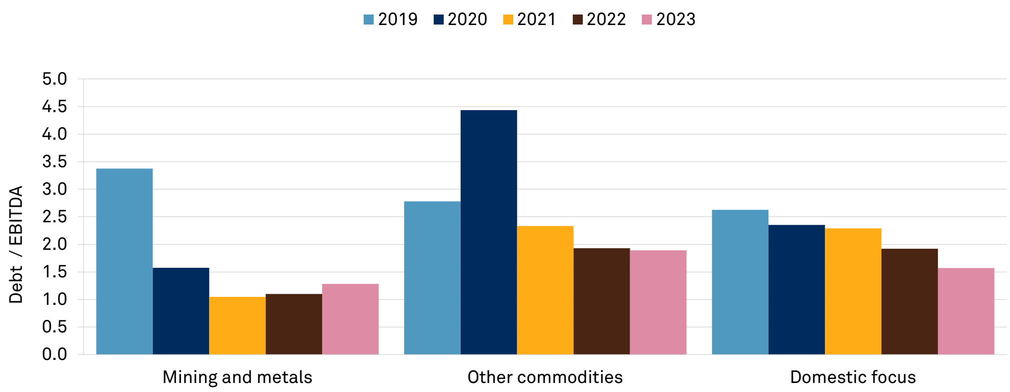
Corporate entities in emerging market economies have been able to transfer rising costs to their products and services, and EBITDA margins are showing a positive trend (see our credit conditions update, "Ratings Inflation, War, And COVID Drag On," published May 17, 2022, on RatingsDirect). Furthermore, leverage is manageable, with net debt to EBITDA below 3.5x in most markets. On the other hand, tightening financing conditions make it difficult for high-yield issuers to refinance or issue new debt.

This holds true for corporates based in South Africa and across SSA. About 60% of the corporates we rate in the region are listed and/or headquartered in South Africa, but many South Africa-based corporations also have pan-African operations and/or exposure to developing and developed end markets. In collating our corporate regional statistics, we have included corporates headquartered in SSA, as well as those headquartered outside SSA that derive at least 50% of their earnings from the region.

Net debt to EBITDA is reducing across most corporate sectors in SSA (chart 14); our classification of leverage by sector highlights useful industry-specific trends. While mining and domestic-focus companies began deleveraging in 2019 or earlier, and this continued through 2021, other commodity producers experienced quite severe COVID-19-related stress, with leverage spiking in 2020 as those product prices took a hit. In general, domestically focused companies maintained their credit metrics through the pandemic by adhering to strict financial policies, cost discipline, and cash conservation, together with creditor forbearance. At the same time, miners' volumes were hampered by lockdowns, but elevated commodity prices, especially for precious metals (gold and PGM), led to a steep fall in leverage from 2020. Looking ahead, we expect elevated (albeit moderating) commodity prices should keep commodity producers' leverage low, while top line and margin recovery among domestic-focus companies (somewhat slowed by inflationary pressures on consumers) leads us to anticipate further net debt reduction through 2023.

Chart 14

Debt To EBITDA Trend For Sub-Saharan African Corporations (EBITDA Weighted)

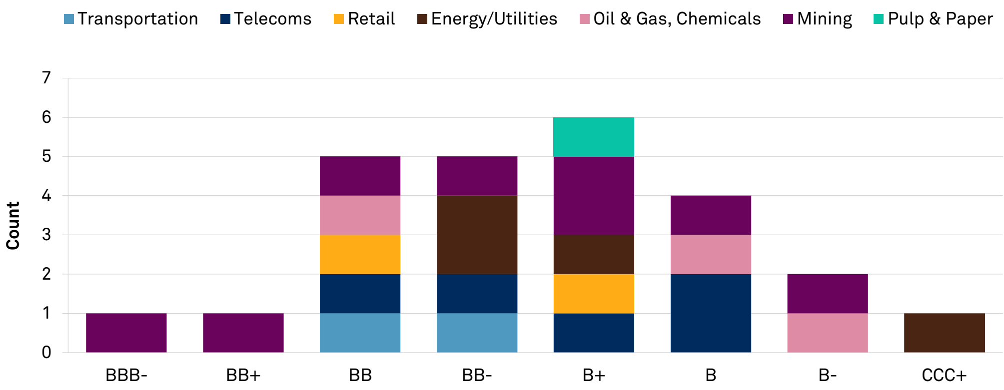


Source: S&P Global Ratings. Notes: 'Other commodities' includes oil and gas, chemicals, pulp/paper and building materials. 'Domestic focus' includes telecoms, utilities, infrastructure, retail, transportation and healthcare. *Excludes Eskom Holding SOC Ltd.

The vast majority of our SSA ratings are speculative grade (see chart 15). This reflects both the smaller size of many companies relative to global peers and the impact of country and sovereign risks as key rating constraints. In South Africa, for instance, our ratings range from 'CCC+' to 'BBB-' with the median rating at 'BB-', in line with the long-term foreign currency sovereign rating on South Africa. For SSA companies outside South Africa, our ratings range from 'B' to 'BB+', with the median in the single 'B' category.

Chart 15

Rating Distribution Mix By Industry



Source: S&P Global Ratings.

South Africa: Manageable Inflation Amid Missed Opportunities

We view inflationary pressures on corporates, while not benign, as manageable for companies operating mainly in South Africa. South Africa's CPI is rising on the back of higher transport, food, and housing prices, and we forecast it at about 5.9% for 2022 versus 4.5% in 2021 and 4.6% before the pandemic. Most companies embarked on cost efficiency initiatives throughout the pandemic and have focused on deleveraging since 2020, so are well placed to absorb higher costs. However, the impact of inflation on consumer spending and affordability, given the high proportion of food and utilities (including power and fuel) in the average consumption basket, could depress the revenue of domestically focused companies such as retailers, telecoms, and health care providers.

Part of the reason for tempered inflation is the power generation mix. For national integrated electricity provider Eskom, about 90% of generation is fueled by coal, mined locally and supplied to Eskom under long-term contracts at reasonable rates. Eskom's limited need for gas and oil derivatives to fuel generation protects the country from even higher utility bills, given the soaring prices of oil and gas. That said, Eskom's tariff increase for the year ending March 31, 2023, is 9.6%, well above CPI, and the rising incidence of generation failures at coal-fired plants results in increased use of diesel generators to keep the lights on. Increased diesel-fired generation will enlarge Eskom's cost base, which could translate into elevated electricity tariffs in the future, while power outages could hamper economic growth. Moreover, higher inflation leads to rising pressure on wages, increasing the risk of strikes, and civil unrest such as we saw in July 2021. The rising cost of fuel and its derivatives will affect companies, particularly in the mining and transportation industries. Notably, the use of road transport has accelerated over the past few years, given capacity constraints on several key bulk-commodity export rail lines.

South Africa's infrastructure challenges, notably electricity generation shortages and inefficient rail and port infrastructure, have prevented base metal and mineral commodity exporters from taking full advantage of the commodity price boom, which we see as a significant opportunity loss. We estimate South Africa's coal exports through the Richards Bay Coal Terminal will reach only 50 million–55 million tons in 2022, down from 58.7 million tons in 2021 and falling short of its almost 80 million-ton annual capacity.

Nigerian Corporates: Elections Loom After Recovery Boost From Oil Prices

Nigerian corporate issuers have largely recovered from pandemic lows, with higher oil prices contributing to a rebound across the oil and most non-oil sectors, supporting an economic recovery. However, structural bottlenecks, foreign exchange shortages, and security issues remain key growth constraints, and elections are set for February 2023.

The commissioning of the 650,000 barrel/day Dangote oil refinery in 2022 should support GDP growth and the government's fiscal and balance-of-payments positions. It may also moderate inflationary effects in the country to an extent, since Nigeria currently imports most of its refined fuel. Taken together, the picture looks brighter for domestically focused corporates as well. For example, in the telecommunications sector, regulatory roadblocks to adding new subscribers are abating, and the government has recently licensed several mobile money operators, which should have a positive impact on financial inclusion, and increase the ease with which individuals can pay for goods and services.

Sub-Saharan African (Excluding South Africa) Corporate Entity Profiles

The corporate entities we rate in SSA (except in South Africa) operate in the oil and gas, mining, telecom, utility/power, and retail industries. Some South Africa-based companies, such as MTN Group and gold miners AngloGold Ashanti and Gold Fields, have extensive operations across the region.

Most of the non-South Africa-headquartered companies in SSA rated by us are commodity exporters with limited product and/or country diversification. Domestic-focus companies tend to be more diversified across the region (in the case of telecom and tower companies, and fuel retailer Vivo Energy) but may have significant exposure to one or more regional jurisdictions. In general, country risk (typically assessed as high or very high for African countries other than South Africa, Botswana, and Morocco) constrains the ratings, and reflects lower levels of development in infrastructure, supply chain, skills availability, and regulatory spheres, all of which can increase the cost of doing business in the region. Country and sovereign constraints to ratings are common in SSA, and some regional issuers have lower ratings than their business and financial risk profiles imply because of constraints linked to where they operate.

Notably, we do not rate any corporates domiciled in Angola, D.R. Congo, Ethiopia, Ghana, or Kenya, but many rated pan-African issuers have extensive exposure to these and other countries in the region.

Banks: A Look At South Africa And Nigeria

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South Africa's Banking Sector Is Recovering Quicker Than Expected

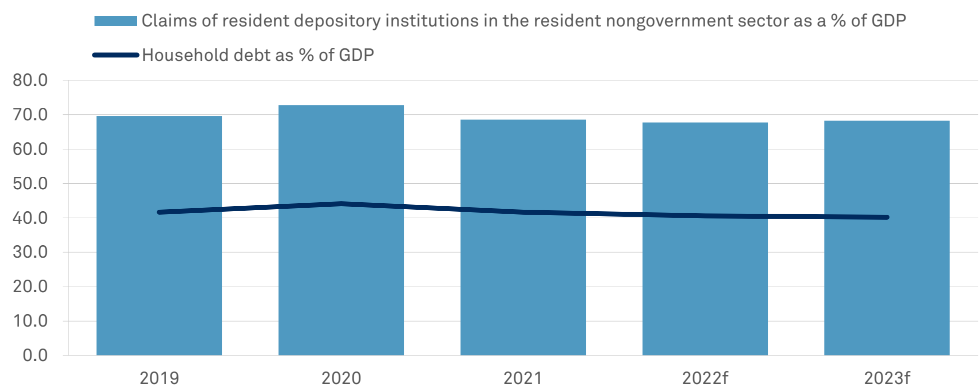
- We expect domestic credit growth will be muted at 5% in 2022, owing to moderate GDP growth, but that credit losses will stabilize and average 1% of systemwide loans in 2022-2023.
- Banks' earnings will likely recover to pre-pandemic levels this year as lower impairment charges and higher interest rates support net interest margins and revenue.
- As a result, we expect banks will remain well capitalized through year's end, also supported by the Financial Sector Laws Amendment Bill passed in January; we expect a deposit insurance scheme and, ultimately, an effective resolution regime, will be implemented over the short term.

Credit Leverage Will Stabilize At Moderately High Levels

The South African Reserve Bank (SARB) has been actively adjusting its main lending rate since late 2021 and raised it by another 50 basis points in May 2022 to 4.75%. This will push the ratio of household debt to disposable income up slightly but it should stabilize at 68% through 2024. Household lending growth, which is generally more cyclical, increased 5.4% in 2021, closer to 6% in 2019. Mortgage lending increased 4% in 2021, amid relatively stable residential real estate prices in real terms.

Chart 16

Credit Leverage In The Economy Has Been Steady



Source: S&P Global Ratings

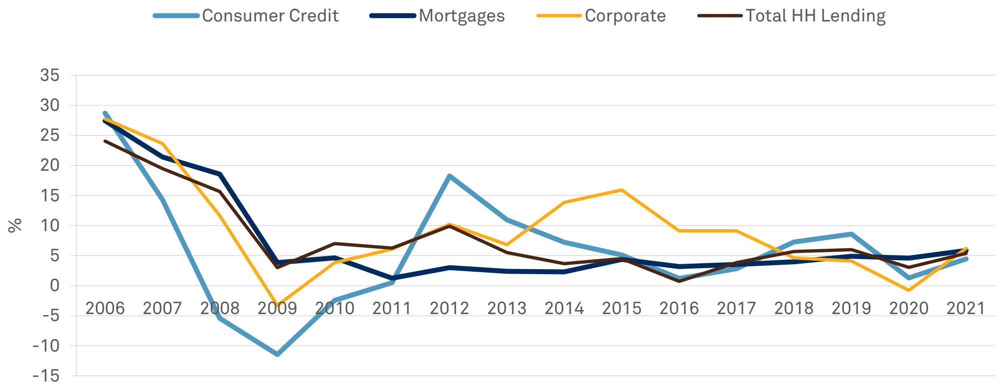
A Corporate Lending Rebound Signals Continued Growth

The country's reforms are taking shape gradually, which supported an improvement in business confidence early 2022, but geopolitical risks could suppress corporate investments. That said, we consider the South African banking sector is likely to be among the least affected among emerging markets by the Russia-Ukraine conflict.

Corporate lending grew 6.2% in 2021 (see chart 17) after a contraction of almost 1% in 2020. The digital spectrum auction reform and the independent power producer program could spur lending opportunities in the telecommunication and renewable energy sectors.

Chart 17

Credit Growth By Asset Class

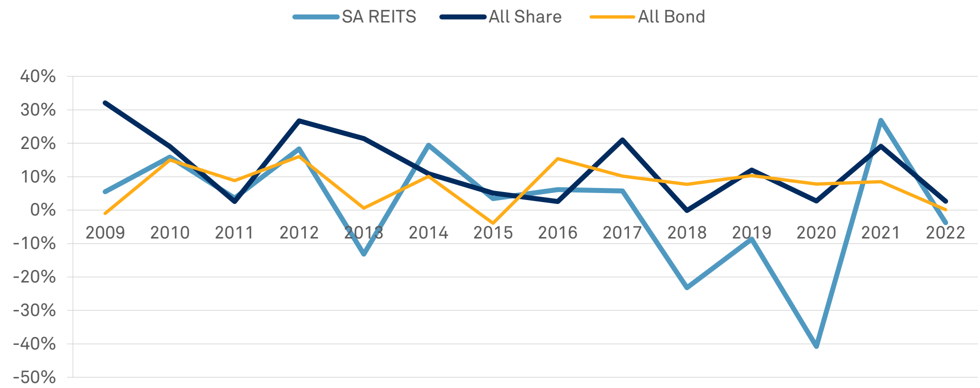


Source: S&P Global Ratings

More positively, the mining companies have deleveraged, taking advantage of high commodity prices. Commercial real estate also showed signs of recovery in 2021 (chart 18), regaining some of the capital market losses recorded in 2020 because of lower valuations. Credit losses in the banking sector have been very low, reflecting a diversified and moderate exposure to commercial real estate.

Chart 18

Performance of Main Market Indices



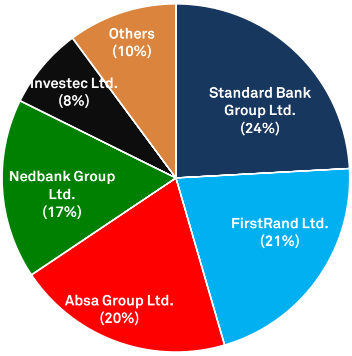
Source: S&P Global Ratings

Financial Performance Will Strengthen In 2022

Competitive dynamics in the banking sector are stable and largely underpinned by top-tier banks' entrenched market share (chart 19) and diversified business models.

Chart 19

South African Banks Market Share



Source: S&P Global Ratings

Lower impairment charges and higher interest rates will support net interest margins. We forecast that credit losses will average 1% through 2023, closer to the 0.8% average in 2017-2019, although the top-tier banks' ratios will likely be below the sector average. Nonperforming loans (NPLs) will continue to reduce, reaching less than 4.0% of total loans by 2023 versus 4.5% in 2021. We forecast the return on equity will improve to 16% in 2022 after climbing to 14% in 2021, while the return on assets will see an uptick to 1.3% in 2022 from 1.0% in 2021. Banks resumed dividend payments in 2021 on the back of resilient earnings in 2020.

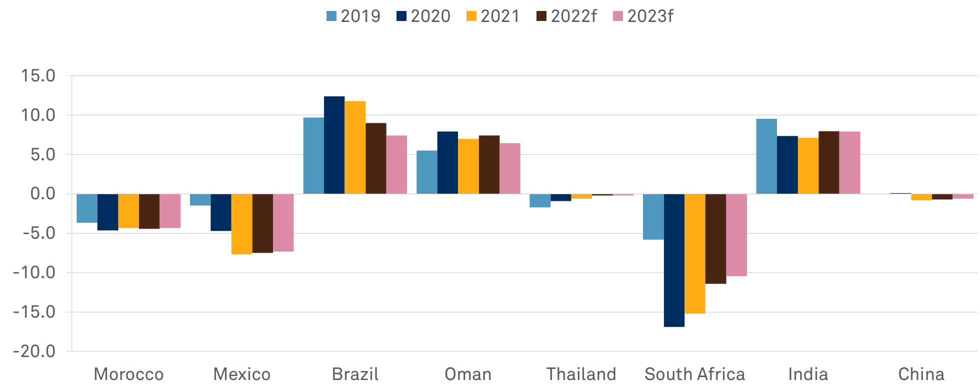
Banks' Funding Profiles Are Supported By The Closed Rand System

The South African banking sector is inherently exposed to concentrated short- and medium-term wholesale funding from nonbank financial institutions. Still, in a crisis, rand liquidity remains in the country because of resident exchange controls, which mitigate banks' exposure to institutional funding. In a crisis, exchange controls help maintain rand liquidity.

Major banks are not exposed to large refinancing risk thanks to their limited exposure to international funding. That said, South Africa's financial sector remains vulnerable to changes in global financing conditions, which are tied to U.S. interest rates.

Chart 20

Emerging Markets--Net Banking Sector External Debt



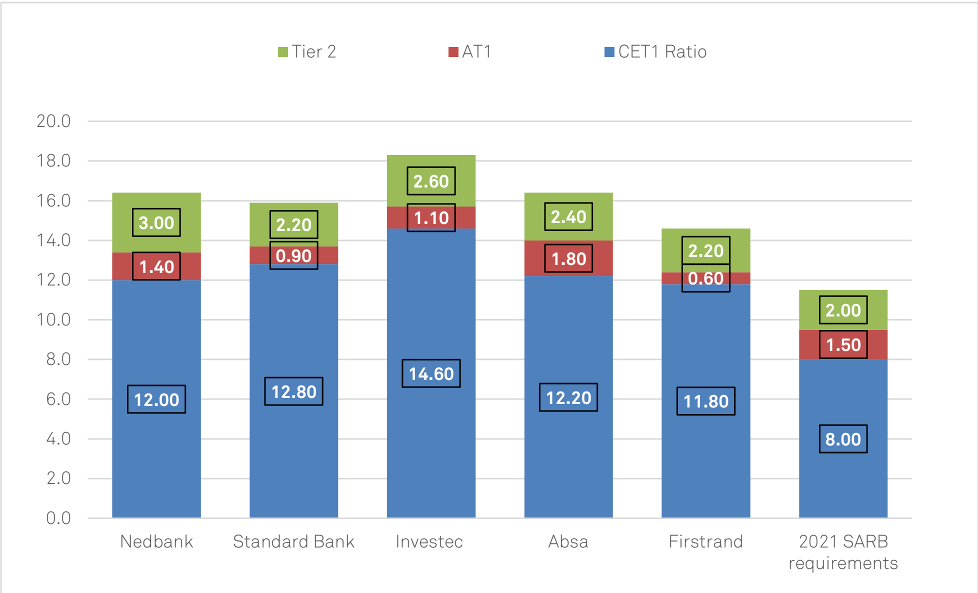
Source: S&P Global Ratings

Regulatory Reforms Will Reinforce The Banking Sector's Stability

The SARB reinstated the systemic risk capital (Pillar 2A) buffer, adjusted the calibration of the capital requirement for domestic systemically important banks (D-SIB) at midyear 2021, and phased out the committed liquidity facility as planned at year-end 2021. The Financial Sector Laws Amendment Bill was adopted by parliament in 2021 and passed recently. This paves the way for the SARB to issue prudential standards for an effective resolution regime, including the finalization of the calibration of additional loss-absorbing capital instruments issued by D-SIBs. We expect a deposit insurance scheme, and ultimately an effective resolution regime, will be implemented over the short term. We do not include uplift for extraordinary support in the form of additional loss absorbing capacity in our issuer credit ratings on South African banks.

Chart 20

South African Banks Will Remain Will Capitalized (% of risk-weighted assets)



Source: Banks Pillar III Disclosures as at Dec. 2021

Nigeria's Banking Sector Shows Resilience Despite Economic Setbacks

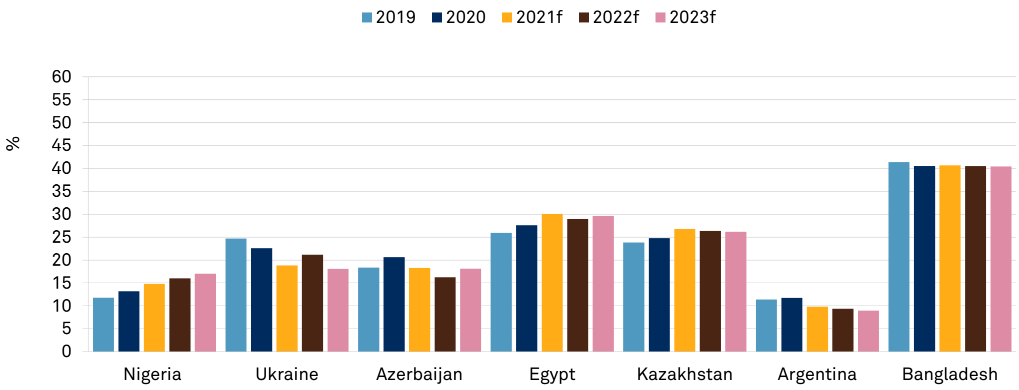
- We expect credit growth will average 18% through 2023 on the back of double-digit inflation and the weak naira, while tight U.S. dollar supply will continue to constrain corporates' growth prospects.
- The banking sector faces short credit cycles as a result of high economic imbalances stemming from volatile oil prices; however, we expect credit losses will stabilize at 1.2% of systemwide loans in 2022 while NPLs will gradually fall to the 5% regulatory limit by 2023.
- Refinancing risks in the sector will remain manageable as banks continue to proactively manage their U.S. dollar balance sheets.

Financial Intermediation Is Skewed Toward Corporates But Banks' Retail Portfolios Are Expanding

Nigeria's private-sector leverage is low in absolute terms and compared with peers' (see chart 22). This is despite the central bank's introduction of a minimum loan to deposit ratio of 65%. To spur lending, the Central Bank of Nigeria (CBN) penalizes banks reporting a lower ratio by withholding cash reserves equivalent to 50% of the lending shortfall. Loan growth will reflect the renewed impetus stemming from banks' digital transformation and greater focus on retail lending, as well as the weakening naira. We forecast private-sector credit will average 18% of GDP over 2022-2023.

Chart 22

Claims Of Resident Depository Institutions In The Resident Nongovernment Sector (% Of GDP)

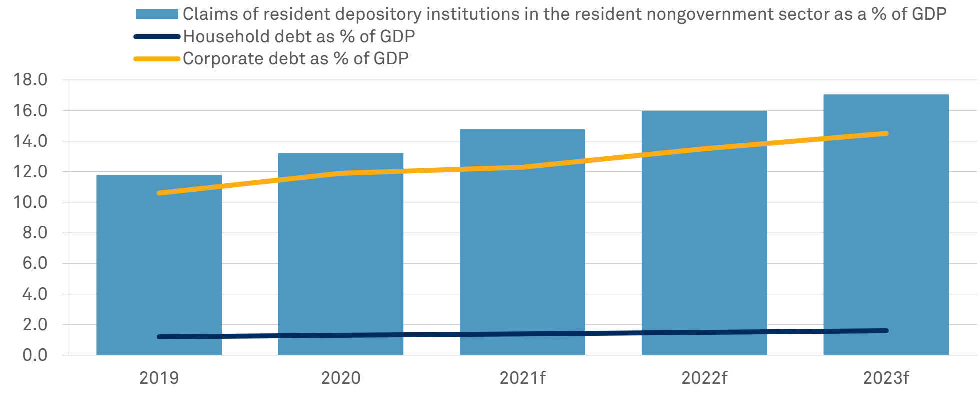


f--Forecasts. Source: S&P Global Ratings.

Banks are essentially serving large and established corporates (see chart 23) while small and midsize enterprises accounted for less than 1% of total loans in 2020. Low wealth per capita, lack of strong credit data, and a large informal sector contribute to the low financial intermediation. The CBN's launch of the e-naira in October 2021 aims to increase financial inclusion, including reducing the size of the informal sector.

Chart 23

Loan Growth Benefits Corporates



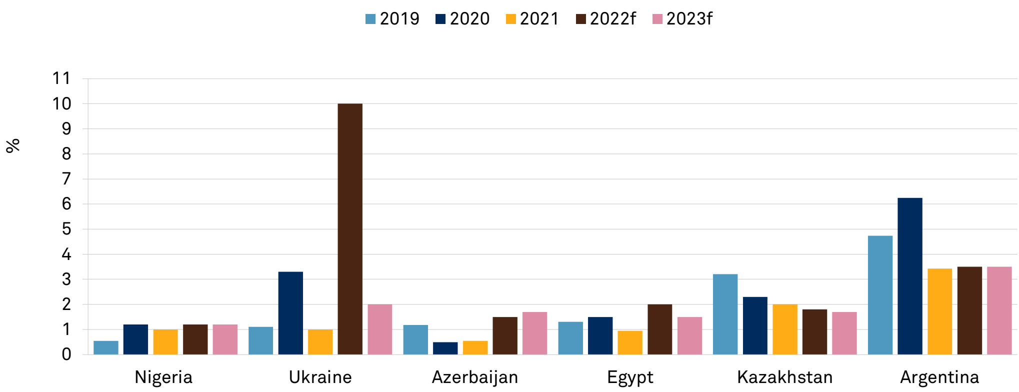
f--Forecasts. Source: S&P Global Ratings.

Credit Risk Stems From Sizable Oil Exposures

Nigeria is exposed to short credit cycles and periods of volatile asset quality because of the high exposures to the oil and gas sector. These loans are extended in foreign currency. Foreign currency lending poses additional credit risks to the sector in a context of tight U.S. dollar supply. We expect credit losses will start stabilizing at 1.2% in 2022 while NPLs gradually decline to 5% of total loans (see chart 24).

Chart 24

Credit Losses In Nigeria Are Less Volatile Than For Most Peers

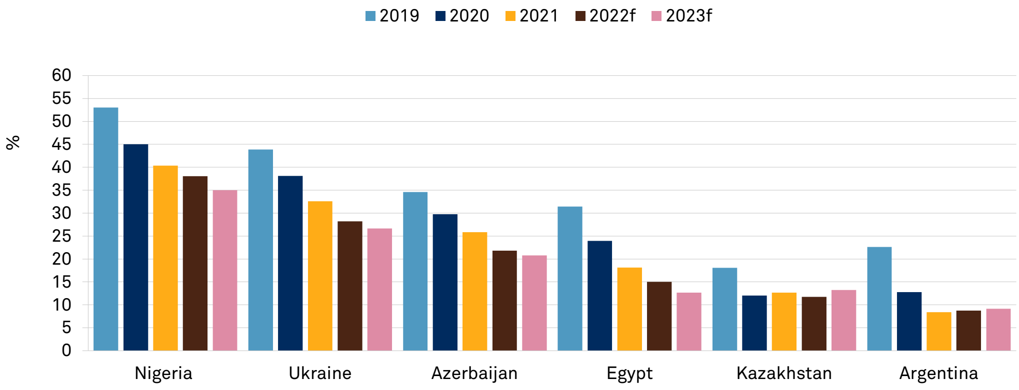


Source: S&P Global Ratings

The naira devaluation in 2017 led to an increase in the share of foreign currency lending to about 50% of total loans (see chart 25). We forecast this will gradually trend down over the next two years as many banks attempt to de-risk their lending portfolios. Additional credit risk stems from concentration in the oil and gas sector, which exposes banks to transition risk. Nigerian banks are slowly reducing their exposures to these sectors, however. We also see high large single-name and industry concentrations that tend to materialize into higher credit risks for some banks. The 20 largest loans average approximately 30%-40% of gross lending,

Chart 25

Dollarization Of The Banking Sector Stems From Oil And Gas Exposures



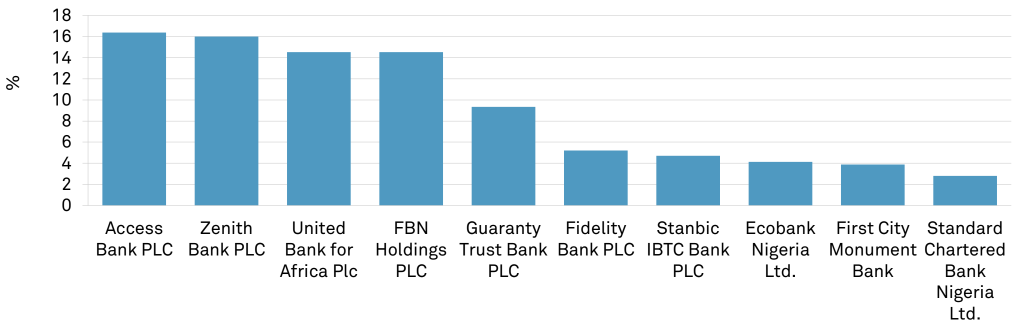
Foreign currency lending % of total domestic loans. Source: S&P Global Ratings

Profitable Banks Underpin The Sector's Stability

The banking system is relatively concentrated, with the top 10 banks accounting for about 90% of system assets (see chart 26). Leading banks have a diversified business model enabling them to shield their financial performance against a volatile operating environment. The 2010 banking reform helped shape the stability and existing competitive dynamics, which are supported by a clear tiering of the banking sector.

Chart 26

Industry Stability Has Improved Over Time



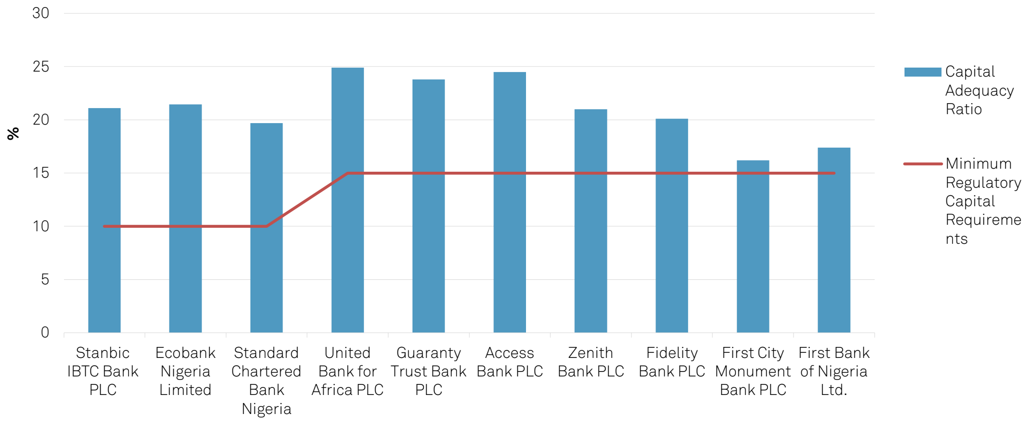
Source: S&P Global Ratings; Nigerian Banks by Market Share % of System Assets

Interest income will reinforce banks' earnings capacity because of the high base interest rate and optimization of noninterest income stemming from transactional banking. However, their cost bases will remain high on average because of the high levies of the Asset Management Corporation of Nigeria (AMCON). The CBN created AMCON in 2010 to help clean up asset quality in the banking system over the 10 years following the 2009 financial crisis, but it is likely to remain for a longer period. We expect returns on equity will improve further to 21%-23% through 2023.

Nigerian banks are transitioning to Basel III with a sufficient buffer to cater for the prevalent high economic risks (see chart 27). Domestic systemically important banks (DSIBs) and banks with an international banking license are subject to a minimum of 15% capital while all other banks must meet the 10% minimum capital requirement. Mid-tier banks operating only in Nigeria have the flexibility to convert their international license. DSIBs will also need to adhere to a higher loss absorbency requirement of 1.0%, consisting wholly of common equity tier 1 capital, and all banks will need to add a capital conservation buffer of 1.0% and a countercyclical capital buffer ranging from 0% to 2.5%, as determined by the CBN from time to time.

Chart 27

Nigerian Banks Report Their Capital Adequacy Ratio Under Basel III



Data as at Dec. 31, 2021, except for Stan Chart Nigeria which is as at Dec 2020. CAR--Capital adequacy ratio. Source: S&P Global Ratings.

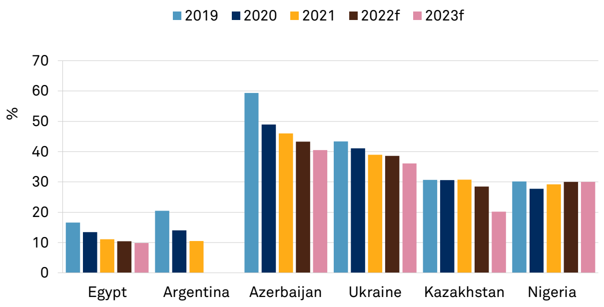
The Sector's Dollarization Is Stable Despite Tight U.S. Dollar Supply

Nigerian banks' dual-currency balance sheets pose additional risks in a context of a restrictive foreign exchange regime but banks have been managing this risk proactively. They prioritize foreign exchange lending to borrowers with foreign exchange revenue and benefit from stable foreign exchange deposits.

We expect the banking sector's external position to stabilize at manageable levels in the next two years. Net banking sector external debt will likely average 10% of systemwide loans through 2023 from 8% in 2019. Foreign currency deposits will remain broadly stable, accounting for 30% of the sector's funding base.

Chart 21

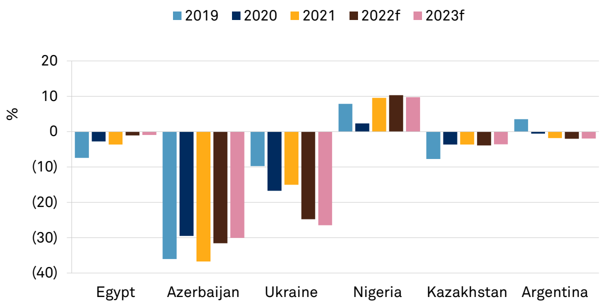
Dollarization is Higher For Oil Driven Economies



Systemwide Liabilities In Foreign Currency As A % Of Systemwide Liabilities. Source: S&P Global Ratings

Chart 22

External Refinancing Risk is Manageable



Net Banking Sector External Debt As A % Of Systemwide Domestic Loans Source: S&P Global Ratings

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Related Research

- The Global Food Shock Will Last Years, Not Months, June 1, 2022
- Economic Research: Food Price Shock Reverberates Through MENA Economies, May 26, 2022
- Emerging Markets Monthly Highlights: China's Lockdowns Ratchet Up Risks, May 19, 2022
- Which Emerging Markets Are Most At Risk From Slower-Than-Expected Growth In China?, April 26, 2022
- Economic Research: Which Emerging Markets Are Most Vulnerable To Rising Food And Energy Prices?, April 21, 2022

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