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African Markets Revealed

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Wayne Barker, Heal I, 2014. Beaded Panel, 180 x 180cm.

Born in 1963, Wayne Barker grew up at the Valhalla military air base near Pretoria, which at the time was a centre of apartheid militarism. After finishing his schooling at Capital College, he studied art at Pretoria Tech. In 1976 he became an apprentice woodcarver and later studied at the Michaelis School of Art, University of Cape Town.

Barker's life and work are rich in stories, events, anecdotes, controversies and interventions, and his art is never disengaged from what he lives. He is a shrewd critic of the times, making incisive social and political commentary. In 1990 he submitted an artwork under his own name, and another under the name Andrew Moletse, to the Standard Bank National Drawing competition. Barker's own submission was not accepted, but the work by 'Moletse' was. As per Barker's intentions, this raised considerable consternation and debate, particularly around the perception and fear that white artists would be overlooked in the drive by selection committees of the 1990s to address racial imbalances in competitions and art collections because of indiscretions under apartheid.

In 1989 he, along with Gunther Herbst and Morris La Mantia, opened the Famous International Gallery (Fig) as a venue for up-and-coming young artists who could not get a break but also, importantly, as a way to challenge the monopoly of commercial galleries.

Barker held his first solo show, 'Images on Metal', at the Market Theatre Gallery, Johannesburg, in 1987. Today, over three decades later, he stands at the centre of art-making in South Africa. He is irrepressible.

Source: Standard Bank Corporate Art Collection

Contents

Weathering the EM storm

- Economic growth in Africa will likely accelerate in the next 2-y. The strong global economy appears sufficiently robust to elevate commodity prices. Growth for the continent's commodity exporters will therefore gain momentum.
- As was evident when commodity prices declined, especially between mid-2014 and early 2016, the recovery in economic growth will not be uniform across the commodity-producing countries. Countries experiencing broad macroeconomic rebalancing, characterised by an improving C/A balance and rising FX reserves together with declining inflation, will also most likely experience a meaningful and durable acceleration in economic growth. Egypt and Nigeria are such countries. Those in which balance of payments pressures linger will probably experience sub-par economic growth. We would put Angola in this camp.
- Despite the sell-off in risk assets, there are some carry trades that will likely remain attractive over the next 4-m. Ghana's balance of payments (BOP) appears solid, which will probably support the GHS. A rebound in USD/GHS, which had increased to about 4.63 at the time of writing, from nearly 4.40 in late Mar, looks highly probable. Although not rising as much, USD/NGN is also poised for a reversal. USD/EGP is another trade we favour, supported by high yields. BOP pressures, linked to the government's external financing constraints, might undermine the ZMW.
- Duration is a harder call to make. Inflation has fallen quite a lot in some countries, leaving many 12-m T-bill and bond yields positive in real terms. Central banks have eased monetary policy, and bond yields are mostly around 15% and lower. There are very few countries, such as Nigeria and Kenya (due to the infrastructure bonds), that have liquid bond markets that would leave investors still confident to hold bonds at sub-15% yields. Zambia is an outlier, with bond yields likely to remain fairly high despite inflation in single digits. The government's financing needs suggest that bond yields will be closer to 20%, rather than 15%, this year.
- EM contagion is undermining sentiment towards African Eurobonds. But the sell-off may be transient, with a robust reversal highly probable in the coming months. We favour oil sovereigns. But there are several other countries with sound fiscal and BOP metrics. These too are likely to outperform. Senegal, Ethiopia, Kenya and Ivory Coast feature here.

Steady growth acceleration in the offing

The global backdrop is strong and will likely continue to improve – making it all the more likely that growth on the African continent will accelerate this year and next.

In the Apr edition of its *World Economic Outlook* the International Monetary Fund forecast that global economic growth was on course to return to 3.9% y/y this year and next, from what it estimates was 3.8% y/y growth in 2017 and 3.2% y/y in 2016. Much of this acceleration is attributable to developed or advanced economies that the IMF believes will grow at rates in excess of potential. Emerging markets will also likely accelerate, helped in part by the recovery in commodity prices. Nonetheless, strife in countries such as Venezuela and Libya has restrained this acceleration. Still, it is evident that a recovery in trade and growing investment spending are helping to underpin the global economic upswing.

We also believe that, on balance, the policy backdrop will support Africa's growth over the coming 2-y. There have been some notable improvements in policy conduct, which has set the stage for macroeconomic rebalancing in countries that experienced a severe drop in economic growth as a consequence of lower commodity prices, the latter especially acute between 2014 and early 2016.

USD performance, YTD

Asset class	Return, %
FX	
Africa 8, spot (with carry)	-0.9 (2.8)
Africa 10, spot (with carry)	-1.2 (2.1)
EM 10, spot (with carry)	-5.1 (-3.7)
Bloomberg USD index, spot	0.9
Local bonds	
Africa 8	4.4
Africa 10	3.9
EM 10	-6.0
Bloomberg DM	-1.1
Credit	
Africa (ex SA)	-3.5
Africa	-3.5
EMBI Global	-4.8
Bloomberg Global HY Corporate	-0.8
Equity	
MSCI Frontier Africa (ex SA)	2.6
MSCI Africa	-7.6
MSCI EM	-1.2
MSCI DM	1.1

Source: Bloomberg; Standard Bank Research

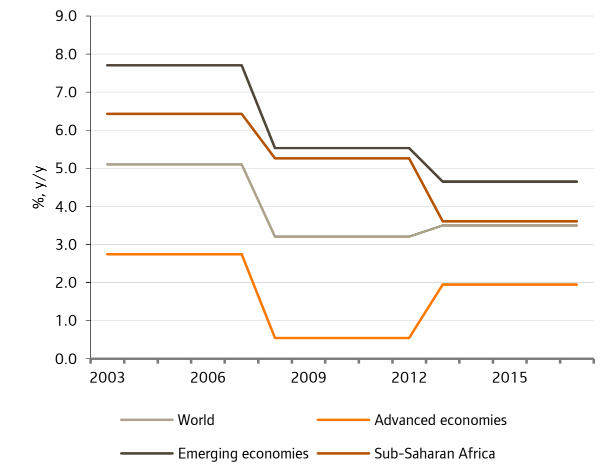
However, overall macroeconomic balance is critical for ensuring sustained economic acceleration. Of course, there has been a broad-based increase in commodity prices since early 2016. Copper prices are up nearly 20%, other base metals have increased by similar magnitudes, while oil prices are up over 40%. Such recovery not only underpinned economic growth but should also have bolstered foreign exchange reserves.

As it turns out, the experience differs from country to country. Despite the increase in commodity prices, some commodity exporters have witnessed persistent FX reserve losses over the last 2-y. This implies underlying macroeconomic imbalances that have not been corrected by policymakers. There is a strong likelihood that these countries will struggle to regain their pre-2011 economic growth momentum.

Figure 1: Global GDP growth

Source: International Monetary Fund

Figure 2: 5-y average growth rates



Source: International Monetary Fund

Even though the IMF is optimistic about the cyclical rebound in global economic activity, it still issued a sombre prognosis of the medium-term global growth outlook, pointing to several structural challenges that will undermine economic growth, especially for developed countries. Figures 1 and 2 show that much of the recent acceleration in global economic growth can be attributed to developed economies. Although emerging market economies have grown faster than developed economies, emerging market growth has slowed down since the global financial crisis. Indeed, the marginal acceleration in global growth in the last 5-y was entirely due to the revival of advanced economies; emerging market economies though slowed down.

Regarding the slowdown in African economic growth since 2011, it was mostly metals and oil exporters that slowed down. The inability of policymakers in some of these commodity exporters to allow their currencies to depreciate, as with members of the Central African Monetary Union, or policymakers choosing not to allow their currencies to depreciate, as with Nigeria and Angola, has aggravated the economic slowdown. Those commodity exporters, such as Mozambique and Zambia, that allowed their currencies to adjust to a lower commodity price environment, did not slow as much.

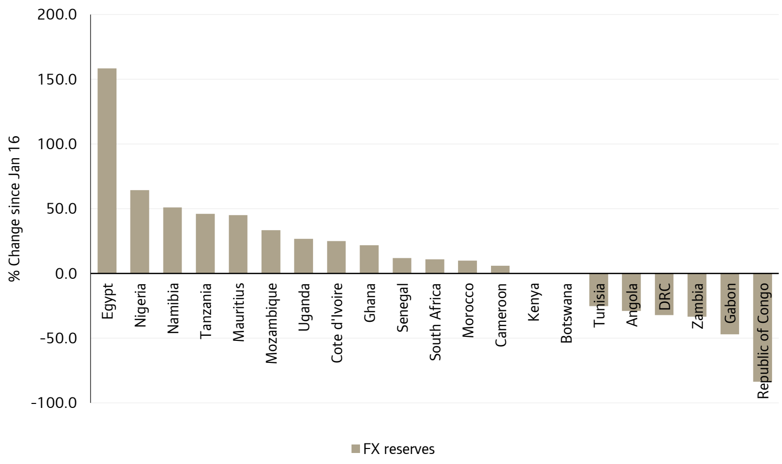
BOP dynamics matter for economic growth: take two

We have made the argument that BOP strength was a key differentiator amidst the slowdown in Africa's economic growth between 2011 and 2016. We extend this argument about how crucial BOP dynamics are for economic growth. Both the magnitude and durability of the cyclical economic revival among African commodity exporters will depend on the strength of the BOP in each country. It is hard to envisage that a country like Angola, which is still rationing FX supply, would recover in the near term to anything like the growth trajectory that preceded the last 5-y.

Generally, it is reasonable to believe that countries that are still beset by underlying BOP pressures will find it hard to see a prolonged revival in economic growth. Indeed, those countries are more prone to succumb to disturbances.

The easiest way to ascertain which countries are susceptible to a BOP shock, is the trajectory of FX reserves. Commodity exporting countries that have continued to experience a decrease in FX reserves, despite an improving global growth backdrop and a recovery in commodity prices, are the most vulnerable.

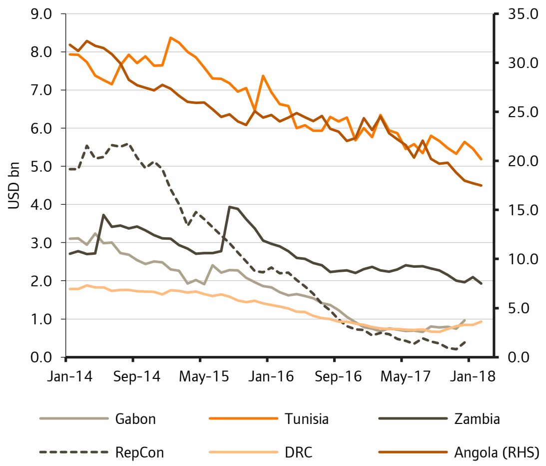
Figure 3: Change in FX reserves since Jan 16



Source: International Monetary Fund

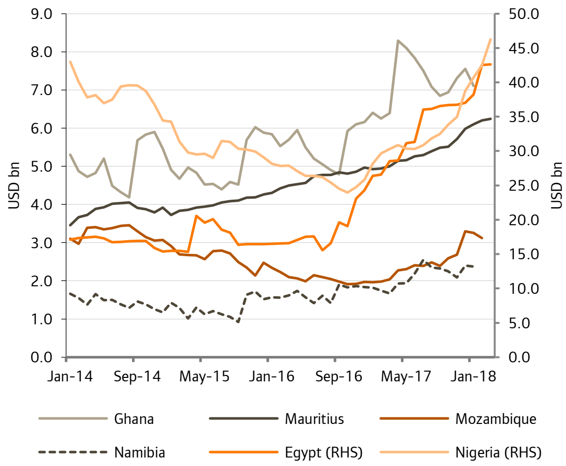
Figure 3 shows the change in FX reserves from Jan 16 to the latest available FX reserves data for each country at the time of writing. Our argument is that imports are probably still quite strong in commodity-exporting countries that have experienced a continuous decline in FX reserves despite the increase in commodity prices. Such FX reserve losses jeopardise the economic growth outlook for these countries.

Figure 4: Declining FX reserves



Source: International Monetary Fund

Figure 5: Rising FX reserves



Source: International Monetary Fund

Given that the pressure on economic growth in the last 5-y was particularly acute for commodity exporters, one would have expected that the recovery in commodity prices since 2016 would alleviate the BOP pressures these economies experienced. However, this has not been the case for all.

At the outset, we must make it clear that there is probably an asymmetry in how improving FX reserves might affect economic growth. We are not arguing that countries that have experienced an increase in FX reserves are likely to have accelerating GDP growth. But countries that were experiencing falling FX reserves and were rationing FX supply until commodity prices bottomed out in 2016, but now have rising FX reserves and do not have FX shortages, are likely to experience a durable acceleration in GDP growth over the next 2-3 years. Egypt and Nigeria fall in this category, as does Mozambique.

We argue that the revival in Ghana's economic growth is at least partly attributable to the re-establishment of external balance that has led to rising FX reserves. But nothing about the increase in FX reserves in Mauritius points to an imminent revival in economic growth there.

FX reserves in the DRC and Gabon are lower than in Jan 16 but have now stabilised in both countries. However, the persistent decline in FX reserves in Angola, the Republic of Congo and Zambia is ominous, implying that a fiscally driven macroeconomic rebalancing process is required to stem FX reserve losses. There is a very strong possibility that, even if there were to be a recovery in economic growth in those economies without the necessary fiscal restraint, persistent FX reserve losses would trigger the sort of crisis that ultimately plunged the Nigerian economy into a recession in 2016.

Policymakers in some countries seem to suspect nefarious motives whenever the IMF warns of fiscal risks in those countries. To be honest, we too don't always heed IMF warnings about fiscal risks. However, when such fiscal risks jeopardise the BOP, we sit up and take notice. Surely, the experience of the last 3-y should be enough to convince one that when a BOP crisis erupts, and the policy response is not appropriate, the impact on economic growth can be disastrous. Despite our otherwise constructive outlook for Africa, we would argue that there are some countries that face severe headwinds to economic growth because of their weak BOP positions.

Commodity prices take a break

Since the end of 2017, commodity prices have eased, especially metals prices. At the time of writing, the LMEX Index was down 3.7% from the end of 2017. Admittedly, prices have fluctuated, with no directional bias in evidence.

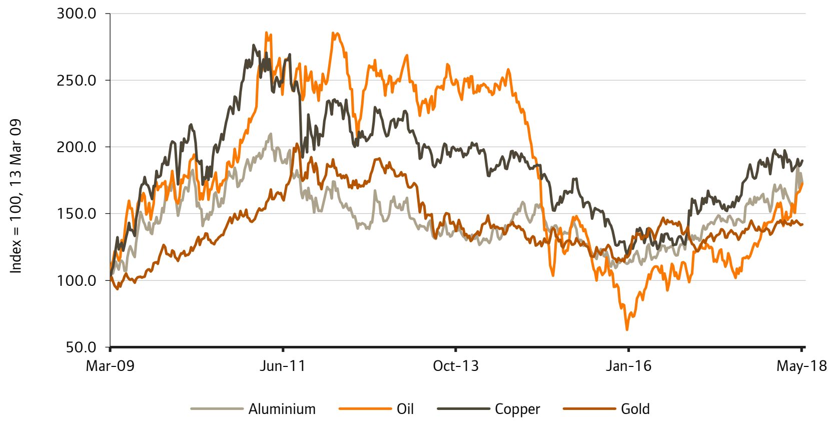
It still looks likely that prices will not fall meaningfully from current levels. Given the global growth story, it would be hard to justify an expectation of a durable generalised decline in commodity prices.

Copper prices have been broadly trending sideways in a USD6,600 to USD7,200 per ton range since the end of Aug 17. Judging by Bloomberg consensus forecasts, the bias for prices is to the upside. The consensus if for prices to rise to USD7,000/MT by the end of this year and around USD7,250/MT by the end of 2021. Even as prices were rising from early 2016, consensus forecasts were being adjusted upwards. Some analysts have pointed to the risk of tight supply as a factor likely to support prices on a multi-year basis. These analysts expect growth in global supply to be limited, with potential mine disruptions skewing the risks to the downside. Hence, the market is expected to have multi-year deficits.

Supply-demand dynamics might be influencing expectations for oil prices, too. However, Bloomberg consensus forecasts are biased to the downside. When Brent crude oil prices rose from a trough around USD27.90/bbl in Jan 16, Bloomberg consensus forecasts hardly budged, projecting the price to be around USD62.0 to USD65.0 per barrel at the end of 2018 and 2019. In recent months the Brent crude oil price rose above

USD70.0/bbl. Yet, Bloomberg consensus forecasts for the end of 2018 and 2019 are still stuck around USD65.0/bbl.

Figure 6: Commodity prices not falling



Source: Bloomberg

Perhaps the market anticipates a supply response from the US to the currently elevated prices. We have also expressed the view that, were oil prices to remain elevated for long, in all likelihood US shale production would be ramped up. Such increased production would weigh on prices.

Some analysts have pointed to supply bottlenecks in the US due to pipeline capacity constraints as a factor that has restrained US supply. But those constraints are likely to be addressed over the next 12-m. Perhaps the consensus is justified to expect prices falling back below USD70/bbl over that period.

Elevated oil prices do not seem to have engendered exuberance among oil exporters in Africa. Oil price assumptions used in the budgeting process were quite conservative. The Angolan budget was passed with an oil price assumption of USD50/bbl. Even though the Nigerian Senate raised the oil price assumption from the initial level that the government provided, it still put it at USD51/bbl. This should ensure significant revenue overruns should oil prices remain considerably higher than the budget assumption, with these countries amassing fiscal savings that should bolster FX reserves.

As we pointed out in the Jan edition, up until 2016 it was fairly clear that some of these oil-exporting countries needed to implement serious structural adjustments, for example to lower recurrent expenditure by cutting the proportion going to salaries, while increasing capital expenditure. The IMF has implored them to reduce the fiscal deficit. Had they done so, then rising oil prices would have meant that FX reserves would have been in an even stronger position. But that is not necessarily the case. Some of these countries are being bailed out by higher oil prices, and policymakers may come to believe that these will obviate the need for fiscal reform.

The recovery in commodity prices, coupled with a ramp-up in coal production and exports, has been a boon for Mozambique. Despite the limited access to external financing by the government, a fallout from the hidden debt saga that ultimately prompted the government to default on the Eurobond, FX reserves have risen since late 2016.

Given how large copper exports in Zambia are as a proportion of total exports, one would have been justified to anticipate a similarly sprightly trajectory for FX reserves from 2016. But is hasn't been the case in part because imports were rather strong despite a tight monetary policy stance that restrained private domestic spending. But the higher copper prices have been beneficial for the DRC, the continent's largest copper producer. FX reserves seem to have stabilised, even though they are not rising particularly strongly. Even the prospect of a new mining code does not seem to have dampened sentiment in the sector, with production set to grow by 3.7% y/y this year after rising 6.4% y/y last year.

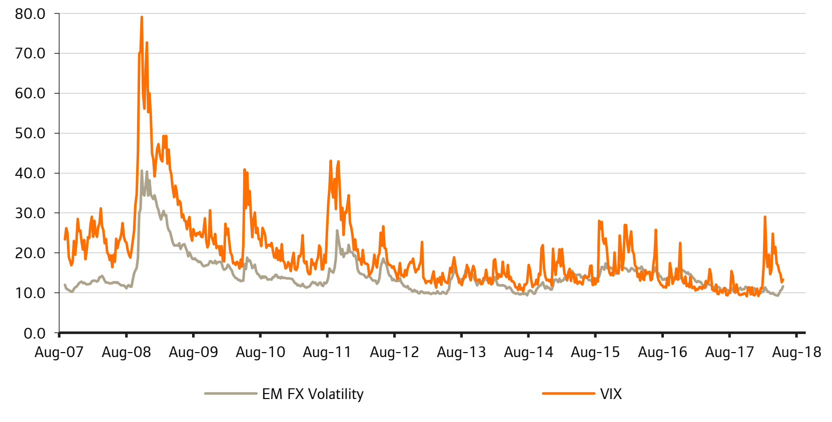
The impact of higher oil prices will be worth watching for other reasons, too. We suspect that it many prompt some governments to turn to populist policies. When oil prices were lower, it was relatively easy for many governments to introduce reforms to fuel pricing that removed, or significantly reduced, the government subsidy. As part of its economic program the Egyptian government is committed to reducing subsidies, not just on fuel, but electricity tariffs, too. Even though it does not have an IMF-funded program, the Mozambican government also made an explicit commitment to remove those subsidies. So too has the Zambian government. Now that Brent crude is close to USD80/bbl, with sporadic calls in the market for USD100/bbl oil prices, the resolve of these governments to ensure that consumers pay the full price for fuel will be tested.

Even in Nigeria, fuel retailers complained about the pricing formula. Some reported not being able to import fuel at the government mandated exchange rate, arguing that the retail price would need to be lifted. Fuel shortages arose towards the end of 2017 as only the Nigerian National Petroleum Corporation was in a position to supply fuel. That may well be the case for some time.

Global risk appetite likely to be rekindled

Even though we said in Jan that there would be numerous occasions in the coming 4-m when risk aversion would rise, leading to sell-offs of risky assets, we still expressed the view that the rally in risk assets would go on for a while longer. After all, many of the feared events over the past 8-y – like the European debt crisis in 2011, taper tantrum in 2014, Brexit vote in 2016 – turned out to have only a transient impact that did not alter the bull market in stocks and other risk assets.

Figure 7: Volatility moderating again



Source: Bloomberg; Standard Bank Research

There has certainly been a major sell-off in risk assets since the beginning of the year. After such a prolonged period of low volatility during 2017 – sure, the Venezuelan default spiced things up – there was a stunning rally at the end of the year that just looked overdone. US equities shot up sharply and EM bond spreads collapsed without there being a discernible trigger. The market was due a correction.

We still maintain that there will come a time when the current bullish run in risk assets will turn substantively, with a sell-off that will be durable. However, given the global growth backdrop, we doubt that what we have seen since the beginning of the year is such a sell-off. Hence, we are inclined to believe that it is a correction in an ongoing bullish run in risk assets.

Risk appetite buckled over the past 5-m, with the VIX index, our preferred measure of global risk appetite, rising to multi-year highs above 30. At the time of writing, the index seemed to be settling-in below 15, well on its way to the lows around 10 during 2017.

The US administration's tactics in international relations – 'America first' - have been one factor to worry the markets. The markets feared the spectre of a trade war between the US and its erstwhile trade partners – NAFTA members, China and the European Union – and broadly rising security tensions involving North Korea and Syria. But the seemingly antagonistic posture adopted by the administration, in view of the unilateral imposition of tariffs perhaps in contravention of existing international trade rules, seems not to preclude negotiations. Perhaps the markets will come around to discounting the seemingly inflammatory pronouncements made by the administration and any retort they may attract from other countries.

Global rates sustainably off the zero lower bound

It is highly probable that we are on the cusp of a significant structural break for US rates. Depending on how one draws the trend lines, the US 10-y Treasury yield is either bumping up against the upper bound of the trend channel that has been in place since the 1980s, or it already has broken through it.

Figure 8: US Treasury 10-y yields testing the 3.0% level

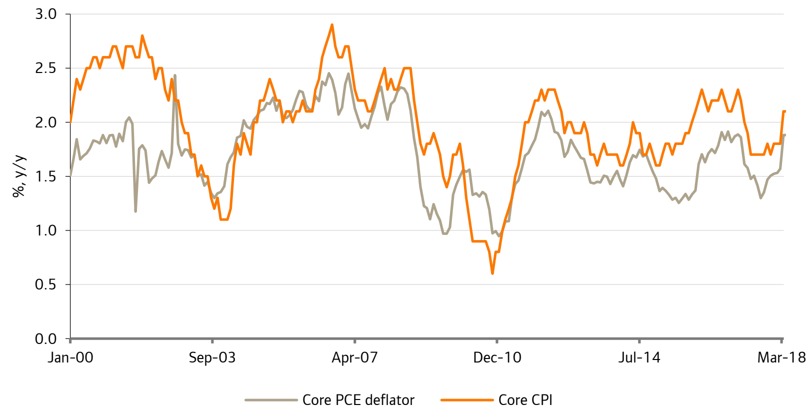
Source: Bloomberg

The 10-y yield broke through 3.0% earlier than most forecasts that put the rate there at the end of the year. The FOMC continues to signal its intention to keep increasing the Fed Funds rate. Yet at the last meeting in Apr, it also assured the market that it would be prepared to let inflation rise above 2.0% y/y for a while. In effect, it was communicating its view that 2.0% y/y was not a ceiling but a target, implying that the market should expect inflation to sometimes be above and sometimes below 2.0% y/y.

When the Fed made the pledge to let inflation to sometimes exceed 2.0% y/y, inflation was pretty close to 2.0% y/y. In fact, the PCE core deflator had just accelerated to a 1.9% y/y pace of increase, having been at 1.5% y/y in Dec 17. Over the past few years, we noticed that the Fed consistently forecast that inflation would reach 2.0% y/y, while inflation was consistently below that level. Indeed, this failure to achieve the 2.0% y/y target may have been a factor that cast doubt on the FOMC's ability to persistently increase policy rates, contributing to keeping 10-y yields low.

Perhaps if inflation, indeed, rises and stays above 2.0% y/y and the Fed does not quicken the pace of Fed funds rate increases, then the market will come to price in a higher inflation premium on US yields. This might ensure that yields are much higher than previously, perhaps with the 10-y yield approaching 3.5% by mid-2019, as forecast by Steve Barrow, our G10 Strategist.

Figure 9: US PCE core deflator and core CPI



Source: Bureau of Economic Analysis; Bureau of Labor Statistics

Irrespective of what might prompt sustainably higher US 10-y yields, should rising yields necessarily cause concerns for our markets? We are still fairly constructive. Specifically, since the increase in US yields is occurring against a backdrop of strong economic growth both in the US and globally, we believe that the influence of stronger growth for African markets will tend to predominate.

Having started the year with a view that there would be three hikes this year, market consensus has gravitated to four hikes this year. This is testament to both FOMC communication as well as the strength of the US economy. The consensus forecast for 2018 growth in the US, as surveyed by Bloomberg, has increased to 2.8% y/y from about 2.3% y/y in Sep 17. Similarly, the consensus forecast for 2019 economic growth has increased by nearly 50 bps, to 2.5% y/y over the same period.

It is perhaps fitting that inflation expectations have also trended higher since the beginning of the year. The Bloomberg consensus forecast for the PCE core deflator at the end of 2018 has increased to 1.9% y/y, 0.2 percentage points higher than at the beginning of the year. Tellingly, this increase has partially reversed the collapse that occurred in H2:17. The Bloomberg consensus is that the 10-y Treasury yield will be closer to 3.2% by the end of this year.

None of the analysts polled by Bloomberg expect the European Central Bank to change its policy stance this year. The majority expect it to start hiking in H2:19. Even then, the consensus (median) expectation is that the bank will take its main refinancing rate to 0.2% at the end of next year. The consensus forecast still puts the 10-y Bund yield at about 1.0% by the end of this year, grinding marginally higher to 1.3% by the end of 2019.

Figure 10: 10-y generic US Treasury and German bund yields

Source: Bloomberg

Figure 11: EM 10-y average bond yields versus US Treasury 10-y yields

Source: Bloomberg; Standard Bank Research

Limited political risks

We see limited political risks over the next 4-m among the countries in our coverage. There are very few elections over this period, with only the municipal elections in Mozambique in Oct worth noting. Of course, there are elections planned later this year in the DRC, and in Nigeria and Malawi in early 2019. The period leading to those might lead to a ratcheting of political noise. Nonetheless, we doubt that such noise will have a substantive market impact.

The Mozambican elections are worth watching for at least one key reason: Afonso Dhlakama, the leader of the opposition RENAMO party, died a few weeks ago. Bear in mind that the party boycotted the last municipal elections because it demanded greater regional autonomy. Those demands worsened relations with the government to such an extent that conflict broke out. But a peace deal was struck, with one of the government’s concessions being the devolution of more powers to the provinces.

But that deal was struck with the leadership of Dhlakama. It will be worth watching to see if the new party leadership will be committed to carrying on with talks for a negotiated settlement. In addition to greater regional autonomy, which would probably require a constitutional amendment, RENAMO's fighters would need to be integrated into the army.

The timing of the DRC general elections is still hard to pin down. On paper they will be held in Dec. But we wouldn't be surprised if they were to be delayed for some technical glitch. There are numerous potential candidates, for example the procurement of ballot materials might not be timely, or the registration of voters might take too long. In any event, the testing of electronic voting equipment is underway. There is always a risk that protests against the government might turn violent.

Even though the Nigerian elections will be in Feb 19, political noise has started ratcheting up. There are some noted political heavyweights that have come out to criticise President Buhari and the achievements of his administration over the last 3-y. Atiku Abubakar, the former Vice President under President Obasanjo's administration, has indicated his intention to run. Other prominent names might also come to light.

However, it is worth appreciating that the election timetable is long. Party primaries are not scheduled to conclude until 7 Oct, after which we will really know who the candidates for the presidency are. Of all the aspirants for the presidency, perhaps it is President Buhari who is more or less assured of getting the nod from his party. Others may have to contest the party primaries first before they are confirmed as presidential candidates. So, some of the policy pledges that might be flying around as we approach the party primaries will turn to nought.

Malawi's election in Apr 19 will probably be tightly contested. Alliances might emerge making it tough to determine who will have the upper hand. But we remain of the view that there will not be a deterioration in macroeconomic policy management over the course of the year. True, the next review of the IMF-funded program, which the IMF Executive Board approved in May, will likely only be conducted closer to Dec.

There have been indications that the ruling party in Angola will arrange handover of the party's presidency to the country's President Lourenço. Recall that when former president Dos Santos handed over power he retained the party's presidency. Since then Lourenço has solidified his control over the administration, making several high-profile changes in the leadership of key institutions, including the central bank, Sonangol – the national oil company, the sovereign wealth fund, the military and intelligence services.

The sovereign wealth fund and Sonangol were led by former President Dos Santos's son and daughter respectively. However, there have been accusations of financial mismanagement, perhaps a key factor prompting Lourenço to remove them from office. Nonetheless, these high profile leadership changes probably indicate that the leadership of the party is firmly behind Lourenço, making the transition in the party's presidency possible.

Attracting investment to the country is probably the biggest challenge facing the administration. These political developments probably won't matter much in that endeavour. But creating the right investment climate will. Hence, the change in the investment law, removing minimal capital requirements and requirements for foreign companies to seek local partners when establishing operations will turn out to be more consequential. But above all, none of this will matter unless policymakers can eliminate FX constraints.

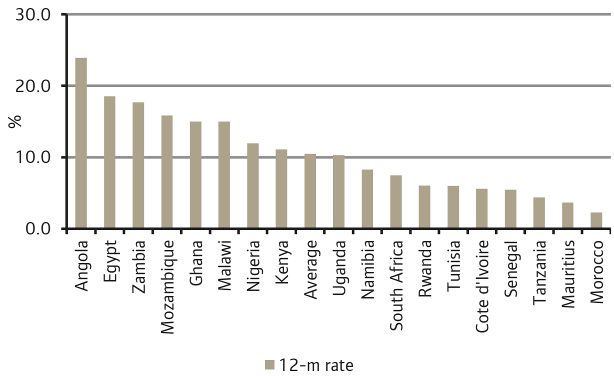
FX strategy: low yields lead to waning attraction of the carry

It is increasingly difficult to identify worthwhile opportunities among the currencies in our coverage. Partly this is because the protection of high yields is ebbing away. Inflation among the tradable markets has fallen below 10%, pulling T-bill yields with it.

As such, only a handful of countries, among them Egypt, Ghana, Malawi, Mozambique and Zambia, have 12-m T-bill yields 15% or higher.

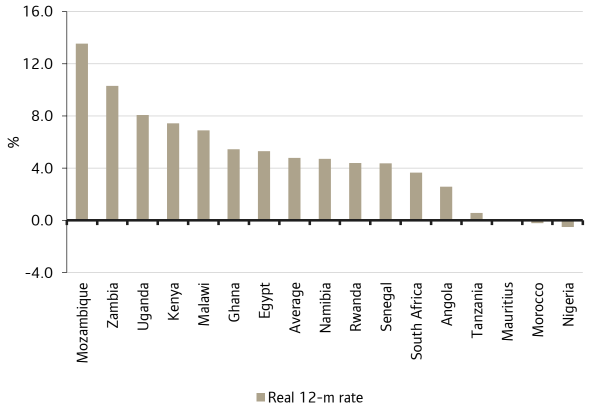
Of course, Ghanaian and Mozambican T-bills are not investable for foreign investors. In any event, there is plenty of interest for Ghanaian bonds among foreign investors. In some ways, the GHS was a beacon for foreign investors over the past 6-m as the sell-off in global markets intensified. We expect this to remain the case on a multi-month basis. There is plenty to support the country's BOP. Oil prices and production are higher, boosting exports and economic growth. Cocoa prices have also recovered, potentially boosting exports further, albeit with some delay. Combined with the ease with which the government can attract capital inflows, there is little wonder then that FX reserves have increased over the past year. Given the depreciation of the past 3-w or so, we will be looking to establish a new position via NDFs in the coming weeks.

Figure 12: 12-m T-bill yields



Source: Various central banks

Figure 13: Real 12-m T-bill yields



Source: Various central banks; Various statistical agencies

Mozambican T-bills are another asset that is not tradable for foreign investors. With yields in the mid-teens, we would happily recommend them to investors. Over the past 18-m or so, we have recommended NDF trades that have worked well despite offering lower implied yields. To be fair, investors always have the choice of local bonds. But these are complex instruments with a coupon that is partially fixed and partially floating. But, so far, the central bank has been hesitant to lower the policy rate, keeping T-bill yields elevated as a consequence.

The attraction of the MZN is a favourable BOP position. Despite the government losing access to some international financing due to its debt saga, FX reserves rose fairly consistently last year. Additionally, the ramp-up in coal production and higher commodity prices have underpinned strong growth in exports. As a consequence, the FX market is rarely ever short of FX for long. Even the depreciation of the MZN from the beginning of the year, following a regulatory change that allows exporters to retain their export earnings in foreign currency, has proven transient. Over the remainder of the year, the central bank will probably mostly intervene to prevent the MZN from appreciating further, rather than attempt to forestall depreciation.

At face value, the EGP should be an easy investment case. The EGP is arguably overvalued, even the IMF intimates at that. Rates are just too high, especially when considering the trajectory for inflation that will most likely take it to single digits before the end of the year. Capital inflows are very strong, leading to a consistent upward trajectory for FX reserves.

So, where is the downside? Positioning by foreign investors is heavy. Hence, they might be twitchy. Indeed, this is probably the reason that USD/EGP rose so much over the past 3-w. True, in the context of what is supposedly a free-floating currency, a move from 17.60 to 17.90 for USD/EGP, less than 2%, is nothing to write home about. That even the move occurred probably speaks more to the central bank's attempt to keep appearances of a fluctuating exchange rate.

What's more, there is very strong evidence suggesting that the central bank is keeping a policy stance that is too tight. Sure, economic growth is strengthening. But that is largely thanks to the currency weakness and robust external demand. The central bank has the room to boost domestic spending and allow the currency to appreciate. But as we saw in Feb 17, the CBE might not be ready for that. Despite the heavy positioning, we still like the carry here.

We also have exposure to the MWK in our shadow portfolio. We believe that the central bank can keep the exchange rate stable for some time, while also keeping rates elevated. Inflation has trended upwards recently. The central bank is becoming concerned with potential upward pressure on food inflation brought about by a combination of inadequate rainfall in parts of the country and the fall armyworm infestation. Given the support of the IMF-funded program, it night well succeed at stemming any upward pressure on USD/MWK that might arise over the coming 12-m.

There is much trepidation regarding USD/ZMW. The high yields make the carry attractive. However, BOP dynamics leave a lot to be desired. Considering that FX reserves fell last year, especially in H2:17, despite copper prices being close to USD7,000/MT, there is clearly underlying BOP weakness. Evidence points to fiscal policy conduct being the culprit, specifically the inability of the government to obtain the external financing it requires to finance the fiscal deficit. Simply switching to domestic financing of the deficit might alleviate funding pressures for the deficit but can incur stress in the BOP.

Therein lies the dilemma for investors. If the government does not find a way to alleviate external financing constraints, then it will rely on domestic financing. That is why last year the government ended up borrowing close to ZMW11bn domestically, having budgeted to borrow just less than ZMW4bn. Given that it is still committed to an infrastructure-heavy spending program, implying that imports will remain elevated, then the pressure on FX reserves will likely be unrelenting.

Positioning is also a concern, with foreigners holding ZMW bonds worth the equivalent of more than 45% of FX reserves. The drain on FX reserves could trigger panic and lead to a sharp depreciation of the ZMW. The increase in implied NDF yields is a sign of mounting stress in the market. The sell-off triggered a stop-loss on the NDF position we hold.

The Central Bank of Nigeria will probably fine-tune liquidity conditions so that it keeps foreign investor interest in local money market instruments adequate so as not to exert upward pressure on USD/NGN. The pace of disinflation has picked up since Nov. But the MPC will probably not be tempted to ease just yet. Perhaps it will do so in H2:18. Elevated oil prices and rising FX reserves – heavy foreign investor positioning notwithstanding – still make this an attractive carry.

We still don't have high conviction that the Banco Nacional de Angola will devalue the AOA such that USD/AOA remains within the forwards. Of course, given that the BNA pegs EUR/AOA, leaving USD/AOA to be a by-product of EUR/USD moves, there is a lot more uncertainty than otherwise would be the case. We are still puzzled as to the motivation for the BNA to continue devaluing the AOA despite no evidence that the FX constraints facing the country have eased.

Sure, the issuance of USD3.0bn in Eurobonds shows that there is latent capacity for the country to attract portfolio and other capital inflows. The amendment of the investment law has the potential to attract more FDI inflows, too. Yet, despite a devaluation that has increased EUR/AOA by more than 30% since the end of 2017, indications are that the black-market rate has not moved. Additionally, while FX availability is problematic, it looks as if FDI inflows too will be limited. We are staying out of any positions on USD/AOA.

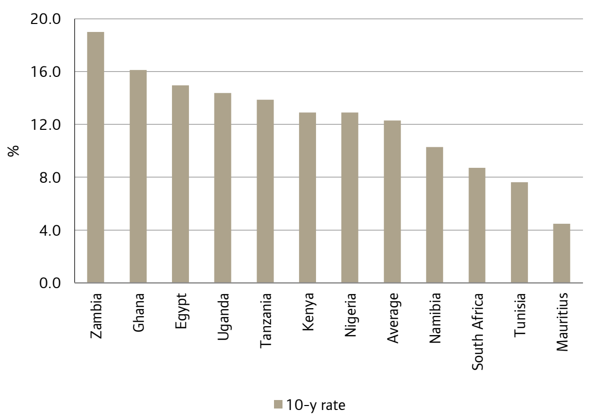
Our stance on the UGX and KES is neutral. Exposure to them has typically guaranteed returns of 1% per month, with hardly any volatility to speak of. This is likely to continue in the near term, with downside risks limited. That said, it is worth noting that USD/UGX has increased over the past 4-w, taking the pair closer to 3,740, from nearly 3,640. There is no indication of durable underlying strength in FX demand that would push the pair sustainably higher in the next 4-m.

While we have been anticipating that a revival of economic activity in Kenya would exert some upward pressure on USD/KES, that might take a while to eventuate. The government has committed to revising the interest rate capping law as part of the budget for FY2018/19. Even if the law were abolished, it would take some time for credit extension to pick up meaningfully to boost FX demand. Hence, USD/KES will likely remain contained.

Fixed income strategy: limited trading opportunities

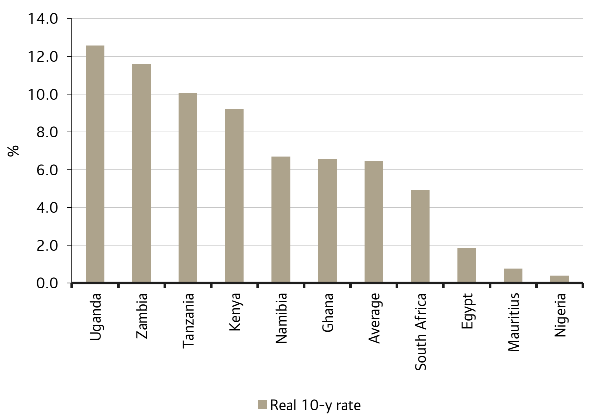
Just as it is the case with T-bill yields, there aren't a lot of markets offering bond yields of 15.0% or more. Zambia, Ghana and Egypt are still the only ones in our coverage. Even in the case of those that have yields in excess of 15.0%, chances are that they won't decline much from current levels. Over the coming 12-18 months, investors will have to be comfortable with bond yields below 15% in many markets. Indeed, they may have to actively trade some of them to derive meaningful returns.

Figure 14: 10-y bond yields



Source: Various central banks

Figure 15: Real 10-y bond yields



Source: Various central banks; Various statistical agencies

Egypt is probably the only market that still offers the chance of significant decline in yields from current levels. It is highly probable that yields will decline further over the next 4–6 months. Inflation is well on its way to single digits, and with it bond yields are likely to fall. Sure, the Monetary Policy Committee of the Central Bank of Egypt is circumspect, opting to leave the policy stance unchanged after the last meeting in May.

However, it can't be too far off from resuming the easing of its monetary policy stance. The CBE has an inflation target of 10.0% to 16.0% y/y for Q4:18. Inflation was 13.1% y/y in Apr, well within the target range. Our view is that it will be in single digits in Q4:18, providing motivation for cutting policy rates further. Yields would likely follow suit, declining over the remainder of the year.

In opting not to cut the policy rate in May, the committee was concerned about potential upside shocks to inflation. After all, the government has undertaken to continue with the removal of energy subsidies. When these are removed, the respective prices will rise, exerting upward pressure on headline inflation. Even in this scenario, we believe that upward pressure on inflation would be transient. Hence, we believe the bias is for the CBE's MPC to lower rates further over the course of the year.

Issuance of bonds may offer opportunities to actively trade such bonds, buying them in the auction and selling them shortly thereafter in the secondary market. Perhaps Ghana and Kenya offer the greatest opportunity in this respect. However, the BOG has managed to sell bonds in the auctions at yields lower than those prevailing in the secondary market. We have wondered whether investor interest in bonds, especially in Ghana, would remain strong if yields reached 15.0%. Perhaps around these levels, the demand for bonds from foreign investor would be limited, diminishing the upside potential from the strategy we envisage.

The upside potential from this strategy is still evident in Kenya, where paper is typically issued at a discount to secondary market levels of similar bonds. Given that inflation is likely to remain fairly subdued, we believe that secondary market yields will be fairly range-bound. Hence, it will be possible to buy paper in the auction and sell it in the secondary market after holding it for a few weeks.

The Financial Markets Conduct Authority Bill that the Kenyan government has proposed would establish an authority that would protect retail financial customers by, among other things, regulating the cost of credit. Passage of the bill and the establishment of the authority will take some time. So, the status quo, with the interest rate cap in place, will persist.

Nigeria is probably another market where actively trading the bonds might provide decent returns. As we argued above, the CBN will probably focus its attention on fine-tuning liquidity conditions in order to prevent significant portfolio outflows from the market. However, there may be delays in making the required adjustments to liquidity operations. As we have seen, such delays, sometimes even leading to a backlog of FX demand developing, could lead to minor panic among some investors. Panicked selling of paper could offer opportunities to pick up paper at decent yields.

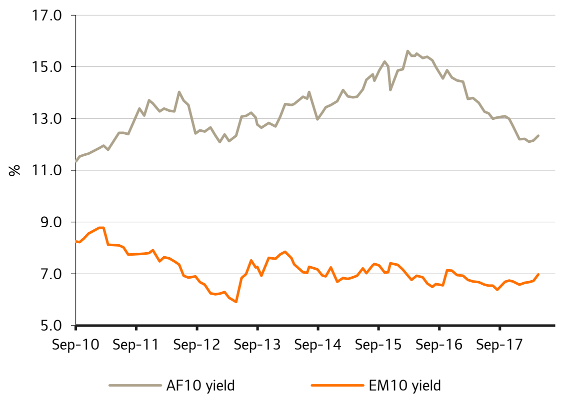
Administrative considerations aside, the CBN has demonstrated a bias to see yields fall further. Of course, with the pace of disinflation having picked up since Nov 17, it is understandable that the CBN would want to see yields fall. So, there will be times when it will not mop up liquidity from the market, leading to lower yields. But the more extreme the decline in yields, say bringing money market rates closer to 11.0%, the greater the chance that foreign investors will attempt to liquidate their positions, thus pushing yields higher across the curve.

The decline in yields across the curve on the continent is a double-edged sword. On one hand, it demonstrates the policy success at addressing some of the problems that initially led to sky-rocketing yields. FX constraints are no longer a problem in Nigeria, easing FX supply constraints. Of course, these concerns have not been completely eliminated, but FX reserves are in a much healthier position now. Similarly, Ghanaian yields are no longer in the mid-20s, indicating policy success at easing the capital flow challenges the country faced between 2013 and 2016, as well as success at taming inflation. The same is true for East Africa, where inflation is now closer to the 5% y/y medium-term target range for most central banks there. Similarly, FX reserves are in a healthier position.

Unfortunately, the success at taming these problems is juxtaposed by similar problems springing up in other emerging market countries. Figures 16 and 17 show that EM local currency yields have started to rise over the past 6-w or so. However, the charts do not quite illustrate the magnitude of the moves in some markets. Argentinian yields for example were in excess of 30%.

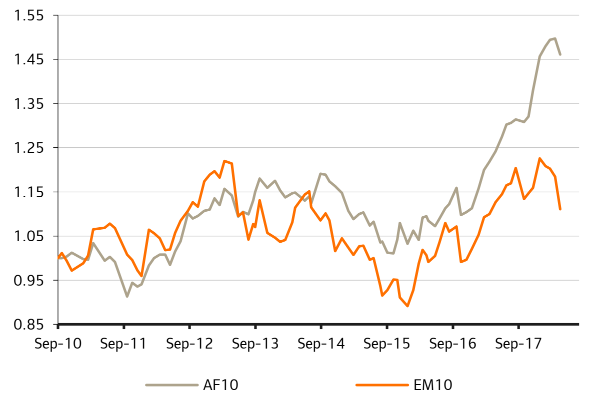
The challenges faced by these countries will likely divert attention away from low-yielding African markets and towards these markets. The advantage for investors is that these other markets are much more developed, with much higher levels of liquidity. This means that investors can invest larger quantities than they can in African markets.

Figure 16: EM10 versus AF10 average 10-y bond yield



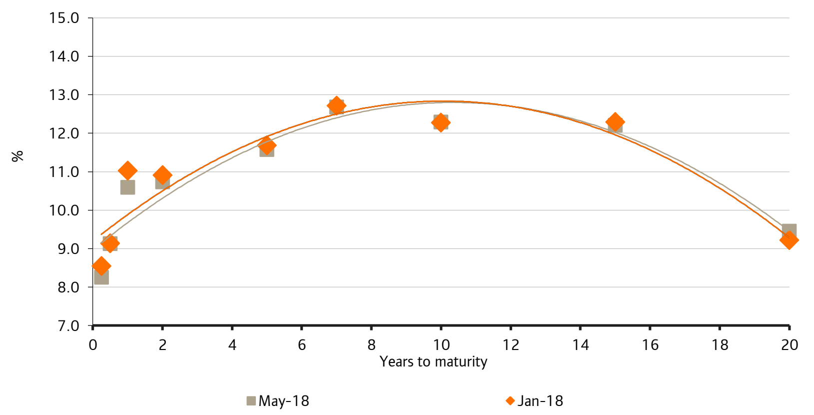
Source: Bloomberg; Standard Bank Research

Figure 17: EM10 versus AF10 average 10-y bond return



Source: Bloomberg; Standard Bank Research

Figure 18: AF10 yield curve simple yield average



Source: Bloomberg; Standard Bank Research

African Eurobonds could rebound

Having languished over the 4-m to Jan, EM bond spreads shot up sharply over the past 5-m, with the JP Morgan EMBI Global spread rising above 360 bps, from just under 290 bps. African Eurobond spreads widened even more dramatically, with the Standard Bank Africa Sovereign Bond Index rising by over 100 bps.

Strategically, we don't believe that this is the start of a bear market that will last. We believe that it is a correction, and we are still inclined to believe that the market will rebound and spreads will tighten again on a multi-month basis.

We are tactically overweight the oil sovereigns, with some of our exposure being to long duration bonds that were recently issued. Angola and Ghana issued paper at the height of the sell-off in risk assets. Angola issued more than they were planning while Ghana issued less. We recently added to our positions in both, taking Angola to 2% overweight and Ghana to 3% overweight.

A feature of the sell-off was that Eurobonds sold off even though commodity prices were largely unaffected. Of course, given the rally in the USD there is always a chance that commodity prices will catch up, too.

However, there are some supply factors that might militate against such a deep correction in commodity prices. Furthermore, even demand looks as if it will support commodity prices, with the robust growth in global economic activity pointing to elevated prices for quite some time. Against this backdrop, it is hard to find reasons for the sell-off in Eurobonds to persist.

However, contagion is one such reason. The upheaval in Argentina and Turkey seems to be spreading to other big emerging markets. If these pressures persist, then sour sentiment could engulf African Eurobonds.

Zambian bonds have underperformed noticeably. The Zambia '24 spread has widened to more or less the same level as the RepCon '29s bonds with very similar modified duration. Perhaps the market is starting to price in the possibility of delays in coupon payments by the Zambian government. There are noticeable BOP pressures, most probably due to fiscal policy conduct, mounting in Zambia. The underperformance of those bonds might just continue for a while longer.

Hedging CNY exposure

Trade consummated between Africa and China is still predominantly conducted in USD. Yet, for importers, it is often cheaper to hedge CNY exposure than to hedge USD exposure. Standard Bank offers forwards that allow African importers to hedge CNY exposure.

Indicative CNY forward prices

	Historical FX levels				Forward prices		
	-12m	-6m	-3m	spot	3-m	6-m	12-m
CNY/BWP	1.51	1.56	1.50	1.55	1.54	1.54	1.54
CNY/GHS	0.63	0.69	0.70	0.73	0.76	0.79	0.83
CNY/KES	15.16	15.61	16.06	15.87	15.97	16.11	16.43
CNY/MUR	5.11	5.09	5.23	5.38	5.37	5.36	5.35
CNY/NGN	1.92	2.08	1.86	1.94	1.96	1.97	2.00
CNY/ZAR	527.88	550.68	575.61	586.12	592.46	598.64	613.26
CNY/UGX	1.51	1.56	1.50	1.55	1.54	1.54	1.54

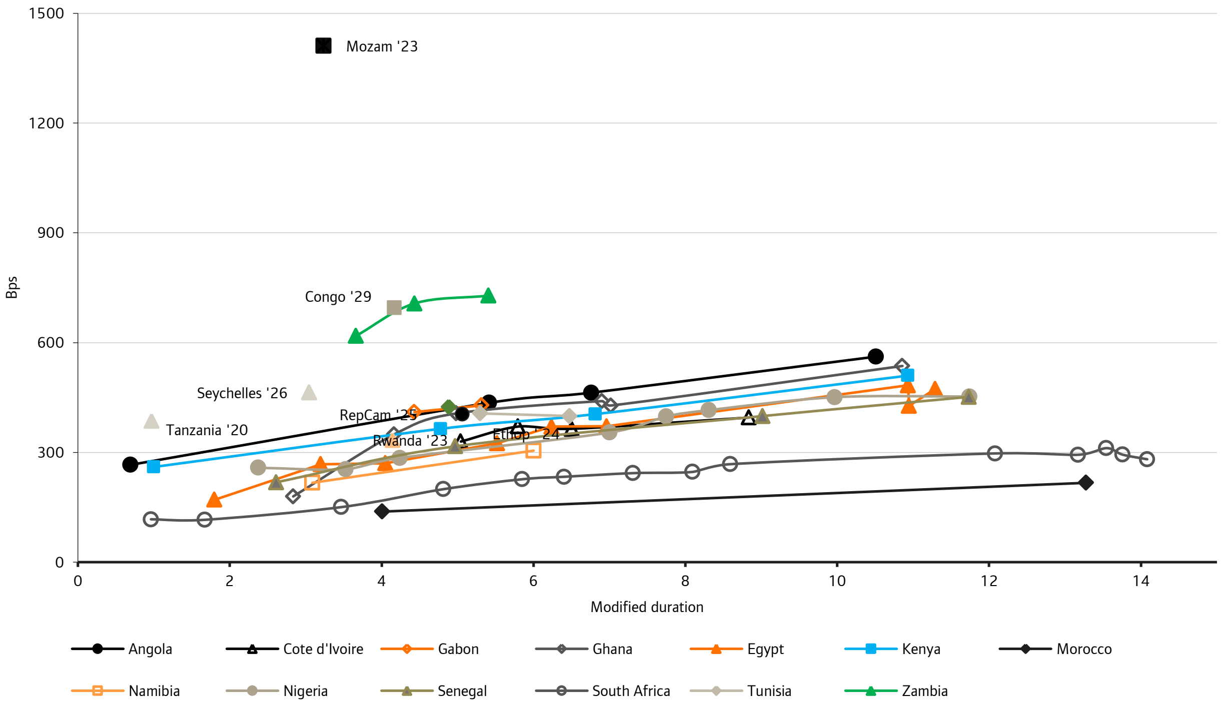
Source: Bloomberg; Standard Bank Research

African Eurobonds

					Spread, bps		Spread change, bps			Total return, %		
Name	**Moody's/Fitch**	**Mid Price**	**Mod Dur**	**Yield, %**	**Over UST**	**Z-Spread**	**1 wk**	**YTD**	**12mths**	**1 wk**	**YTD**	**12mths**
ANGOL 7% 16-AUG-2019	B3/	101.500	0.7	4.84	266	219	-2	124	-5	0.1	0.5	3.6
ANGOL 9.5% 12-NOV-2025	B3/B	112.875	5.4	7.23	436	429	-12	-27	-203	1.5	1.0	14.7
ANGOL 8.25% 09-MAY-2028	B3/Be	104.625	6.8	7.58	463	460	-18			2.3		
ANGOL 9.375% 08-MAY-2048	B3/Be	108.125	10.5	8.61	562	560	-17			3.5		
REPCAM 9.5% 19-NOV-2025	/B	112.375	4.9	7.08	425	415	13	61	-13	0.2	-3.3	2.8
REPCON 3% 30-JUN-2029	/CC	84.500	4.2	9.74	696	680	42	64	-272	-1.0	-1.8	18.4
EGYPT 5.75% 29-APR-2020	B3/B	102.848	1.8	4.18	171	145	-14	6	-126	0.5	0.3	4.7
EGYPT 6.125% 31-JAN-2022	B3/B	102.404	3.2	5.39	268	252	-17	-4	-90	1.0	0.1	4.9
EGYPT 5.577% 21-FEB-2023	B3u/B	100.394	4.0	5.48	271	258	-20			1.4		
EGYPT 5.875% 11-JUN-2025	B3/B	98.537	5.5	6.13	325	319	-15	-14	-70	1.7	-0.2	5.2
EGYPT 7.5% 31-JAN-2027	B3/B	105.604	6.2	6.63	371	367	-12	9	-62	1.8	-1.8	5.2
EGYPT 6.588% 21-FEB-2028	B3u/B	99.409	7.0	6.67	372	369	-15			2.2		
EGYPT 8.5% 31-JAN-2047	B3/B	107.555	10.9	7.83	483	481	-12	6	-61	3.1	-3.5	8.1
EGYPT 6.875% 30-APR-2040	B3/B	95.576	10.9	7.27	427	424	-7	-4	-65	2.5	-2.7	8.1
EGYPT 7.903% 21-FEB-2048	B3u/B	101.834	11.3	7.74	474	473	-11			3.0		
ETHOPI 6.625% 11-DEC-2024	B1/B	98.625	5.1	6.89	405	396	9	58	-46	0.4	-3.5	4.5
GABON 6.375% 12-DEC-2024	/B	97.625	4.4	6.90	410	398	-38	32	-43	2.4	-1.6	4.3
GABON 6.95% 16-JUN-2025	B3/B	98.875	5.3	7.15	429	421	-19	31	-41	1.9	-2.2	4.3
GHANA 9.25% 15-SEP-2022	B3/B	114.500	2.8	4.44	180	160	8	-131	-359	0.2	4.0	14.3
GHANA 7.875% 07-AUG-2023	B3/B	107.000	4.2	6.27	349	336	2	-7	-225	0.6	0.2	13.0
GHANA 8.125% 18-JAN-2026	B3/B	106.375	5.0	6.90	407	397	-3	24	-193	1.0	-1.6	13.2
GHANA 7.625% 16-MAY-2029	B3/	101.875	6.9	7.35	440	437	-16			2.2		
GHANA 10.75% 14-OCT-2030	B1/BB-	126.875	7.0	7.24	428	424	0	48	-122	1.2	-4.7	10.8
GHANA 8.627% 16-JUN-2049	B3/B	102.875	10.9	8.36	536	535	-21			4.1		
IVYCST 5.375% 23-JUL-2024	Ba3/B+	96.125	5.0	6.14	330	321	16	56	-52	0.0	-3.6	4.1
IVYCST 2.5% 31-DEC-2032	/B+	95.000	5.8	6.60	371	362	-1	33	-62	1.0	-2.9	5.1
IVYCST 6.375% 03-MAR-2028	Ba3/B+	98.625	6.5	6.58	365	361	2	47	-43	0.9	-4.4	4.0
IVYCST 6.125% 15-JUN-2033	Ba3/B+	92.875	8.8	6.93	395	390	4	45		1.2	-6.4	
KENINT 5.875% 24-JUN-2019	/B+	101.000	1.0	4.90	261	215	8	93	0	0.0	0.0	2.9
KENINT 6.875% 24-JUN-2024	/B+	102.000	4.8	6.47	365	354	11	29	-76	0.2	-2.0	5.7
KENINT 7.25% 28-FEB-2028	/B+	101.750	6.8	7.00	405	401	14			0.1		
KENINT 8.25% 28-FEB-2048	/B+	101.625	10.9	8.10	510	509	10			0.6		
MOROC 4.25% 11-DEC-2022	/BBB-	100.397	4.0	4.15	139	126	6	56	-5	0.3	-3.3	-0.2
MOROC 5.5% 11-DEC-2042	/BBB-	103.974	13.3	5.21	217	217	3	20	2	1.5	-6.7	-0.6
MOZAM 10.5% 18-JAN-2023	Caa3u/	84.000	3.2	16.81	1,411	1,393	20	-80	-314	0.0	7.2	26.7
REPNAM 5.5% 03-NOV-2021	Ba1/BB+	102.000	3.1	4.86	217	201	2	57	9	0.3	-2.1	0.5
REPNAM 5.25% 29-OCT-2025	Ba1/BB+	95.750	6.0	5.97	305	301	5	46	21	0.6	-4.1	-1.0
NGERIA 6.75% 28-JAN-2021	/B+	103.875	2.4	5.17	258	237	14	3	-55	0.0	0.2	3.5
NGERIA 5.625% 27-JUN-2022	B2/B+	101.250	3.5	5.28	254	240	1	5		0.5	-0.5	
NGERIA 6.375% 12-JUL-2023	/B+	103.250	4.2	5.63	285	273	1	2	-86	0.6	-0.5	5.2
NGERIA 6.5% 28-NOV-2027	B2/B+	100.000	7.0	6.50	354	352	-10	1		1.7	-1.7	
NGERIA 7.143% 23-FEB-2030	B2/B+	101.375	7.7	6.97	399	396	-3			1.5		
NGERIA 7.875% 16-FEB-2032	B2/B+	106.375	8.3	7.14	416	412	-1	14	-28	1.4	-3.2	3.1
NGERIA 7.696% 23-FEB-2038	B2/B+	102.000	10.0	7.50	451	447	4			1.2		
NGERIA 7.625% 28-NOV-2047	B2/B+	101.000	11.7	7.54	453	452	2	0		1.5	-3.2	
RWANDA 6.625% 02-MAY-2023	/B+	102.125	4.1	6.12	334	321	-5	2	-73	0.9	-0.3	5.0
SENEGL 8.75% 13-MAY-2021	Ba3/	110.750	2.6	4.80	219	198	-9	43	-61	0.6	-1.1	3.3
SENEGL 6.25% 30-JUL-2024	Ba3/	101.250	5.0	6.00	317	307	13	64	0	0.1	-4.0	1.0
SENEGL 6.25% 23-MAY-2033	Ba3/	93.625	9.0	6.97	400	395	10	77	26	0.6	-9.1	-2.0
SENEGL 6.75% 13-MAR-2048	Ba3/	90.875	11.7	7.53	452	451	7			1.0		
SEYCHE 3% 01-JAN-2026	/BB-	102.110	3.0	7.33	464	444	26	4	-52	-0.3	0.6	5.3
SOAF 6.875% 27-MAY-2019	Baa3/BB+	103.314	1.0	3.45	117	71	1	12	1	0.1	0.6	1.5
SOAF 5.5% 09-MAR-2020	Baa3/BB+	103.186	1.7	3.62	116	89	7	1	-50	0.1	0.2	2.1
SOAF 5.875% 30-MAY-2022	Baa3/BB+	105.953	3.5	4.24	151	136	7	10	-39	0.2	-1.0	1.5
SOAF 4.665% 17-JAN-2024	Baa3/BB+	99.225	4.8	4.82	200	190	4	5	-21	0.5	-1.4	1.0
SOAF 5.875% 16-SEP-2025	Baa3/BB+	104.223	5.9	5.17	227	222	9	11	-10	0.4	-2.2	0.3
SOAF 4.875% 14-APR-2026	Baa3/BB+	97.481	6.4	5.27	234	231	-1	16	0	1.1	-2.9	-0.4
SOAF 4.85% 27-SEP-2027	Baa3/BB+	96.000	7.3	5.40	244	242	2	15		1.0	-3.3	
SOAF 4.3% 12-OCT-2028	Baa3/BB+	90.964	8.1	5.45	247	245	1	19	-5	1.2	-4.1	-0.6
SOAF 5.875% 22-JUN-2030	Baa3/BB+	101.922	8.6	5.65	268	264	-6			2.0		
SOAF 6.25% 08-MAR-2041	Baa3/BB+	103.122	12.1	5.99	297	295	5	9	18	1.2	-5.0	-2.5
SOAF 5.375% 24-JUL-2044	Baa3/BB+	92.140	13.2	5.97	294	294	2	17	29	1.6	-6.0	-3.5
SOAF 6.3% 22-JUN-2048	Baa3/BB+	101.843	13.5	6.16	312	314	-1			2.0		
SOAF 5.65% 27-SEP-2047	Baa3/BB+	95.380	13.8	5.99	294	296	1	4		1.9	-4.4	
TNZNIA 6.4499% 08-MAR-2020	/	102.875	1.0	6.15	386	346	-1	208	168	0.1	0.0	2.5
BTUN 5.75% 30-JAN-2025	B2/B+	93.725	5.3	6.94	407	400	-24	62	-14	2.2	-3.9	2.5
BTUN 8.25% 19-SEP-2027	B2/WD	108.923	6.5	6.93	399	396	10	-39	-88	0.3	1.4	7.5
ZAMBIN 5.375% 20-SEP-2022	/B	87.500	3.7	8.93	618	604	44	244	174	-1.0	-8.2	-3.3
ZAMBIN 8.5% 14-APR-2024	/B	94.000	4.4	9.87	707	695	60	289	181	-1.9	-11.8	-4.2
ZAMBIN 8.97% 30-JUL-2027	/B	93.500	5.4	10.16	728	721	41	253	163	-1.3	-12.9	-5.0
SB Africa Eurobond (incl. SA)	B+		6.8	6.96	401	398	3	49	-20	0.8	-2.5	4.5
SB Africa Eurobond (excl. SA)	B+		6.6	7.22	428	424	3	57	-25	0.9	-2.5	5.2

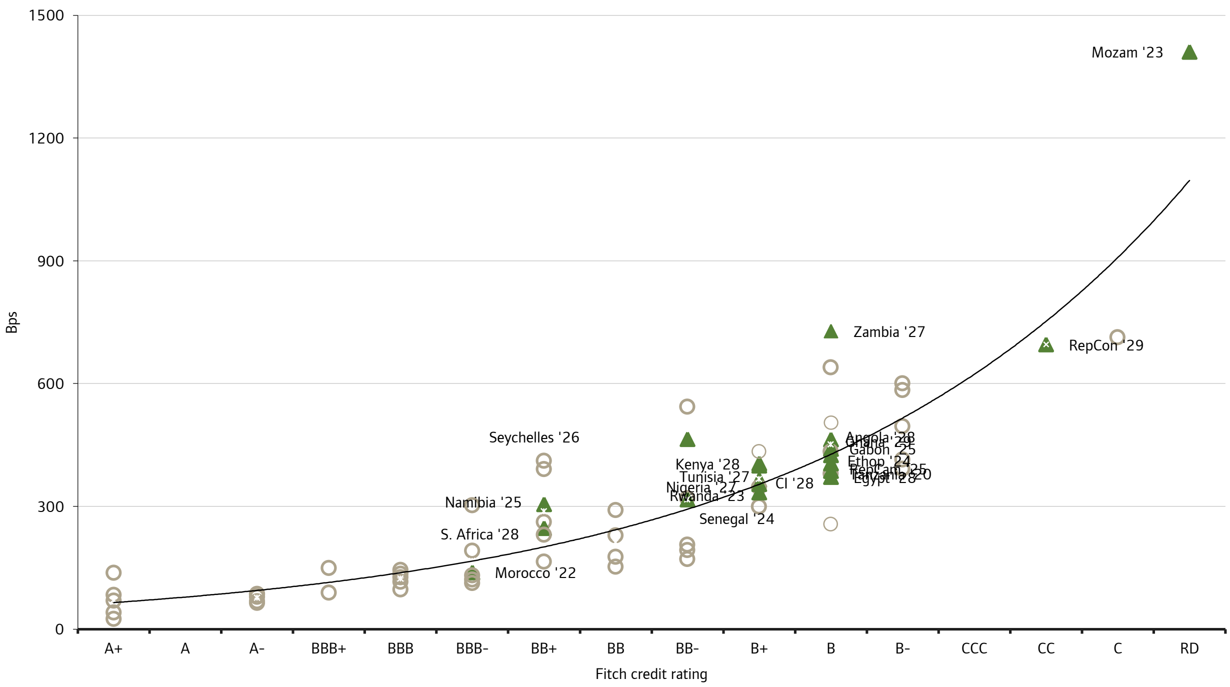
Source: Bloomberg; Standard Bank Research

Figure 19: African sovereign USD bonds (spread over US Treasuries versus modified duration)



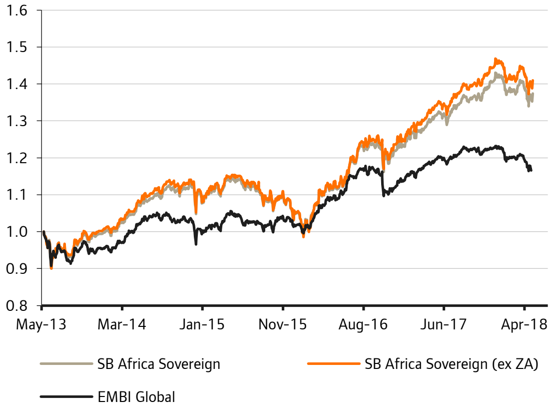
Source: Bloomberg; Standard Bank Research

Figure 20: African and broader EM bonds (spread over US Treasuries versus credit rating)



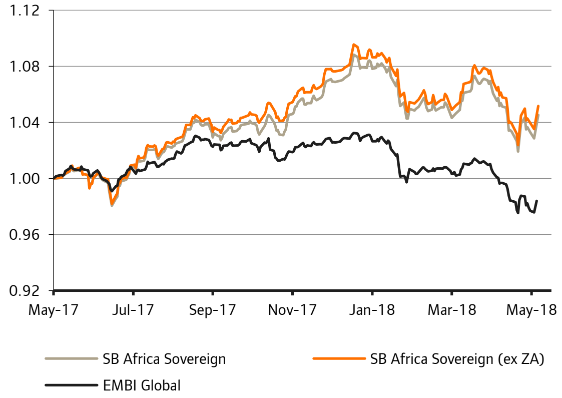
Source: Bloomberg; Standard Bank Research

Figure 21: African Eurobonds (5-y performance)



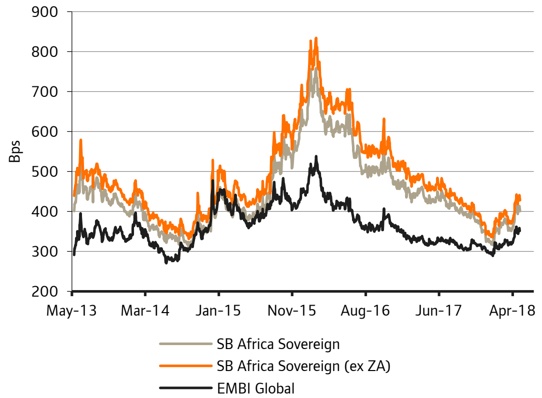
Source: Bloomberg; Standard Bank Research

Figure 22: African Eurobonds (1-y performance)



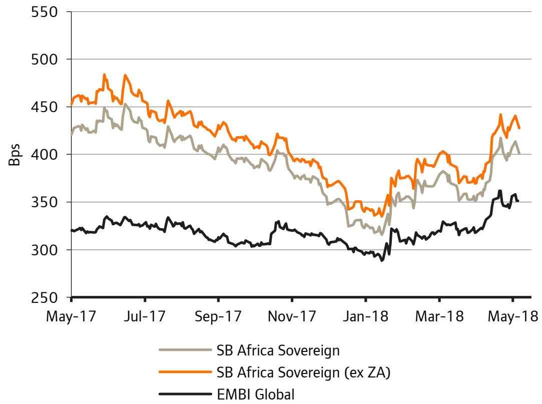
Source: Bloomberg; Standard Bank Research

Figure 23: African Eurobonds spread over UST (5-y)



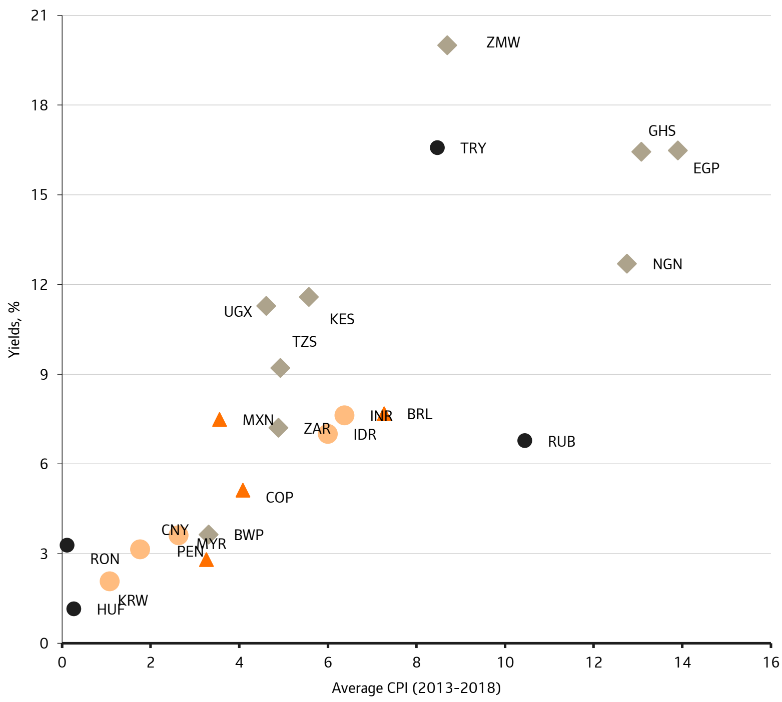
Source: Bloomberg; Standard Bank Research

Figure 24: African Eurobonds spread over UST (1-y)



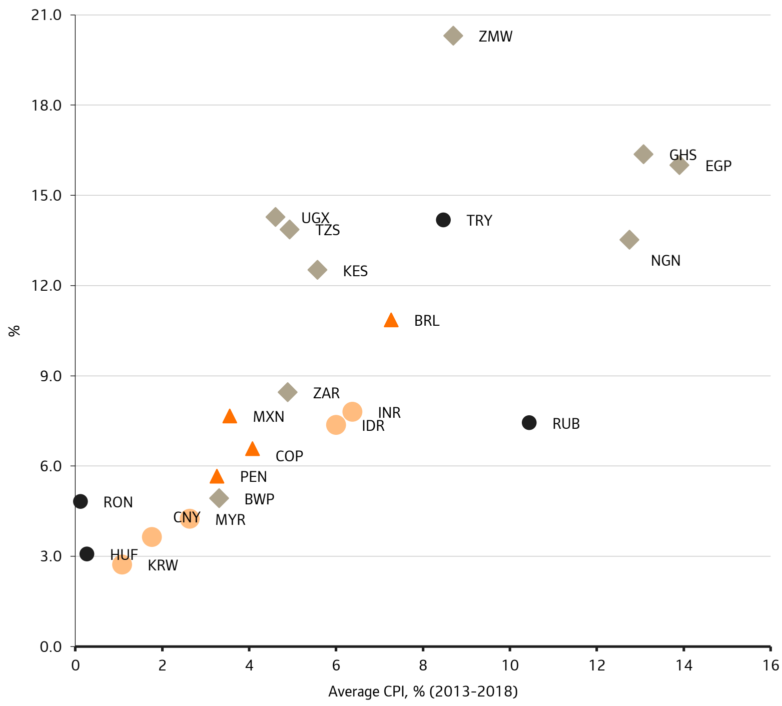
Source: Bloomberg; Standard Bank Research

Figure 25: Local 2-year bonds vs. past and forecast inflation



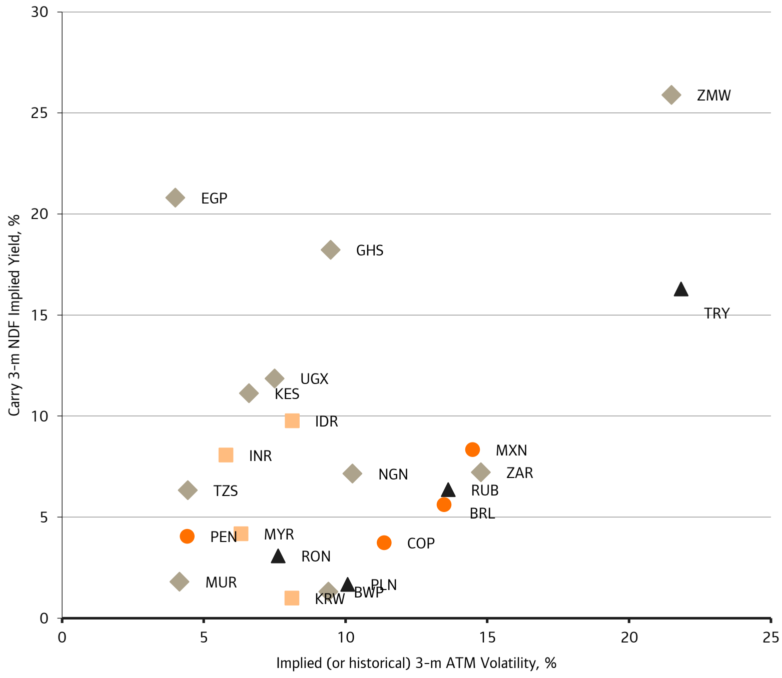
Source: Bloomberg; Standard Bank Research

Figure 26: Local 10-year bonds vs. past and forecast inflation



Source: Bloomberg; Standard Bank Research

Figure 27: NDF carry rates vs. implied vols



Source: Bloomberg; Standard Bank Research

Table of expected returns over the next 3 months

		Yield, %				Total return, %		
Country	Tenor	Current yield	Slide	Forward	SB forecast	Slide	Forward	SB forecast
Botswana	2Y	3.39	3.21	3.69	3.10	1.6	-0.5	1.4
	5Y	4.40	4.36	4.58	3.81	1.4	-0.3	3.7
	10Y	4.83	4.82	4.94	4.30	1.3	0.3	5.3
Egypt	2Y	16.40	16.66	16.12	15.80	3.7	4.5	5.0
	5Y	15.30	15.37	15.11	15.10	3.6	4.4	4.5
	10Y	15.20	14.99	15.10	15.00	4.8	4.3	4.8
Ghana	2Y	16.16	16.09	16.65	15.30	4.2	3.3	5.3
	5Y	16.25	16.29	16.50	15.50	3.9	3.2	6.5
	10Y	16.23	16.24	16.39	15.20	4.0	3.3	8.9
Kenya	2Y	12.21	12.10	12.85	11	3.2	2.0	5.0
	5Y	12.64	12.65	12.97	12.2	3.1	2.0	4.7
	10Y	12.79	12.79	13.01	12.7	3.2	2.0	3.7
Nigeria	2Y	13.52	13.61	13.47	12.50	3.2	3.5	5.0
	5Y	13.10	13.13	13.05	12.60	3.2	3.5	5.0
	10Y	13.53	13.49	13.52	12.90	3.6	3.5	6.7
South Africa	2Y	7.23	7.16	7.33	7.20	1.9	1.6	1.9
	5Y	7.93	7.89	8.01	8.00	2.2	1.7	1.7
	10Y	8.66	8.63	8.73	8.50	2.3	1.7	3.2
Tanzania	2Y	6.99	6.53	7.59	8.2	2.5	0.7	-0.3
	5Y	10.78	10.56	11.29	10.6	3.5	0.8	3.4
	10Y	13.32	13.24	13.78	13.8	3.7	0.9	0.8
Uganda	2Y	10.97	10.78	11.24	11.6	3.1	2.3	1.7
	5Y	12.66	12.57	12.91	12.8	3.5	2.3	2.7
	10Y	13.98	13.95	14.21	14.5	3.7	2.3	0.8
Zambia	2Y	16.62	16.28	17.64	16.90	4.7	2.6	3.7
	5Y	18.24	18.20	18.85	18.80	4.7	2.7	2.8
	10Y	18.74	18.72	19.19	19.50	4.8	2.7	1.4

Source: Bloomberg; Standard Bank Research

Notes: Yield curve scenarios: “Slide” = the bond yields slide along the unchanged yield curve, “Forward” = the yield curve evolves according to its embedded forward rates, “SB forecasts”= Standard Bank Research expectations

Asset class expected performance summary (3 months)

	FX	Rates	Credit	Equity
Angola	↓↓	→	→	
Botswana	→	→		↑
Côte d' Ivoire	↓	→	↑	→
Democratic Republic of the Congo	→	↓		
Egypt	→	↑	↑	↑
Ethiopia	↓	→	↑	
Ghana	→	↑	↑	→
Kenya	→	↑	→	↑
Malawi	→	↑		
Mauritius	↑	↑		↑
Morocco	↑	→	→	↑
Mozambique	→	↓↓	→	
Namibia	↑	↑	↑	↑
Nigeria	→	↑	↑	↑
Rwanda	↑	↑	→	↑
Senegal	↓	→	→	→
South Africa	→	→	↓	→
Tanzania	↓	→	→	↑
Tunisia	→	→	↓	→
Uganda	↓	↓		→
Zambia	↓	↑	→	↑

Source: Standard Bank Research

Recommended trades: performance

Open Trades

	Entry date	Entry yield, %	Entry FX	Latest yield, %	Latest FX	Total return, %	
Positions						**Since inception**	**1-month**
Uganda: buy UganGB '18	22-Feb-16	20.50	3440	9.00	3741	40.0	-0.5
Ghana: buy GHGB '20	31-Oct-16	20.00	3.99	16.55	4.62	17.6	-3.0
Zambia: buy ZAMGB '26	18-Nov-16	24.50	9.81	19.95	10.35	51.1	-11.0
Nigeria: buy 12-m T-bill	03-Aug-17	22.60	366.00	10.26	361.39	20.2	0.8
Egypt: buy Egypt '27	23-Nov-17	15.88	17.69	14.97	17.92	10.0	-0.3
BEAC: sell USD/XAF 2-y NDF	24-Nov-17	4.25	550.62	4.98	558.64	-0.5	-4.8
Ghana: sell USD/GHS 6-m NDF	19-Dec-17	12.30	4.53	17.82	4.66	1.9	-3.4
Zambia: sell USD/ZMW 12-m NDF	19-Dec-17	13.15	9.83	24.89	10.35	-6.0	-8.5
Kenya: buy Kenya IS '33	29-Jan-18	12.50	102.40	11.94	101.75	7.7	-1.1
Nigeria: buy NIGB '27	27-Feb-18	13.70	361.00	13.40	359.50	4.6	0.0
Malawi: buy 12-m T-bill	02-May-18	15.00	725.50	15.00	726.04	0.6	
Egypt: buy 12-m T-bill	01-May-18	16.92	17.70	17.70	17.92	-1.0	
Total portfolio internal rate of return since prev. AMR (18-Jan-2018)						1.5	

Source: Bloomberg; Standard Bank Research

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Angola: structural reforms surely must follow

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	-0.6	-4.0	-4.7	-1.0	-2.9	2.0	-4.7	-4.3	-4.0	-3.7	6.4	6.2
CPI (% y/y) pa	20.4	28.9	35.8	42.3	39.2	34.3	29.5	25.9	23.6	20.9	21.0	19.8
M2 (% y/y) pa	17.2	25.3	22.0	19.6	7.1	-0.8	-2.7	-0.9	2.5	4.4	4.4	4.6
CA/GDP (%) pe	-7.4	-7.0	-5.4	-3.0	-0.6	-0.4	-0.5	-0.7	-0.3	0.1	0.6	1.0
FX reserves (USD bn) pe	24.4	24.1	23.0	24.4	22.8	20.3	19.7	18.1	17.7	17.6	17.3	17.9
Import cover (months) pe	9.1	9.9	10.4	11.4	10.6	9.4	9.2	8.4	6.0	6.0	5.9	6.1
3-m rate (%) pe	14.6	14.2	13.9	16.5	16.1	16.2	16.2	16.2	16.2	16.2	16.2	16.2
1-y rate (%) pe	17.3	18.4	18.6	24.7	23.9	23.9	23.9	23.9	23.9	23.9	23.9	23.9
USD/AOA pe	160.4	165.9	165.9	165.9	165.9	165.9	165.9	165.9	214.6	235.2	246.6	253.4

Source: Banco Nacional de Angola; Instituto Nacional de Estatística de Angola; Standard Bank Research
Notes: pe – period end; pa –a period average

GDP growth: perhaps out of recession

We see an uptick in GDP growth this year and next, reaching 1.2% y/y and 2.4% y/y respectively, supported by improved oil prices which should improve FX liquidity and encourage aggregate demand. Both gross domestic expenditure (GDE) and net exports are likely to be lifted by better oil prices and easing inflation.

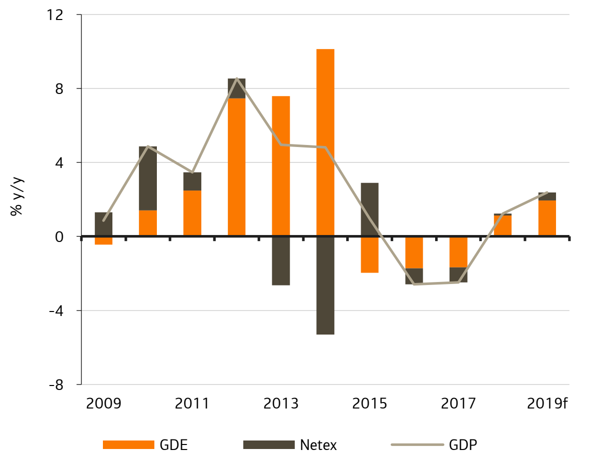
The National Institute of Statistics of Angola's (INE) preliminary estimates for 2017 GDP growth, based on quarterly data and updated annual data for 2016, show that the economy was in deep recession in the past 2-y. The last time the economy grew was in 2015, at 0.9% y/y, followed by contractions of 2.6% y/y and 2.5% y/y in 2016 and 2017 respectively.

The Angolan economy was severely hit by the oil price collapse in mid-2014, which caused severe FX liquidity pressures and impelled the authorities to adopt some degree of monetary tightening and fiscal consolidation measures.

From a sectoral perspective, the quarterly data shows that the oil sector increased its participation in GDP from 38% in 2016 to 42% during 2017, with the non-oil GDP easing from 62% to 58%. A number of government initiatives to promote investment, reduce oil dependency and increase confidence, including the recent request to the IMF for a Policy Coordination Instrument, should support President João Lourenço's structural reform agenda.

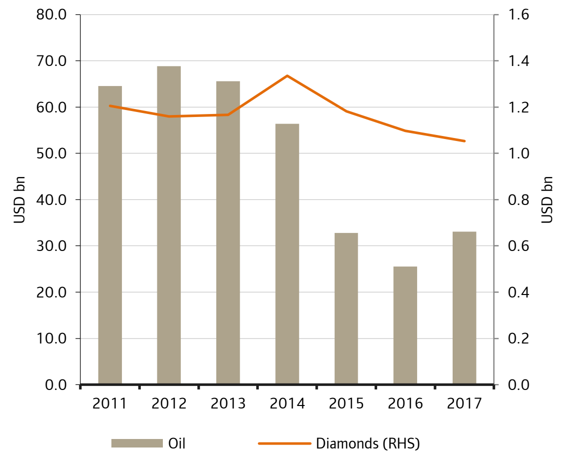
Despite the 5.4% y/y decline in oil output to 595.8m barrels in 2017 (1.63m bpd) reported by the Ministry of Finance, preliminary data from INE shows that oil-GDP grew by 8.2% y/y, in real terms in 2017 from a contraction of 2.7% y/y during 2016. The non-oil economy remained in recession, with a contraction of 2.5% y/y in 2016 and 8.9% y/y in 2017.

Composition of GDP growth by demand



Source: Instituto Nacional de Estatística de Angola; Standard Bank Research

Principal exports



Source: Banco Nacional de Angola; Ministério das Finanças; Standard Bank Research

Balance of payments: modestly better

The Brent crude price has risen substantially, trading near USD80.0/bbl recently from an average of USD54.1/bbl in 2017 and USD43.6/bbl in 2016. This should support the Angolan BOP.

However, during Q1:18 the volume of oil exports dropped by 7.3% y/y to 1.5m bpd, highlighting the negative impact of challenging operating conditions, maturing fields, and low investment.

Even so, the price increase was enough to compensate for the drop in volumes. As a result, oil export proceeds increased by 14.2% y/y to an average of USD3.0bn per month during Q1:18 from an average of USD2.6bn during Q1:17.

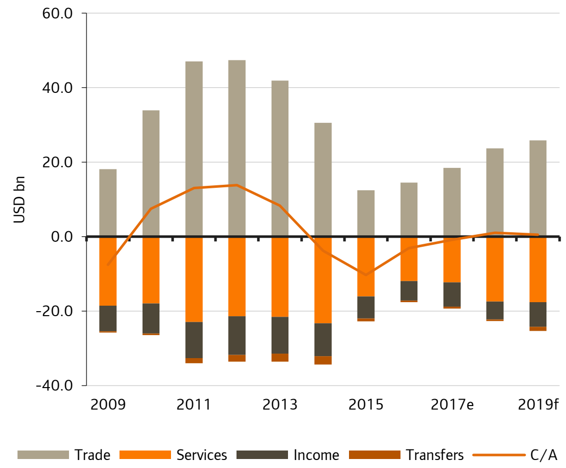
Despite the BNA devaluing the AOA since the beginning of the year, we do not expect a meaningful adjustment in the balance of payments.

As a result, even with export proceeds increasing, we expect only a modest improvement in the C/A balance, which could turn into a surplus of around 1.1% of GDP this year from what we estimate was a deficit of 0.8% of GDP last year and 3.1% in 2016.

Gross FX reserves declined to USD17.4bn in Apr, which represents around 7-m of import cover. Reserves increased by1.3% m/m in Mar, the first monthly increase in many months, perhaps attributed to the recovery of USD500m that was illegally transferred to the UK. The recent USD3.0bn Eurobond issuance brings some temporarily relief.

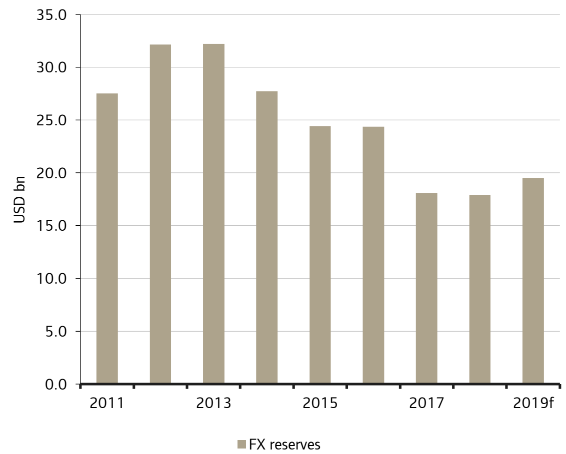
Most likely, FX reserves will rise to USD 17.9bn, compared to 2017, and increase in 2019 as the BOP improves. Were FX reserves to decline further it would limit the BNA's ability to increase FX sales and clear the backlog of FX demand.

Current account developments



Source: Banco Nacional de Angola; Standard Bank Research

FX reserves at year-end



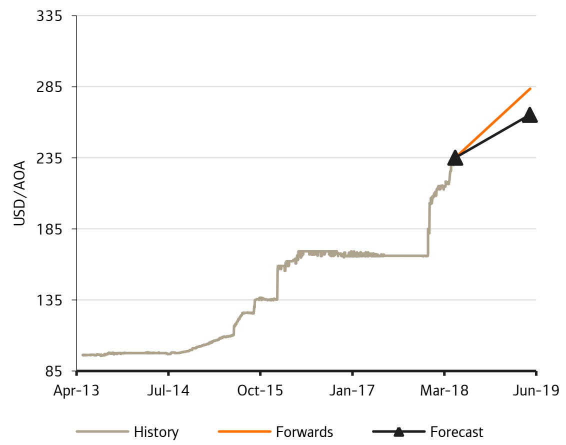
Source: Banco Nacional de Angola; Standard Bank Research

FX outlook: USD/AOA still heading higher

We have lifted our year-end forecast for USD/AOA to 253.4. In Jan the BNA started to implement a new FX regime that ensured that the official exchange rate would be determined via auctions. The BNA's FX sales between Jan and Apr totalled EUR2.8bn, which is 48.6% less than the amounts sold during the same period of 2017. Clearly, FX sales remained insufficient to clear the FX backlog, which suggests that the USD/AOA will still head higher.

After the sharp devaluation in the first two auctions, which pushed the official EUR/AOA rate at the end of Jan 39% higher than it was in Dec 17, the BNA capped the pace of change of EUR/AOA to a maximum of 2% per auction. The pair actually increased by 1.7% m/m in Feb, 0.9% m/m in Mar, 3.2% m/m in Apr and by mid-May was trading 0.8% higher than the Apr close.

USD/AOA: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: debt service pressures persist

Even when considering a budgeted decline in the fiscal deficit to 3% of GDP this year, from an estimated 5.6% in 2017, debt service will increase to 116.3% of fiscal revenues from 89.4% in 2017. Large maturities of debt, which have increased refinancing requirements, are the culprit. After all, interest expenditure will amount to just 22.3% of revenues. Clearly, the government will need to lengthen the maturity profile of debt.

Debt service pressures reflect an increase in the overall stock of government debt to GDP to 70.8% in 2018 from 68.6% in 2017. The stock of government domestic debt at the end of 2017 amounted to 34% of GDP, or AOA6, 240.5bn. 64% of this represented non-dollar-linked long-term bonds, 10% represented dollar-linked long-term bonds, 18.6% was T-bills, while 7.4% was other loans. External debt amounted to 34.6% of GDP.

Apr 18 data shows that the government is increasing the maturity profile of its domestic debt, which will ease short-term debt service pressures. The stock of long-term government bonds increased by 11.5% from its level in Dec 17, to AOA5,151.5bn, with the T-bill stock declining by 36.1% to AOA740.7bn.

The Angolan government recently raised USD3.0bn in Eurobonds, comprising a 10-y bond of USD1.75bn and a 30-y bond of USD1.25bn. Underlining the strong demand for Angolan paper, the bonds rallied in the secondary market.

The high demand for the Eurobonds shows that international investors are confident that President João Lourenço agenda of reforms will be enacted. We see the recent request for an IMF non-funded program (Policy Coordination Instrument) as a strong commitment to help drive Angola's government structural reform agenda, with the potential to lift foreign direct investment and increase economic diversification.

Central government budget

% of GDP	2016	2017	2018
Total revenue	17.4	17.7	18.4
Oil	8.2	9.3	10.1
Total expenditure	21.9	23.0	21.5
- wages	8.4	8.1	6.9
- interest	2.8	3.9	4.1
- development	3.9	4.6	3.9
Overall balance (commitment)	-4.5	-5.3	-3.0
Overall balance (cash basis)	-4.4	-5.6	-3.0
Net domestic borrowing	-7.6	2.7	0.7
Net external borrowing	12.0	2.9	2.4

Source: Ministério das Finanças; Standard Bank Research

Eurobond prices - mid

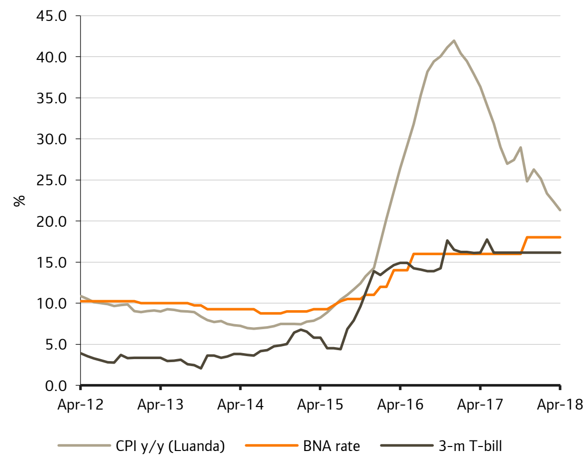
Source: Bloomberg

Monetary policy outlook: neutral bias

We expect headline inflation to close the year at 20.9% y/y, with the view that unwinding base effects and low aggregate demand will compensate for the impact of AOA devaluation. Inflation data reported to Apr shows the continuation of a declining trend, supported by unwinding base effects. Luanda inflation printed at 21.3% y/y in Apr from a peak of 42% y/y in Dec 16.

We see the BNA keeping its main policy rate at 18% this year, and starting to ease next year. Growth in monetary aggregates has started to rise but remains at historically low levels. The local currency component of money supply, M2, grew 4% y/y in Mar after contracting by 0.5% y/y last Dec. Growth in private sector credit accelerated to 9.5% y/y in Mar from 2.6% y/y at the end of 2017, showing an easing in the crowding-out effect. Government borrowing expanded at a slower 21.3% y/y pace in Mar from 23.8% y/y last Dec.

Inflation and interest rates



Source: Banco Nacional de Angola; Instituto Nacional de Estatística de Angola

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	25.1	25.9	26.7	27.5	28.2	29.0	29.8
Nominal GDP (AOA bn)	13 195	14 324	13 950	16 550	18 350	23 872	28 079
Nominal GDP (USD bn)	137	145	115	101	111	102	105
GDP / capita (USD)	5 444	5 606	4 316	3 669	3 916	3 512	3 519
Real GDP growth (%)	5.0	4.8	0.9	-2.6	-2.5	1.2	2.4
Oil ('000 barrels per day)	1 724	1 621	1 708	1 730	1 632	1 652	1 691
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	2.7	-2.1	-1.9	-4.4	-5.6	-3.0	-3.7
Budget balance (incl. Grants) / GDP (%)	2.7	-2.1	-1.9	-4.4	-5.6	-3.0	-3.7
Domestic debt / GDP (%)	10.9	14.7	23.0	31.3	34.0	30.8	30.5
External debt / GDP (%)	11.5	13.9	19.3	28.8	34.6	40.0	41.1
Balance of Payments							
Exports (USD bn)	69.6	60.9	34.4	28.3	32.0	41.6	44.3
Imports (USD bn)	49.2	53.5	38.0	25.7	25.8	35.3	36.0
Trade balance (USD bn)	20.4	7.3	-3.5	2.6	6.2	6.3	8.3
Current account (USD bn)	8.3	-3.7	-10.3	-3.1	-0.8	1.1	0.5
- % of GDP	6.1	-2.6	-8.9	-3.0	-0.7	1.0	0.5
Financial account (USD bn)	-8.2	-1.0	6.9	6.0	-5.5	-1.3	1.1
- FDI (USD bn)	-13.2	-2.3	8.2	1.4	-3.9	-1.6	1.4
Basic balance / GDP (%)	0.1	-3.2	-2.9	2.9	-5.7	-0.2	1.6
FX reserves (USD bn) pe	32.2	27.7	24.4	24.4	18.1	17.9	19.5
- Import cover (months) pe	7.9	6.2	7.7	11.4	8.4	6.1	6.5
Sovereign Credit Rating							
S&P	BB-	BB-	B+	B	B-	B-	B-
Moody's	Ba3	Ba2	Ba2	B1	B2	B3	B3
Fitch	BB-	BB-	B+	B	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	8.8	7.3	10.2	31.9	32.2	21.3	18.1
Consumer inflation (%) pe	7.7	7.5	14.3	41.9	26.3	20.9	14.6
M3 money supply (% y/y) pa	9.0	19.9	11.0	20.9	-1.0	4.0	10.7
M3 money supply (% y/y) pe	13.2	16.2	11.8	14.3	-0.1	5.4	8.8
BNA rate (%) pa	9.8	9.0	9.9	14.8	16.3	18.0	17.3
BNA rate (%) pe	9.3	9.0	11.0	16.0	18.0	18.0	16.0
3-m rate (%) pe	3.6	6.4	13.9	16.5	16.2	16.2	14.4
1-y rate (%) pe	5.8	7.5	12.6	24.7	23.9	23.9	22.0
USD/AOA pa	96.6	98.6	121.1	164.0	165.9	234.3	267.8
USD/AOA pe	97.6	103.1	135.3	165.9	165.9	253.4	278.2

Source: Banco Nacional de Angola; Instituto Nacional de Estatistica; Ministério das Finanças; Bloomberg; Standard Bank Research

Notes: pa – period average; pe – period end

Botswana: reaping some positives from diversification

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	2.3	3.9	6.9	4.3	0.9	1.0	1.1	6.5	4.1	4.3	4.7	4.7
CPI (% y/y) pa	2.9	2.7	2.7	2.8	3.9	3.7	2.7	2.9	3.0	3.5	3.7	3.8
M2 (% y/y) pa	11.5	9.9	4.3	4.9	3.8	1.2	4.0	5.8	10.0	12.5	12.4	11.0
CA/GDP (%) pa	8.0	10.3	19.7	11.5	19.3	12.6	8.1	13.2	14.1	14.0	13.1	13.4
FX reserves (USD bn) pe	7.6	7.4	7.6	7.2	7.0	7.3	7.5	7.5	7.8	8.2	8.2	8.0
Import cover (months) pe	14.7	14.4	14.8	14.0	17.0	17.6	18.0	18.1	13.9	14.8	14.8	14.3
3-m rate (%) pe	1.4	1.1	1.0	1.0	1.3	1.5	1.4	1.3	1.2	1.3	1.3	1.4
5-y rate (%) pe	4.4	4.4	4.0	4.3	4.3	4.4	4.2	4.1	4.1	4.2	4.2	4.3
USD/BWP pa	11.22	10.89	10.62	10.66	10.46	10.32	10.21	10.23	9.51	9.60	9.77	9.88

Source: Statistics Botswana; Bank of Botswana; Ministry of Finance; Standard Bank Research
Notes: pe – period end; pa –a period average

GDP growth: mining recovery

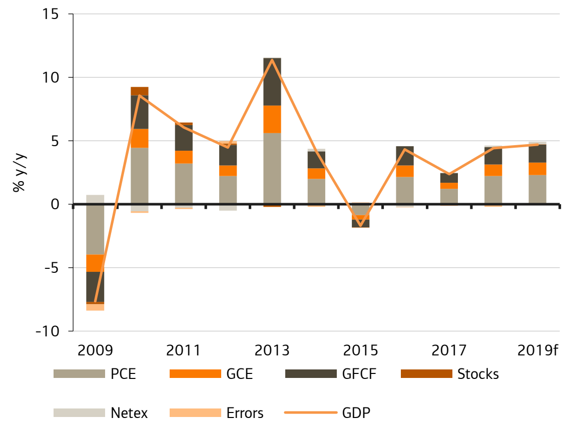
The global economic recovery and higher commodity prices will likely support Botswana's economy. Q4:17 GDP growth was a positive surprise at 6.5% y/y, overshooting our 2.7% y/y forecast. 2017 growth was 2.4% y/y, also higher than our 1.4% y/y forecast (but lower than 2016 GDP growth of 4.3% y/y). The budget 2018 forecast growth of 5.3% y/y for 2018; we expect GDP growth of 4.4% y/y in 2018 and 4.7% y/y in 2019. We expect the mining sector to recover and boost the economy in 2018, as growth in the sector turned positive in H2:17, printing 4.4% y/y in Q3:17 and 0.2% y/y in Q4:17, driven by diamond and coal mining. We also expect the recovery in the global economy to boost the Botswana mining sector.

Although the closure of BCL and Tati mines affected electricity distribution in 2017, it is likely that the resumption of operations by Mowana and Thakadu copper mines in Q2:17 will add to real value added. We expect the mining sector to continue to grow in 2018 and boost electricity distribution and other sectors.

Growth in the non-mining sectors also entered positive territory in 2017. Trade, hotels, and restaurants contributed the most toward 2017 real GDP growth, followed by the finance & business services and transport & communication sectors recording 7.3% y/y, 5.0% y/y and 4.7% y/y respectively. Economic diversification is therefore yielding positive results, which we expect to continue this year.

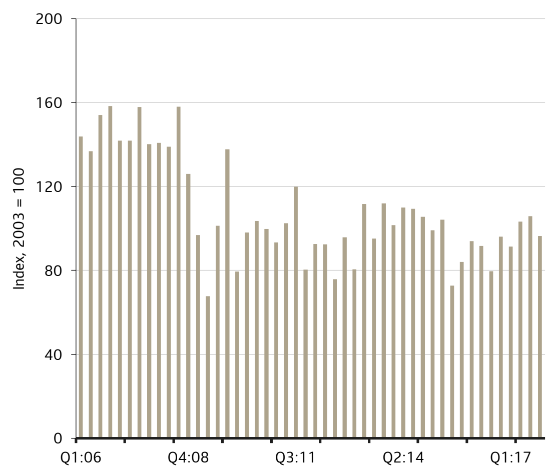
Growth in gross domestic expenditure was negative in 2016 and 2017, 0.5% y/y in both years, largely as a result of declining inventory and investment in machinery and equipment. In 2017 exports and imports declined by 13.3% y/y and 23.8% y/y respectively. We expect gross domestic expenditure to recover in 2018 and the recovery in the global economy to have a positive impact on exports. The downside risks to the positive outlook remains elevated due to Botswana's dependence on diamond for exports.

Composition of GDP by demand



Source: Statistics Botswana; Standard Bank Research

Diamond production



Source: Markit; Bloomberg

Balance of payments: sustained surplus

We expect stronger commodity prices and the recovery in global growth to boost exports in 2018. We look for a rebound in exports to USD7.6bn in 2018 from USD6.0bn in 2017. Imports are likely to recover in line with the broader recovery in economic activity. We expect a rebound in imports to USD6.7bn in 2018, reducing the trade surplus. Nonetheless, a depreciation of the BWP in H2:18 is likely to restrain growth in imports somewhat.

Moreover, as we expect a weaker BWP from H2:18, we expect it to enhance Botswana's attractiveness to international tourists, thus boosting the net services surplus, ensuring that the C/A balance remains in surplus.

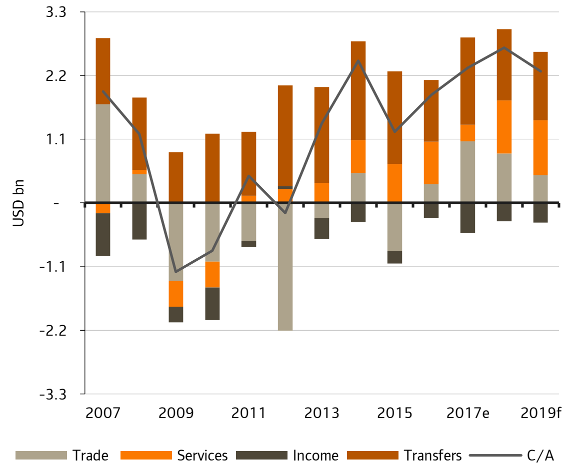
The C/A balance recorded a large surplus around USD2.3bn (13.2% of GDP) in 2017, compared to USD1.9bn (11.5% of GDP) in 2016. Exports fell from USD6.5bn in 2016, to USD6.0bn in 2017, as diamond revenues declined. Imports declined, from USD6.2bn in 2016 to USD5.0bn in 2017, reflecting weak growth.

But inflows of SACU transfers from South Africa are likely to decline due to subdued economic performance in South Africa. In addition, the recovery of the overpayment from South Africa in FY2016/17 will reduce these flows in 2018.

On the financial account, there have been recurrent net capital outflows since 2015, widening further in 2017 to USD1.6bn, from USD0.4bn in 2016, largely due to portfolio investment outflows to international markets.

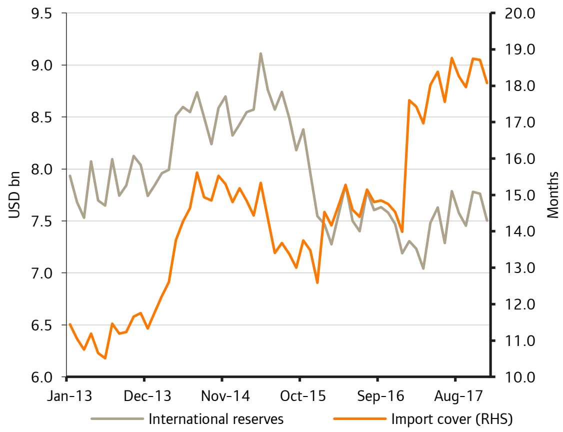
We anticipate FX reserves rising to nearly USD8.0bn in Dec 18, covering 14.3-m of imports. FX reserves increased to USD7.5bn in Dec 17, covering 18.1-m of imports (high import cover partly attributable to lower imports) from USD7.2bn, covering 14-m of imports in Dec 16.

Current account developments



Source: Bank of Botswana; Standard Bank Research

FX reserves



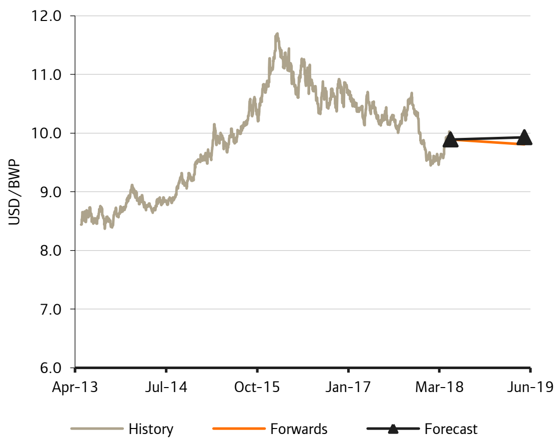
Source: Bank of Botswana; Statistics Botswana; Standard Bank Research

FX outlook: USD/BWP heading higher

The FX rate was stable in 2017, with the BWP depreciating against the ZAR, while appreciating against the SDR over the 12 months to Dec 17. In line with USD/ZAR, USD/BWP has been appreciating since Jan 18. This is not surprising given that the ZAR has a 45% weight in the BWP nominal effective basket. There is a risk of further ZAR weakness from Q3:18, with USD/ZAR likely around 12:25 (although it is currently trading above year end forecast).

Against this background, and given that BOB policy is targeting a negligible 0.3% downward crawl in the NEER in 2018, we believe that it is reasonable to expect BWP to depreciate against the USD and appreciate against the rand.

USD/BWP forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: deficit widening

The fiscal deficit for FY2017/18 was much lower than presented in the Budget Strategy Paper. The Finance Minister expected the deficit to widen to BWP6.5bn from the originally budgeted BWP2.4bn. The initially budgeted deficit of BWP2.4bn or 1.3% of GDP was reiterated in the FY2018/19 budget speech.

Looking to FY2018/19, the government expects the fiscal deficit to widen to BWP3.59bn or 1.8% of GDP. Despite the notional easing of the fiscal stance, the key message in the budget speech is expenditure restraint with the vision to return the country to a sustainable fiscal surplus. The widening of the FY2018/19 budgeted deficit was even regarded as temporary.

The government will be guided by the Medium Term Debt Management Strategy to finance the expected deficit. The fiscal deficit projected for FY2018/19 will, thus, be financed through borrowing and drawing down the government cash balances at the BOB.

Therefore, over the short and medium term, there is potential for a flattening of the yield curve, in spite of the potential additional supply of paper. In any event, the issuance of such paper is likely to be concentrated at the short end.

In an effort to address the issue of loss-making state-owned enterprises (SOEs), the government has established institutions to monitor SOEs finances and governance. This will ensure that SOEs deliver on their mandates, reducing the need for the government to provide them with financial support.

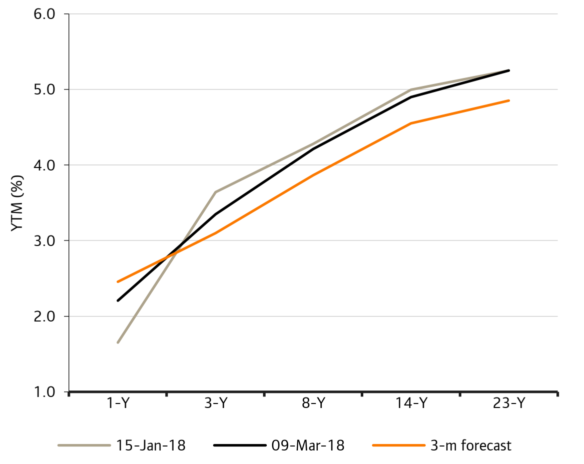
The Ministry of Finance is also in the process of introducing transfer pricing rules in the Income Tax Act, which is likely to reduce mispricing, increase tax revenue and also improve certainty for taxpayers.

Central government budget

% of GDP	FY2016/17	FY2017/18	FY2018/19
Total revenue	31.9	29.4	30.6
Total expenditure	31.2	30.7	32.3
Recurrent	23.8	23.5	24.5
- development	8.4	8.5	9.2
Overall balance (+ grants)	0.6	-1.3	-1.7
Overall balance (- grants)	0.6	-1.5	-1.9
Net domestic borrowing	0.0	0.0	0.0
Donor support (grants)	0.02	0.01	0.02

Source: Ministry of Finance, Statistics Botswana, Bank of Botswana, Standard Bank Research

Changes in yield curve

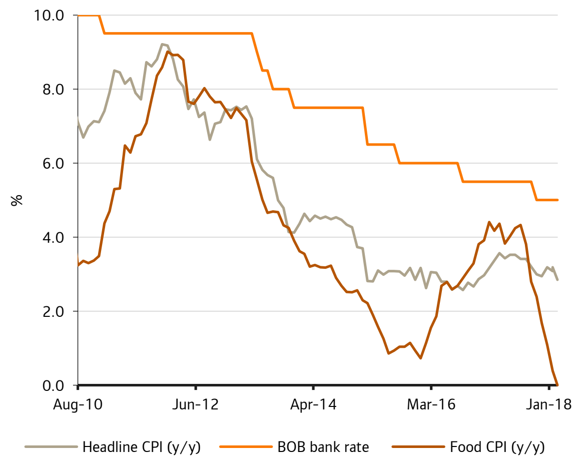


Source: Bloomberg; Bank of Botswana; Standard Bank Research

Monetary policy outlook: still an easing bias

Even though the MPC kept the policy rate unchanged at 5% on 30 Apr 18, we expect it to lower the policy rate in 2018, prompted by subdued economic growth and stable inflation. The MPC reiterated that economic growth remained below potential. Inflation remained low in 2017, around the lower-end of the 3.0% y/y – 6.0% y/y objective range. Inflation pressures remain muted, with only the housing and education sub-indices recording average growth of more than 5% y/y in the 12-m to Mar 18. All other sub-indices recorded average rates below 4.0 % y/y. Of course, the upside risks to the positive outlook relate to adjustment in administered prices. Nonetheless, although 2017 GDP growth was 2.4% y/y, higher than our 1.4% y/y forecast, it remained modest. Indeed, the BOB will likely maintain its assessment that economic growth is below potential. Moreover, there are no underlying inflation pressures in the economy.

Inflation and interest rates



Source: Statistics Botswana; Bank of Botswana; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	2.1	2.1	2.1	2.1	2.2	2.3	2.3
Nominal GDP (BWP bn)	125.2	145.9	145.9	170.6	180.1	194.4	210.2
Nominal GDP (USD bn)	14.82	16.21	14.31	15.73	17.48	20.06	21.15
GDP / capita (USD)	7 211	7 846	6 892	7 539	7 944	8 723	9 194
Real GDP growth (%)	11.4	4.2	-1.6	4.3	2.4	4.4	4.7
Diamonds ('000 carats)	22 693	24 658	20 824	20 892	23 000	23 300	23 500
Coal (Thousand tons)	1 496	1 712	2 066	2 100	2 200	2 300	2 200
Central Government Operations							
Budget balance / GDP (%)	1.1	5.2	3.9	-4.1	0.6	-1.3	-1.5
Domestic debt / GDP (%)	5.5	5.0	5.4	5.0	5.2	5.1	5.3
External debt / GDP (%)	17.5	15.2	17.2	14.7	13.9	13.4	13.4
Balance of Payments							
Exports (USD bn)	7.8	8.4	6.2	6.5	6.0	7.6	8.4
Imports (USD bn)	8.1	7.9	7.0	6.2	5.0	6.7	8.0
Trade balance (USD bn)	-0.3	0.5	-0.8	0.3	1.1	0.9	0.5
Current account (USD bn)	1.37	2.45	1.23	1.86	2.33	2.68	2.27
- % of GDP	9.6	15.6	8.2	11.5	13.2	13.4	13.1
Financial account (USD bn)	-0.95	0.27	-0.73	-0.44	-1.47	-2.30	-2.57
- FDI (USD bn)	0.30	0.40	0.49	-0.58	0.11	0.62	-0.18
Basic balance / GDP (%)	11.3	17.6	12.0	8.2	14.0	16.4	9.9
FX reserves (USD bn) pe	7.7	8.3	7.5	7.2	7.5	8.0	8.0
- Import cover (months) pe	11.5	12.6	12.9	14.0	18.1	14.3	12.1
Sovereign Credit Rating							
S&P	A-	A-	A-	A-	A-	A-	A-
Moody's	A2	A2	A2	A2	A2	A2	A2
Fitch	NR	NR	NR	NR	NR	NR	NR
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.9	4.4	3.1	2.8	3.3	3.5	3.4
Consumer inflation (%) pe	4.4	4.1	3.1	2.8	2.9	3.8	3.5
M2 money supply (% y/y) pa	6.0	7.8	18.6	7.7	3.7	11.4	7.7
M2 money supply (% y/y) pe	4.0	10.0	19.9	5.4	6.1	10.6	7.4
BOB policy rate (%) pa	8.6	7.5	6.8	5.8	5.4	4.3	4.3
BOB policy rate (%) pe	7.5	7.5	6.0	5.5	5.0	4.3	4.3
3-m rate (%) pe	3.6	3.3	1.2	1.0	1.3	1.4	1.3
5-y rate (%) pe	4.9	5.0	5.5	4.3	4.1	4.3	4.5
USD/BWP pa	8.4	9.0	10.2	10.8	10.3	9.7	9.9
USD/BWP pe	8.7	9.3	10.9	10.7	10.2	9.9	10.0

Source: Bank of Botswana; Statistics Botswana; Ministry of Finance; Standard Bank Research; Bloomberg

Notes: pe – period end; pa –a period average

Côte d'Ivoire: overweight the Eurobonds

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	7.8	7.5	8.2	10.5	7.2	7.5	8.4	7.3	6.5	7.5	7.5	8.5
CPI (% y/y) pa	0.6	1.3	0.7	0.6	1.1	1.0	1.5	0.9	0.1	0.5	1.1	1.2
M3 (% y/y) pa	18.6	13.5	11.5	10.3	6.1	10.4	18.0	14.3	15.4	18.5	14.2	12.7
CA/GDP (%) pe	-1.0	-1.0	-1.1	-1.1	-3.6	-3.8	-1.8	-4.1	-3.2	-2.9	-2.5	-2.5
FX Reserves (USD bn) pe	4.7	4.4	5.0	5.2	5.9	5.7	5.5	5.4	6.2	7.0	6.4	6.2
Import Cover (months) pe	6.6	6.2	7.0	7.2	7.4	7.1	6.9	6.8	7.3	8.2	7.5	7.2
Marginal lending rate (%) pe	3.5	3.5	3.5	3.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
USD/XOF pe	597	584	694	612	619	579	570	564	547	547	570	547

Source: Bloomberg; International Monetary Fund; Ministère de l'Economie et des Finances; Institut National de la Statistique; Banque Centrale des Etats de l'Afrique de l'Ouest; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available

GDP growth: still strong, but normalizing

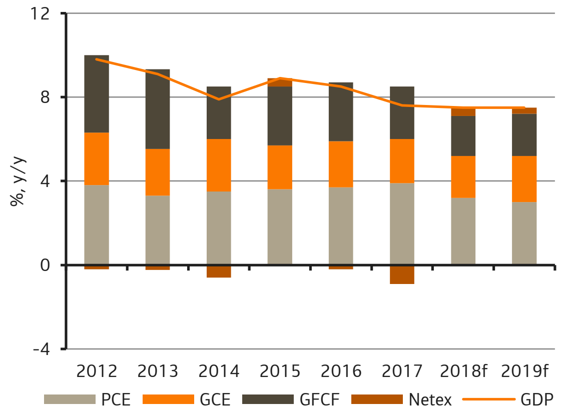
We are still happy with Côte d'Ivoire's medium-term growth trajectory, given the increased share of private sector investment in this economy. As such, we expect that real GDP growth will average around 7.5% y/y over the next 2-y despite continuing concerns relating to the political environment ahead of the 2020 presidential elections.

In a move to continue with reforms in the military, the Minister for Defence recently announced the voluntary retirement of over 2,000 personnel. This comes after the administration retired around 1,000 personnel last year, amid mutiny from different factions of the military. In our view, the risk of continued agitation by the military still exists due to the belief that the government can afford more bonus payments. Although this could be disruptive, we do not expect that it would deter potential long-term private sector investments.

Growth will likely be underpinned by a positive swing in net exports, as cocoa prices have risen, outpacing the expected increase in machinery and equipment imports. The planned increase to cocoa farm-gate prices during the main harvest season should also serve to incentivize increased agricultural activity. More importantly, the agro-processing sector continues to develop, with a flurry of investment announcements made in recent months.

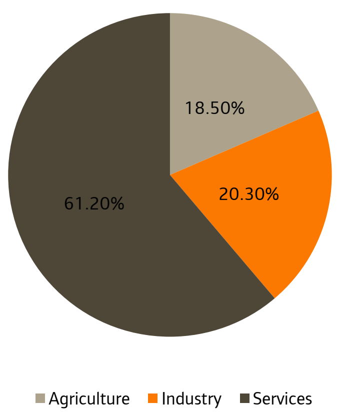
Political uncertainty is likely to mount ahead of the 2020 elections that are set to dominate headlines over the next 18 months. This is one of the factors that potential real sector investors will likely weigh up in making investment decisions ahead of the first change in president since the 2010 crisis. Ahead of those elections, President Ouattara's ruling coalition is set to merge into one party.

Composition of GDP by demand



Source: Banque Centrale des Etats de l'Afrique de l'Ouest; International Monetary Fund; Standard Bank Research

Composition of GDP by sector (% of total), H1:17



Source: Banque Centrale des Etats de l'Afrique de l'Ouest; International Monetary Fund; Standard Bank Research

Balance of payments: stable C/A deficit

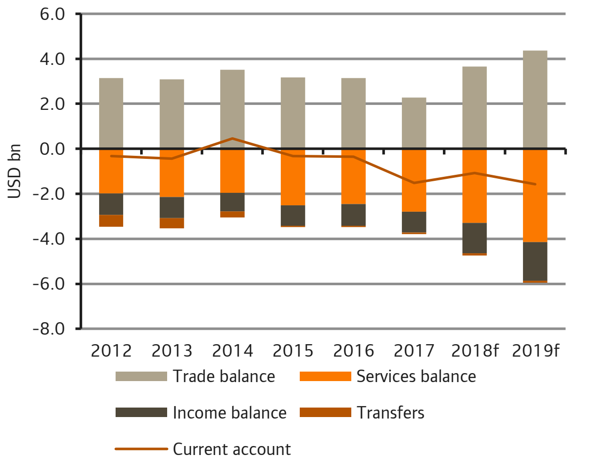
The positive cocoa price trajectory (recouping most of its loses from last year) implies that the C/A deficit will narrow this year. We expect the C/A deficit to narrow to USD1.1bn (2.5% of GDP) this year, before rising towards USD1.6bn (3.0% of GDP) next year. Indeed, an increase in capital investment-related imports should limit a potentially larger improvement in the C/A balance. As a consequence of both the rise in cocoa prices but also a rise in cocoa production volumes and Eurobond proceeds, we expect FX reserves to rise, potentially reaching USD6.2bn by the end of this year and USD6.7bn by the end of next year. The potential cocoa production coordination agreement between Côte d'Ivoire and Ghana should prove supportive.

Even if they were to ease slightly over the next 2-y, reflecting some concerns around elections, FDI inflows will probably remain healthy. Despite losing the case against Ghana over disputed waters, the country has other smaller proven oil reserves which should attract investments.

Tourism income in Côte d'Ivoire (albeit historically small as a share of total foreign earnings) continues to rise, and has the potential to rise much faster in coming years. For one, the increase in direct flights to Europe and the US in particular should help improve access to the country for both business and recreational trips. Indeed, an increase in hospitality-linked investment is visible in Abidjan as more international hotel franchises make investment announcements.

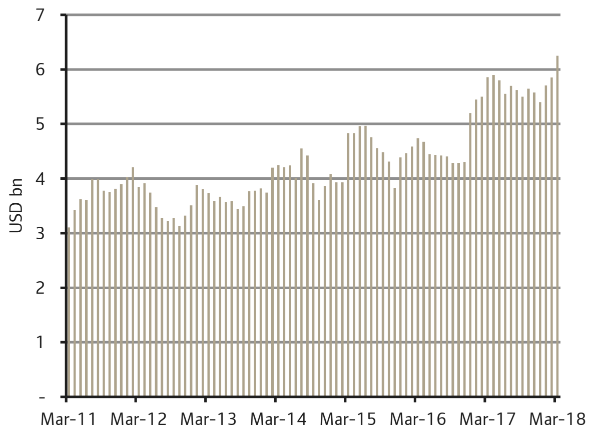
The Eurobonds will continue to receive an outsized share of portfolio flows, compared to the domestic market. This is to be expected, given the lower yields on offer in the domestic market. Indeed, the authorities may issue more euro-denominated bonds in coming years as EUR-based investors find these attractive due to limited FX risk.

Current account



Source: Banque Centrale des Etats de l'Afrique de l'Ouest; International Monetary Fund; Standard Bank Research

FX reserves



Source: Bloomberg; Standard Bank Research

FX outlook: still managing EUR/USD

Despite the fact that the USD has strengthened against currencies of the US's trading partners, our G10 Strategist, Steve Barrow, still expects EUR/USD to head higher on a multi-year basis. However, he suspects the pair will trade broadly flat this year. As such, we are happy to keep our long 2-y USD/XAF NDF position. For investors and corporate treasurers who require XOF locally, the commission charged by banks can vary vastly depending on the point-in-time during the cocoa exporting cycle. Of course, this commission can vary depending on the mode of entry into the market – either via the central bank or commercial banks. With the external environment improving, rumours about a potential devaluation or a total de-peg of the XAF and/or XOF from the EUR have died down. We think this will remain so over the course of the next 12-m. In any case, any currency movement will come with sufficient warning.

USD/XOF: forwards versus forecasts

Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: take advantage of wide Eurobond spreads

Limited room for both expenditure cuts and strong revenue mobilization, in our view, will likely result in the fiscal deficit moderating only slightly to 4.0% of GDP this year, from 4.6% of GDP in 2017 despite cocoa prices having rallied strongly, as the government also plans to increase its farm-gate price, thus resulting in a net neutral fiscal impact.

Revenue collection in the first 2-m of this year appears on track, according to official data. At 4.0% y/y, growth in revenue and expenditure tracked the budgeted estimates. As such, we have no reason to believe the fiscal deficit target will not be met. There is also nothing to suggest that the authorities will struggle with funding this deficit. In addition to commercial sources of funding, the country still has access to a reasonable amount of concessional bilateral funding.

Having said that, the authorities will continue looking to access international capital markets as the main avenue for raising budget funding. It already sold USD2.1bn worth of Eurobonds in Mar (the order book was over 2x oversubscribed), split between EUR and USD-denomination. Our expectation is for the euro-issuances to rise in coming years due to what authorities perceive as strong appetite from investors.

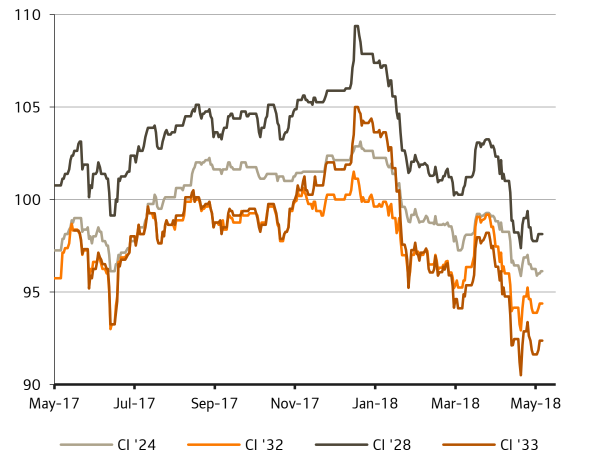
In our view, the Eurobonds will continue trading heavy in coming months, potentially trading wide to other credits with less positive macroeconomic fundamentals, due to security and political concerns. We do not expect any of these to remain enduring and as a result, will be looking for periods of political news-induced pressure to gain more exposure to the credit. The Eurobonds have lost 5.2% YTD, with the 33s performing the worst. We are currently overweight the USD bonds.

Budget

	FY2016	FY2017	FY2018
% of GDP			
Total revenue (+ grants)	21.7	20.6	21.5
Tax Revenue	17.4	17.0	17.1
Non-tax Revenue	2.6	2.8	2.8
Grants	1.7	1.4	1.7
Total expenditure	25.8	25.0	25.5
- Salaries, etc	7.1	6.9	6.7
- Interest	1.7	2.0	2.3
Capital expenditure	7.5	7.7	7.9
Primary Basic Balance	-1.0	-0.8	0.9
Budget Deficit (incl Grants)	-4.1	-4.6	-4.0
Domestic Financing	0.6	-1.3	0.1
External Financing	3.5	5.1	3.2

Source: Finance Ministry; Standard Bank Research

Eurobond prices - mid

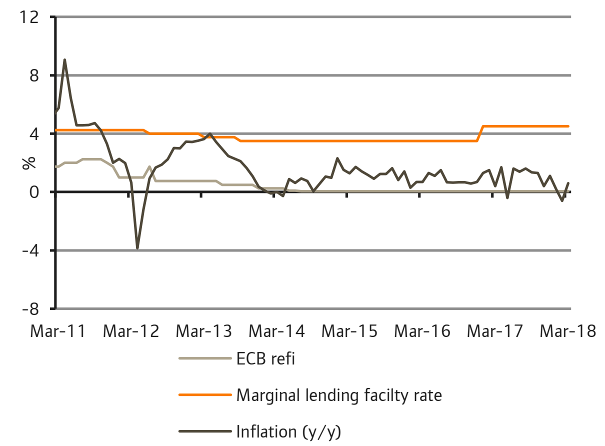


Source: Bloomberg

Monetary policy outlook: still a holding pattern

Inflation and inflation expectations are so benign that it is hard to expect that the BCEAO will change its monetary policy stance any time soon. In fact, the move to raise the Marginal Lending Rate by 100 bps, to 4.5%, in early 2017 was quite strange, as there was no sign of a pick-up in inflation expectations. Sure, inflation rose to a high of 1.7% y/y in Apr 17, but then it moderated to around 0.4% y/y in Dec, and crucially it has remained below the 2.0% y/y ceiling set for the region since then. We expect headline inflation to average 0.7% y/y this year, as food inflation pressures subside due to improved weather conditions. Headline inflation was 0.1% y/y in Apr, indicating that price pressures remain subdued. As expected, money supply grew modestly in Q1:18 rising to 15.4% y/y, from 5.1% y/y in Jan 17.

Inflation and interest rates



Source: Banque Centrale des Etats de l'Afrique de l'Ouest; Bloomberg; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	23	23	24	24	25	25	26
Nominal GDP (XOF bn)	15 346	16 796	18 495	20 214	21 973	23 777	25 875
Nominal GDP (USDbn)	31.0	33.9	31.1	32.5	37.3	43.0	52.2
GDP / capita (USD)	1,347	1,472	1,297	1 355	1 493	1 721	2 007
Real GDP growth (%)	9.1	7.9	8.9	8.5	7.6	7.5	7.5
Oil production (m bbl)	9.1	6.8	8.5	10.0	11.0	11.0	15.0
Cocoa production (m tonnes)	1.7	1.7	1.8	1.6	1.8	1.8	2.0
Central Government Operations							
Budget balance (excl. grants) / GDP (%)	-3.6	-4.0	-4.5	-5.8	-6.0	-5.7	-5.0
Budget balance (incl. grants) / GDP (%)	-2.3	-2.3	-3.6	-4.1	-4.6	-4.0	-3.2
Domestic debt / GDP (%)	17.3	16.8	16.1	15.7	16.0	14.0	14.0
External debt / GDP (%)	26.4	27.7	30.8	29.8	28.0	25.0	23.0
Balance Of Payments							
Exports of goods (USDbn)	12.4	11.8	11.5	11.8	11.9	13.9	17.5
Imports of goods (USDbn)	-9.3	-8.3	-8.3	-8.6	-9.6	-10.2	-13.1
Trade balances	3.1	3.5	3.2	3.1	2.3	3.7	4.4
Current account (USDbn)	-0.4	0.5	-0.3	-0.3	-1.5	-1.1	-1.6
- % of GDP	-1.4	1.4	-1.0	-1.1	-4.1	-2.5	-3.0
Capital & Financial account (USDbn)	0.6	0.4	0.6	1.5	1.7	1.8	2.1
- FDI (USDbn)	0.4	0.4	0.4	1.0	1.3	1.6	2.4
Basic balance / GDP (%)	0.0	2.5	0.3	2.1	-0.5	1.3	1.6
FX reserves (USDbn) pe	4.2	5.1	5.4	5.2	5.4	6.2	6.7
- Import cover (months) pe	5.4	7.4	7.8	7.2	6.8	7.2	6.1
Sovereign Credit Rating							
S&P	nr	nr	nr	nr	nr	nr	nr
Moody's	nr	B1	Ba3	Ba3	Ba3	Ba3	Ba3
Fitch	nr	B	B	B+	B+	B+	B+
Monetary & Financial Indicators							
Consumer inflation (%) pa	2.6	0.5	1.2	0.8	1.1	0.7	1.3
Consumer inflation (%) pe	2.6	1.0	1.4	0.7	1.1	1.3	1.3
M2 money supply (% y/y) pa	10.1	14.9	21.0	13.5	12.2	15.2	18.8
M2 money supply (% y/y) pe	11.6	15.9	19.1	9.4	14.0	13.2	18.4
Marginal lending facility (%) pe	3.5	3.5	3.5	3.5	4.5	4.5	4.5
USD/XOF pa	495.2	496.0	594.2	621.8	588.8	552.5	495.9
USD/XOF pe	478.7	544.3	609.9	612.0	564.2	546.6	468.5

Source: International Monetary Fund; Ministère de l'Economie et des Finances; Institut National de la Statistique; Banque Centrale des Etats de l'Afrique de l'Ouest; Bloomberg; Reuters; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated; na — not available

DRC: extractive sector leads

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	2.5	2.5	2.5	2.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
CPI (% y/y) pa	1.6	2.0	5.0	14.8	35.7	47.3	70.1	58.9	38.1	30.8	14.1	15.9
Policy rate (%) pe	2.0	2.0	7.0	7.0	14.0	20.0	20.0	20.0	14.0	14.0	10.0	10.0
M3 (% y/y) pa	4.2	1.9	11.2	18.9	36.7	50.6	46.8	39.6	25.3	14.5	13.3	13.5
CA/GDP (%) pa	-4.1	-4.1	-4.2	-4.2	-4.0	-3.6	-3.4	-3.3	-3.1	-2.8	-2.8	-2.6
FX reserves (USD bn) pe	1 277.0	1 091.0	928.2	852.1	735.9	709.3	660.4	844.0	890.0	810.0	750.0	805.0
Import cover (months) pe	1.3	1.1	1.0	0.9	0.8	0.7	0.7	0.8	0.9	0.8	0.7	0.7
7-d rate (%) pe	0.6	0.8	0.6	4.2	14.0	20.0	20.0	15.1	6.0	6.0	5.0	5.0
USD/CDF pa	926.0	936.0	979.0	1 216.0	1 396.0	1 538.0	1 538.0	1 595.0	1 607.0	1 620.0	1 635.0	1 647.0

Source: Banque Centrale du Congo; Ministry of Finance; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: copper-led recovery, but security risks linger

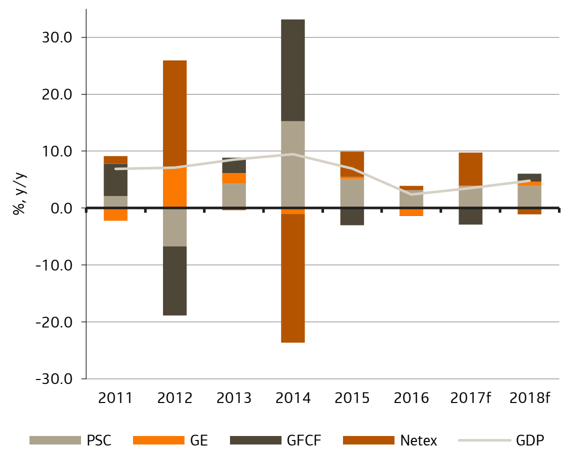
We expect the economic recovery to continue over the next 2-y, with growth of 3.5% y/y in 2018 and 5.3% y/y in 2019. Political and security risks, however, present material downside risk to the growth outlook. That said, mining production is likely to be a significant contributor to growth. On the back of recovering prices, there appears to be renewed strength in copper mining production. Copper mining production in 2017 was up to 1.09m tons from 1.02m tons in 2016. Similarly, cobalt production increased by 19.8% y/y to 82.5k tons in 2017. Preliminary figures in the first 2-m of this year suggest that the growth momentum will continue this year, with production expected to rise above 100k tons, a level last achieved in 2011.

In all likelihood, the new mining code, which is due to be implemented by the middle of this year, will not slow the growth momentum in the sector. In the interim, mining majors are trying to negotiate key parts of the accompanying regulations. While we acknowledge that the new mining code is more punitive, it is not likely to discourage new investment in the sector or reduce production, given the more favourable commodity prices.

Although the growth narrative largely draws from the extractive sector, there are other signs of dynamism in the wider economy. There were a number of infrastructure projects which bolstered cement production for the first 2-m of the year, up 133.4% y/y to 181.9k tons.

To some extent, the growth momentum is still constrained, since the government has been forced to cut back on spending. A deterioration in security conditions could undermine economic activity, especially agricultural production. Political tensions have been on the rise since 2016 when the government failed to hold elections. Despite logistical and financial constraints, both the government and the electoral commission committed to holding elections in Dec 18. Although there appears to be more certainty around elections taking place, the political situation still carries high risks. Ahead of elections, protests could flare up once more, worsening security conditions.

Composition of GDP by Demand



Source: Banque Centrale du Congo; Standard Bank Research

Contribution of GDP by sector (% of total)

	2011	2015	2017
Agriculture, forestry, fishing & hunting	47.7	27.9	16.6
Mining and quarrying	8.9	33.5	26.5
Manufacturing	5.2	5.0	12.2
Electricity, gas and water	3.2	3.5	0.7
Construction	5.2	4.5	3.5
Wholesale and retail trade, hotels and restaurants	16.6	10.5	9.3
Transport, storage and communication	4.2	6.0	12.7
Finance, real estate and business services	5.6	5.0	15.5
General government services	3.4	4.0	3.5
GDP	100	100	100

Source: Banque Centrale du Congo; Standard Bank Research

Balance of payments: financing pressures remain

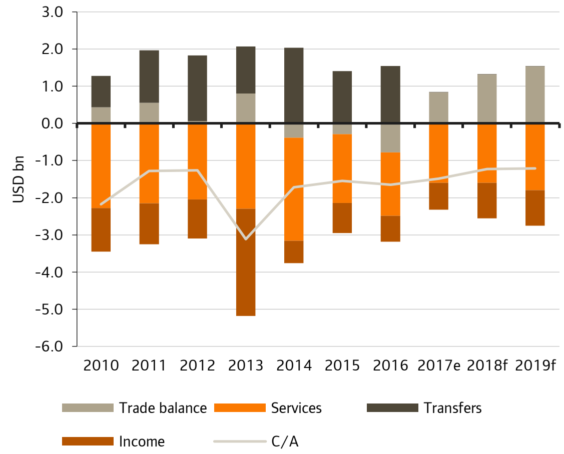
FX reserves will likely remain broadly stable this year, perhaps declining moderately to USD805m by year-end. By the end of 2019 we expect reserves to fall more significantly to USD750m. Correspondingly, import coverage will remain fairly low, hovering around 1-m over the next 2-y.

Stable commodity prices, combined with improving export production, will probably continue providing support for the balance of payments in the near term. Mineral production recovered quite strongly in 2017. In all likelihood, this will continue over the next 2-y, specifically for cobalt production, given the outlook for cobalt prices. In 2017 imports remained fairly weak, while exports rose 31% y/y, bolstering the trade balance.

The trade account will probably remain in surplus in 2018 and 2019, easing pressure on the C/A balance. We expect the latter to decline to 2.4% of GDP in those years from 2.8% of GDP in 2017. Despite low levels of official transfers, as official government aid has stalled, positive developments in the trade account will probably support the overall improvement in the C/A balance. The currency devaluation has limited domestic import demand, and the lack of government aid, should continue constraining import growth; at the same time, export growth is forecast to average 21% y/y. Combined, this would support continued external rebalancing over the next 2-y.

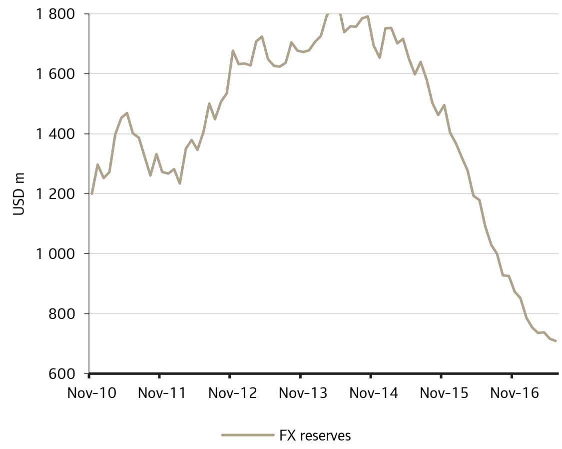
FDI inflows are the predominant source of capital inflows. Buoyant commodity prices should underpin continued investment in the mining sector. Over the next 2-y, following the elections, aid inflows should start slowly normalising, and financing for government projects could also become easier to secure. Over the near term, however, inadequate financial inflows will likely exert downward pressure on FX reserves. The government's precarious fiscal position also presents downside risks to FX reserve levels.

Current account developments



Source: Banque Centrale du Congo; Standard Bank Research

FX Reserves

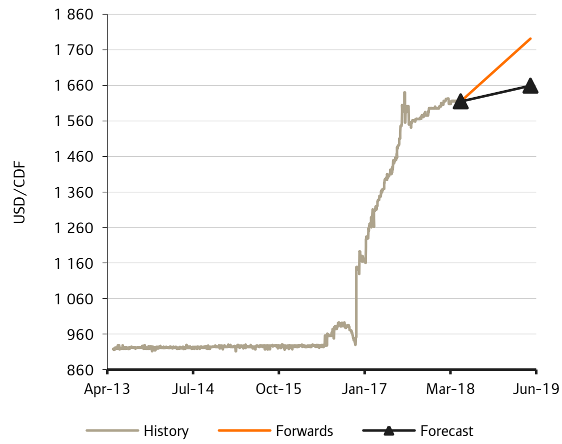


Source : Banque Centrale du Congo

FX outlook: holding steady

Despite risks tilted to the upside, for the next 4-m USD/CDF is likely to remain largely stable. The global backdrop should remain amenable to keeping commodity prices stable and, with it, the currency. For the pair to rise in the near term, there would have to be a resumption of extensive central bank financing of the government. At this point, exchange rate risks associated with political developments are binary; however, a deterioration of security conditions may place upward pressure on USD/CDF. The sharp depreciation in 2017, accompanied by an increase in inflation, will likely restrain import demand, which should also moderate upward pressure on the USD/CDF. We expect the pair to close the year at 1647.

USD/CDF: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: limited external financing

Limited access to external financing impels the government to operate its budget on a cash basis. Any deviation from a balanced cash budget approach implies that the government would have to rely on central bank financing. On the surface, it appears that the 2017 budget balanced on a cash basis. However, there could be up to USD1.2bn in outstanding VAT refunds owed to mining companies. Although there are no formal plans to settle the arrears, revenue authorities seem to have stopped collecting VAT from mining companies, which limits the accumulation of further VAT refund arrears.

Given that just over half of the government's revenue is collected from the mining sector, the changes in the mining code should materially increase future revenue streams. That said, it is difficult to quantify the exact impact these changes will have on government revenue just yet. Although the legislation has been signed into law, some mining companies are still negotiating key points of the accompanying regulation. The regulation is expected to be finalised in Jun, which implies that by Q3:18 the government's mineral receipts could be markedly higher. The new mining code proposes that royalties increase from 2.0% to 3.5% for non-ferrous and base metals, and from 2.5% to 3.5% for precious metals. In addition to these changes to existing mineral royalties, the creation of strategic substances royalty of 10%, which will probably apply to cobalt, would also bolster public finances.

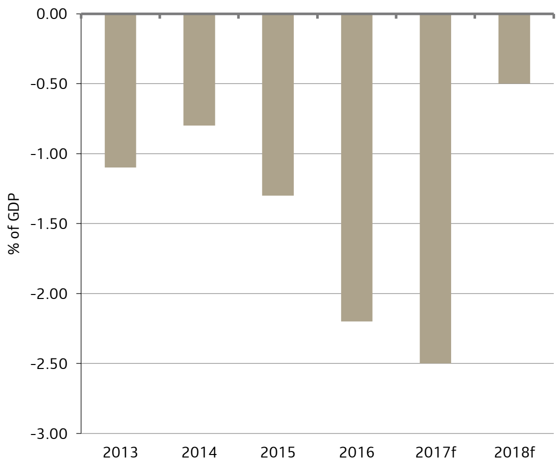
Capital expenditure appears to be on hold while the government prioritizes interest payments on debt and some recurrent expenditure. The budget has set aside CDF912bn (15.0% of the total budget) for elections scheduled in Dec 18. The electoral commission is funded by the government, and alleged funding constraints have contributed to the delay in the government holding elections. In all likelihood, elections will take place over the next 12-m, since more extensive testing of electronic voting equipment is underway.

Central government finances

% of GDP	2015	2016	2017
Total central govt. revenue	11.2	9.6	7.9
Total central govt. expenditure	12.0	10.9	11.3
- Recurrent	11.8	10.9	10.0
- Interest	0.7	0.4	0.5
- Wages	5.1	5.2	3.9
- Development/transfers	1.2	0.8	1.3
Central govt. bal. (ex. grants)	-0.8	-1.3	-3.3
Central govt. bal. (inc. grants)	-0.8	-1.3	-2.5
Net domestic borrowing (saving)	-0.8	-0.9	1.8
Net external borrowing (saving)	0.4	0.3	0.8
Grants (inc. HIPC)	0.0	0.0	0.8

Source: Banque Centrale du Congo; Standard Bank Research

Fiscal deficit



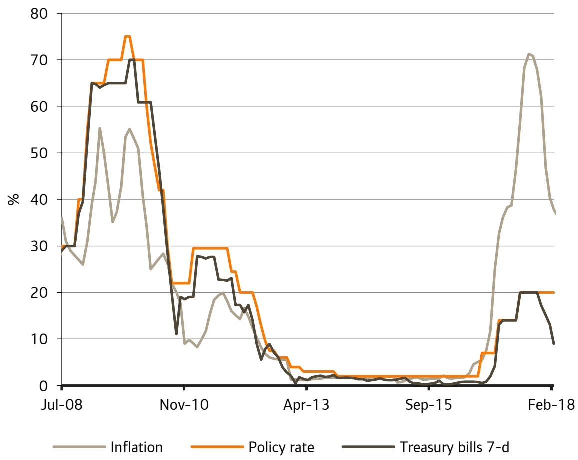
Source: Standard Bank

Monetary policy outlook: easing bias

The pass-through effects of the CDF devaluation were largely responsible for driving up prices. Since the USD/CDF has stabilized, the unwinding of base effects should continue moderating the pace of price increases. The w/w pace of increase in the CPI has stabilised at a low rate, ensuring that the y/y inflation rate, as reported by the BCC, fell to 34.1% y/y in Apr.

On the back of the improving inflation outlook, the BCC cut rates by 600 bps, to 14% in Apr. Consistent with the BCC's forward guidance, at least a further 400 bps rate cut is expected over H2:18. Over the past 4-m, both the 7-d and 28-d rates have fallen consistently, which also points to further easing. Upside risks to our inflation forecasts are disruptions to food supply, a resumption of the depreciation of the CDF probably as a function of excessive money creation by the BCC, and increased spending by political parties ahead of the elections.

Inflation and interest rates



Source : Banque Centrale du Congo

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	77.0	79.1	81.5	83.9	86.3	88.8	91.3
Nominal GDP (CDF bn)	30 051.2	33 224.0	35 111.2	37 936.0	59 370.7	70 864.9	87 284.4
Nominal GDP (USD bn)	32.7	36.0	38.1	39.3	40.7	43.5	50.9
GDP / capita (USD)	424.4	455.4	467.6	468.9	472.1	490.6	557.9
Real GDP growth (%)	8.5	9.5	6.9	2.5	3.5	3.5	5.3
Crude oil ('000 barrels)	8 351.0	8 362.0	8 247.0	7 058.0	6 893.0	7 237.7	7 599.5
Copper ('000 tonnes)	922.0	1 030.0	1 039.0	1 024.0	1 090.0	1 130.0	1 170.0
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-0.5	-1.1	-0.8	-1.3	-2.2	-2.5	-0.5
Domestic debt / GDP (%)	na	na	na	na	na	na	na
External debt / GDP (%)	15.9	13.4	13.6	15.3	14.7	20.5	20.5
Balance of Payments							
Exports (USD m)	11 613.0	12 321.2	10 284.8	8 199.0	10 780.0	12 970.0	15 930.0
Imports (USD m)	10 808.4	12 706.3	10 574.6	8 981.0	9 946.0	11 651.0	14 395.0
Trade balance (USD m)	804.6	-385.1	-289.8	-782.0	834.0	1 319.0	1 535.0
Current account (USD m)	-3 108.7	-1 722.6	-1 545.6	-1 646.0	-1 485.8	-1 230.7	-1 214.7
- % of GDP	-9.5	-4.8	-4.1	-4.2	-3.6	-2.8	-2.4
Financial account (USD m)	3 188.7	1 851.8	1 543.6	1 362.8	1 250.0	1 200.0	1 450.0
- FDI (USD m)	1 697.6	1 499.6	1 165.7	890.0	950.0	1 200.0	1 450.0
Basic balance / GDP (%)	-4.3	-0.6	-1.0	-1.9	-1.3	-0.1	0.5
FX reserves (USD m) pe	1 745.0	1 645.0	1 404.0	852.1	844.0	805.0	750.0
- Import cover (months) pe	1.9	1.6	1.6	1.1	1.0	0.8	0.6
Sovereign Credit Rating							
S&P	B-	B-	B-	B-	CCC+	CCC+	CCC+
Moody's	B3	B3	B3	B3	B3	B3	B3
Fitch	nr	nr	nr	nr	nr	nr	nr
Monetary & Financial Indicators							
Headline inflation (%) pa	1.5	1.8	1.4	5.8	53.0	24.7	16.5
Headline inflation (%) pe	1.7	1.9	2.1	25.0	46.8	15.9	17.9
M3 money supply (% y/y) pa	22.4	19.7	12.1	9.0	43.4	16.6	13.6
Policy bank rate (%) pa	3.0	2.0	2.0	4.5	18.5	12.0	9.0
Policy bank rate (%) pe	2.0	2.0	2.0	7.0	20.0	10.0	8.0
7-d rate (%) pe	1.6	1.2	0.3	4.2	15.1	5.0	5.0
USD/CDF pa	919.8	922.4	921.4	964.4	1 457.2	1 627.3	1 713.5
USD/CDF pe	919.8	911.0	925.0	1 165.0	1 595.0	1 647.0	1 780.0

Source: Banque Centrale du Congo; Bloomberg; International Monetary Fund; Standard Bank Research
Notes: pe – period end; pa – period average; nr – not rated; na – not available

Egypt: poised for powerful growth acceleration

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (%, y/y) pa	3.6	4.4	3.4	3.8	4.3	5.2	4.6	5.0	4.9	5.5	5.9	4.9
CPI (%, y/y) pe	9.0	14.0	14.1	23.3	30.9	29.8	31.9	21.9	13.3	11.6	10.4	8.6
M2 (%, y/y) pe	19.2	20.1	18.6	46.1	44.9	45.3	46.7	18.8	17.1	15.5	13.3	13.0
CA/GDP (%) pe	-5.0	-4.1	-3.8	-13.0	-9.5	-8.9	-8.5	-6.7	-6.0	-5.6	-5.3	-7.8
FX reserves (USD bn) pe	16.6	17.5	19.6	24.3	28.5	31.3	36.5	37.0	42.6	45.2	45.8	47.6
Import cover (mths) pe	3.0	3.2	3.5	4.4	4.8	5.3	6.2	6.3	6.4	6.7	6.8	7.1
3-m rate (%) pe	13.1	14.1	14.9	18.9	19.4	20.4	18.9	18.8	17.6	16.4	14.3	11.5
5-y rate (%) pe	15.1	16.5	17.4	16.7	17.1	18.3	16.2	15.7	15.3	14.9	14.6	14.1
USD/EGP pe	8.88	8.88	8.88	18.07	18.17	18.13	17.64	17.78	17.66	17.65	17.63	17.68

Source: Central Bank of Egypt; Central Agency for Public Mobilisation and Statistics; Ministry of Finance; Ministry of Planning; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: set to speed up

GDP growth topped 5.0% y/y in Q2:17, bringing GDP growth in FY2016/17 to 4.2% y/y, marginally less than 4.3% y/y in FY2015/16 and 4.4% y/y in FY2014/15. We maintain that GDP growth will accelerate, staying above 5.0% y/y on a multi-year basis.

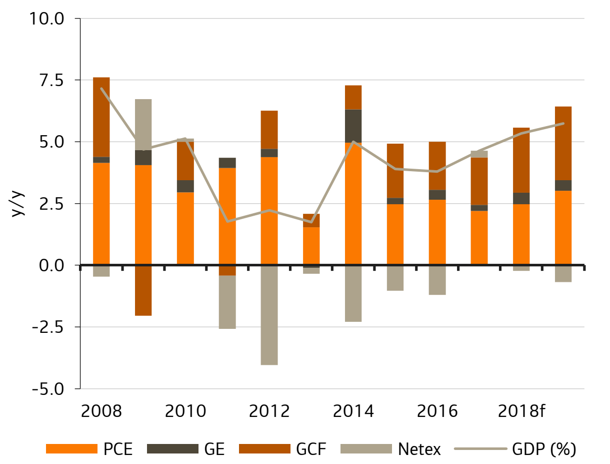
A key factor we have pointed to as likely to contribute to the upsurge in economic growth is an improvement in capital inflows, evidenced by mounting FX reserves. These inflows will likely improve financing of investment spending. Little wonder then that investment spending grew at more than 11% y/y in FY2016/17. We anticipate that investment spending will continue to grow at an elevated pace on a multi-year basis.

That said, it is still worth noting that consumption spending appears restrained, something that might persist in the near term. We suspect that real income gains, given elevated inflation, will lag, depressing private consumption for some time. Nonetheless, inflation is heading towards single digits again, so the drag from this factor is likely to wane. Additionally, government consumption spending will likely remain subdued, especially given that the government is still committed to fiscal consolidation.

The depressed nature of domestic demand is also evident when one looks at trends in the Emirates NBD Egypt PMI. The index has generally depicted recession in domestic spending since late 2015. In that period, the index recorded only two readings above 50.

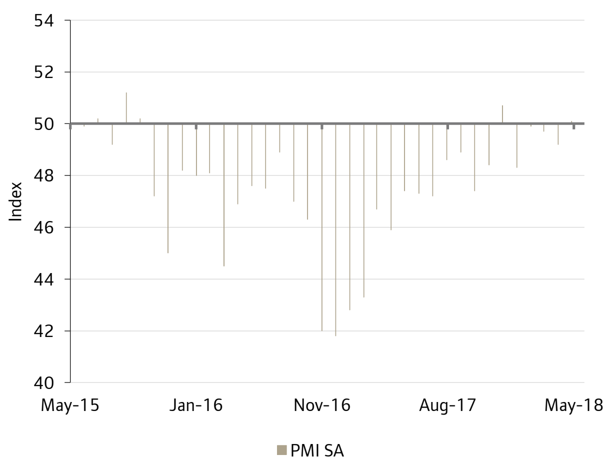
Net exports will likely contribute negatively to GDP growth in the next 2-y, with imports bolstered by an acceleration in domestic demand despite the likely surge in domestic gas production leading to a reduction of imports and potentially adding to exports.

Composition of GDP growth by demand



Source: Ministry of Planning; Standard Bank Research

Emirates NBD Egypt PMI



Source: Bloomberg

Balance of payments: FX reserve growth tapering

The health of the BOP is probably most clearly demonstrated by FX reserves at nearly USD45bn, having been close to USD17bn 24-m ago. We expect reserves rising to just over USD48bn in Q3:19, which might be the peak.

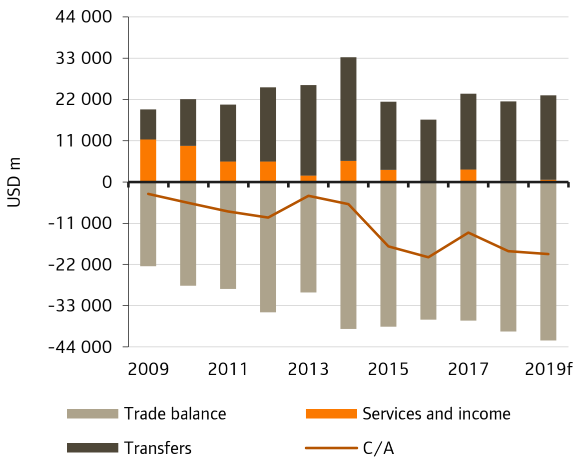
Admittedly, this forecast might look modest. After all, FX reserves rose by over USD13bn during 2017. However, many of the factors that have boosted FX reserves so much are unlikely to recur in the next 2-y. The C/A was depressed in 2017, owing in part to restrained import growth of goods (6.1% y/y) and services (7.4% y/y), while exports of goods (15.8% y/y) and services (32.3% y/y) were much stronger. Similarly, transfers grew by over 22% y/y in 2017.

The acceleration of GDP growth we expect is likely to boost import growth, leading to a wider trade deficit. Hence, the C/A deficit is likely to widen rather than shrink. We would still admit that exports are likely to grow strongly. It is worth noting that services exports, especially tourism, have shown strength in recent months, something that will probably persist over the next 2-y.

Furthermore, it seems reasonable to expect that capital inflows will wane, too. Holdings of EGP bonds and T-bills roughly doubled between Jun 17 and Jan 18, to the equivalent of USD20.0bn. About USD7.5bn of that increase came in Q3:17. It is highly improbable that such a frenetic pace of increase in portfolio inflows will persist.

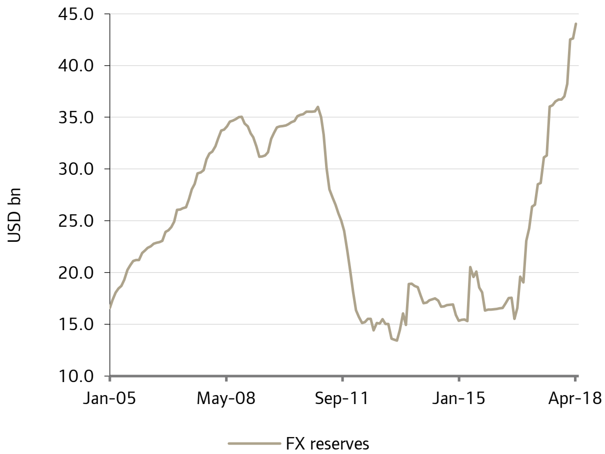
Similarly, government borrowing is likely to wane. In part this will reflect a smaller deficit that the government plans for FY2018/19. Of course, we anticipate that FDI inflows will pick up, offsetting the slack from waning portfolio inflows and government borrowing. Nonetheless, we suspect that FX reserves will grow at a much more restrained pace than in 2017.

Current account



Source: Central Bank of Egypt; Standard Bank Research

FX reserves



Source: Central Bank of Egypt

FX outlook: USD/EGP looks like a peg

If USD/EGP were not 'pegged', what would have stopped the pair from declining over the past 12-m? Surely, on the basis of BOP developments, there is plenty to suggest that the pair should have declined meaningfully. As it was, much of the portfolio inflows to the domestic T-bill and bond market mostly came via the CBE's repatriation mechanism. Were it not for this intervention, then USD/EGP would have fallen, as happened in Feb 17 when the pair briefly fell below 16.00. So, if the pair moved away from 17.65, it would not be because of a material change in BOP; it would be because the CBE has opted to change the rate. At this point, it seems highly unlikely that the CBE would see the need to change the exchange rate. Arguably, at its current level the currency is still somewhat undervalued, thereby not undermining exports. The disinflation momentum is sufficiently strong not to necessitate assistance of EGP appreciation either.

USD/EGP: forwards versus forecasts

Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: to consolidate

Indications are that the government will target a fiscal deficit of 8.4% of GDP in FY2018/19. Reducing energy subsides further would be pivotal in reducing the deficit. But, given the GDP growth target of 5.8% y/y, the government is clearly banking on strong revenue growth, too.

Revenue growth in the 6-m to Dec 17, being the first half of FY2017/18, was very strong. Total revenues amounted to EGP302.5bn, up 37.6% y/y. Whereas at the same time in 2016 revenue collected accounted for 33.4% of total revenue for the year, this time around revenues accounted for 36.2% of full-year revenues.

The component of revenues that stands out is taxes on goods and services. Excise on domestic commodities more than doubled, to EGP45.2bn, while general sales tax on goods rose 64.6% y/y, to EGP61.0bn. Overall taxes on goods and services rose by 80.6% y/y, and accounted for 45.9% of the budgeted total for the year, compared with 35.4% in FY2016/17.

In contrast, expenditure seems to have been quite restrained. Total expenditure was 25.2% y/y higher, not too far off the 17% y/y budgeted increase in spending. At first glance, the 50.9% y/y increase in spending on subsidies, grants and social benefits might look worrisome. However, the Finance Ministry attributes this increase to the exchange rate. The EGP was devalued in Nov 16, increasing the cost of importing fuel and the resultant subsidies paid to the EGPC, the national oil company.

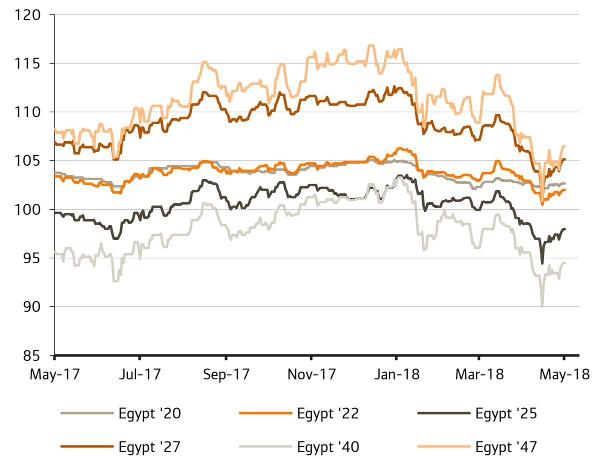
In all likelihood, Egyptian Eurobonds will recover over the coming 4-m. Once the correction is over, the market will likely focus on the progress the government is making in reducing the fiscal deficit. Indications that the government will reduce energy subsidies will likely support the bonds.

Central government budget

% of GDP	FY2015/16	FY2016/17	FY2017/18
Total Revenue	18.0	21.2	21.6
Grants	0.1	0.1	0.0
Total Expenditure	30.6	30.8	31.2
Wages and salaries	7.9	7.2	6.2
Interest payments	9.0	9.2	9.9
Subsidies	7.4	6.5	8.6
Overall balance (- grants)	-12.6	-9.6	-9.6
Overall balance (+ grants)	-12.5	-9.6	-9.6
Net lending	0.5	0.5	0.0
Net external borrowing	0.7	0.9	0.8
Net domestic borrowing	8.2	8.7	8.8

Source: Ministry of Finance

Eurobond prices - mid

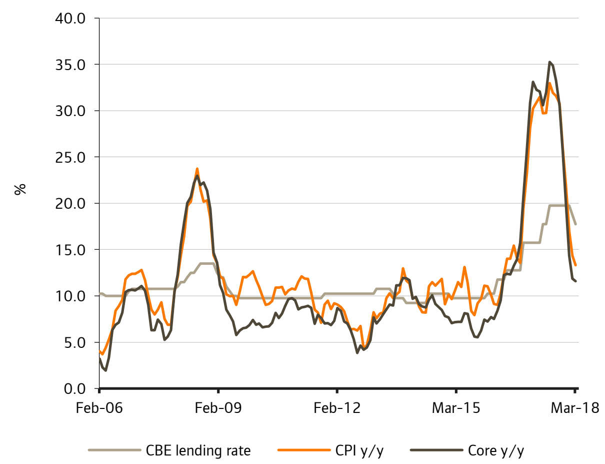


Source: Bloomberg

Monetary policy outlook: further easing

The CBE's MPC will likely continue to ease monetary policy over the course of this year. While at the beginning of the year we were of the view that the MPC would cut policy rates by at least 500 bps this year, the pace of disinflation has been so rapid that it now looks highly probable that the committee will cut rates by a further 500 bps - 100 bps per meeting in at least three of the meetings remaining this year, with a 200 bps cut likely at a future meeting. Real policy rates are elevated, similar to the rates that were recorded in H2:12. At that time, headline inflation averaged 6.0% y/y. Furthermore, economic growth was subdued. In any event, disinflation will likely persist over the remainder of the year, with single-digit inflation likely by Q4:18. Thus, there is nothing to justify such high real policy rates at present. Even if it were to turn out that the removal of more subsides were to exert upward pressure on headline inflation, such pressure would not overwhelm disinflation.

Inflation and Interest rates



Source: Central Bank of Egypt; Central Agency for Public Mobilisation and Statistics

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	81.6	82.8	84.0	85.3	86.6	87.9	89.2
Nominal GDP (EGP bn)	1 805	2 077	2 372	2 788	3 558	4 161	4 785
Nominal GDP (USD bn)	260.1	290.5	303.0	154.3	200.1	235.4	271.1
GDP / capita (USD)	3 189	3 509	3 606	1 810	2 312	2 680	3 040
Real GDP growth (%)	1.7	5.0	3.8	3.8	4.8	5.3	5.7
Oil Production ('000 b/d)	587.8	587.9	603.0	597.1	600.0	600.0	650.0
Gas Production (bcm)	50.5	43.9	39.8	37.6	42.0	45.0	50.0
Central Government Operations							
Budget balance (incl grants) / GDP (%)	-9.80	-8.29	-11.49	-12.51	-9.59	-9.68	-8.83
Budget balance (excl grants) / GDP (%)	-10.10	-13.00	-12.54	-12.64	-9.66	-9.71	-8.86
Domestic debt / GDP (%)	88.50	86.80	88.02	85.46	78.86	79.55	78.51
External debt / GDP (%)	10.96	10.02	8.38	18.08	17.31	16.63	16.84
Balance Of Payments							
Exports of goods and services (USD bn)	44.99	47.36	37.62	34.33	42.11	45.68	56.97
Imports of goods and services (USD bn)	-72.85	-80.95	-69.46	-66.68	-70.87	-80.40	-94.01
Trade balance (USD bn)	-27.86	-33.58	-31.84	-32.35	-28.76	-34.71	-37.04
Current account (USD bn)	-3.70	-5.92	-17.21	-20.10	-13.48	-18.43	-19.21
- % of GDP	-1.42	-2.04	-5.68	-13.03	-6.74	-7.83	-7.08
Capital & Financial account (USD bn)	7.80	2.75	23.32	32.63	24.79	28.85	18.53
- FDI (USD bn)	4.19	4.61	6.93	8.11	6.07	7.32	8.83
Basic balance / GDP (%)	0.19	-0.45	-3.40	-7.77	-3.70	-4.72	-3.83
FX reserves (USD bn) pe	17.00	15.30	16.45	24.27	37.00	47.62	46.94
- Import cover (mths) pe	2.80	2.27	2.84	4.37	6.27	7.11	5.99
Sovereign Credit Rating							
S&P	B-	B-	B-	B-	B-	B-	B-
Moody's	Caa1	Caa1	B3	B3	B3	B3	B3
Fitch	B-	B-	B	B	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%, y/y) pa	9.45	10.08	10.37	13.72	29.61	11.67	9.07
Consumer inflation (%, y/y) pe	11.65	10.13	11.05	23.30	21.87	8.62	8.83
M2 money supply (%, y/y) pa	17.96	16.49	16.89	38.04	26.96	16.44	12.85
M2 money supply (%, y/y) pe	15.36	14.47	19.31	46.07	18.77	12.95	12.69
CBE overnight lending rate (%) pa	10.25	9.75	9.79	12.58	18.08	15.17	9.58
CBE overnight lending rate (%) pe	9.25	10.25	10.25	15.75	19.75	11.75	8.75
3-m rate (%) pe	10.57	11.46	11.18	18.92	18.77	11.50	10.80
1-y rate (%) pe	11.25	12.00	11.35	19.32	18.50	11.90	11.30
5-y rate (%) pe	12.63	13.64	13.17	16.72	15.73	14.10	13.10
USD/EGP pa	6.65	7.08	7.70	10.06	17.92	17.73	17.66
USD/EGP pe	6.94	7.15	7.83	18.07	17.78	17.68	17.65

Source: Central Bank of Egypt; Central Agency for Public Mobilisation and Statistics; Ministry of Finance; International Monetary Fund; Bloomberg; Standard Bank Research

Notes: pe — period end; pa — period average

Ethiopia: FX liquidity challenges persist

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	8.0	8.0	8.0	8.0	10.9	10.9	10.9	10.9	8.5	8.5	8.5	8.5
CPI (% y/y) pa	8.9	7.6	6.3	6.4	7.2	9.0	10.2	13.2	14.7	14.0	12.8	9.7
M2 (% y/y) pe	18.0	19.9	21.8	25.1	29.6	28.8	30.6	32.5	33.1	33.5	31.7	30.2
CA/GDP (%) pe	-12.8	-11.7	-10.7	-9.6	-9.4	-9.2	-9.0	-8.7	-8.7	-8.6	-8.5	-8.5
FX reserves (USD bn) pe	3.5	3.4	3.2	3.0	3.0	3.1	3.1	3.1	3.1	3.2	3.2	3.2
Import cover (months) pe	2.6	2.4	2.3	2.2	2.2	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Policy rate (%) pe	5.0	5.0	5.0	5.0	5.0	5.0	5.0	7.0	7.0	7.0	7.0	7.0
USD/ETB pe	21.6	22.0	22.3	22.4	22.9	23.3	23.5	27.6	27.5	28.3	28.7	29.1

Source: National Bank of Ethiopia; Central Statistics Agency; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available; nr – not rated

GDP growth: reforms needed

We increase our 2017/18 and 2018/19 GDP growth estimates to 8.5% y/y and 9.0% y/y respectively. Surprisingly, GDP growth expanded by 10.9% y/y in 2016/17, way above our expectation of 7.3% y/y, as the industrial sector rebounded sharply, counterbalancing the impact of the drought on agricultural production as well as the impact of greater political anxiety on business confidence.

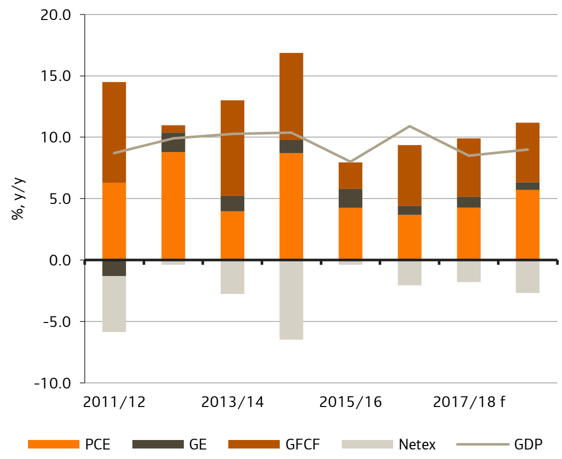
Notwithstanding the real risk of another drought, not an uncommon occurrence in the Horn of Africa, the government's focus on boosting industrial output is likely to remain the cornerstone of the medium-term growth strategy.

Despite a relatively restrictive monetary policy stance being adopted by the NBE to reign in rising inflation expectations, the government's emphasis on increased public investment in infrastructure, in addition to the fading impact of the last drought, should support GDP growth over the coming years.

However, a notable threat to economic growth over the medium term is the ongoing lack of FX liquidity. In fact, for Ethiopia to sustain its impressive GDP growth rates and augment its industrialization ambitions, financial liberalization reforms, as well as increased export growth, will be paramount.

Moreover, even though political unrest over the past couple of years did not meaningfully weigh down economic growth, the euphoria around the new Prime Minister Abiy Ahmed, who hails from the populous Oromo tribe, could ease the frequency of anti-government protests, especially since the Oromo tribe has been disillusioned by perceptions that it has been excluded from enjoying the benefits of Ethiopia's economic growth.

Composition of GDP growth by demand



Source: National Bank of Ethiopia; Standard Bank Research

GDP by sector (% contribution)

	2010/11	2015/16	2016/17
Agriculture, hinting, fishing and forestry	44.6	37.2	36.2
Mining and quarrying	1.4	0.4	0.3
Manufacturing	4.0	6.0	6.1
Electricity and Water	1.0	4.3	0.8
Construction	4.0	1.7	17.3
Wholesale and etail trade	14.5	0.8	1.3
Hotels and restaurants	3.6	16.5	2.1
Transport and communication	4.2	13.8	5
Financial Intermediation	2.5	2.1	3.4
Real Estate, Renting and Business activities	9.3	4.8	4
Public admin and defence	5.4	3.4	5.3
Education	2.3	4.5	3.4

Source: National Bank of Ethiopia

Balance of payments: export growth could take longer to recover

We expect the C/A deficit to narrow to 8.5% of GDP in 2018 and thereafter decline to 7.4% of GDP at the end of 2019.

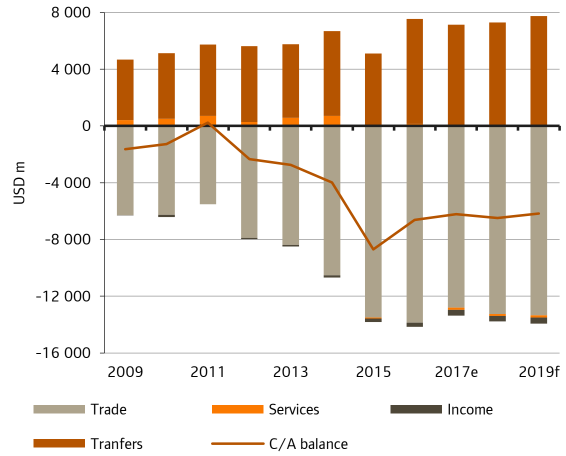
A reduced import burden associated with lower drought-related imports, in addition to the somewhat constraining fiscal policy stance, resulted in net imports declining by 5.9% y/y in 2016/17. Indeed, this trend looks set to continue over the coming year, as domestic demand has slowed down and the government remains keen to consolidate public spending.

However, despite the decline in net imports, export earnings have also been relatively subdued over the past 3-y. Interestingly, the authorities are perhaps more optimistic than we are on an imminent recovery, given that they attribute the recent stagnation to weak global commodity prices and a transitory decline in industrial exports.

Our reservations on whether industrial exports will grow rapidly over the medium term, primarily due to the lack of FX liquidity. A lack of FX would disrupt the supply chain, hindering exports.

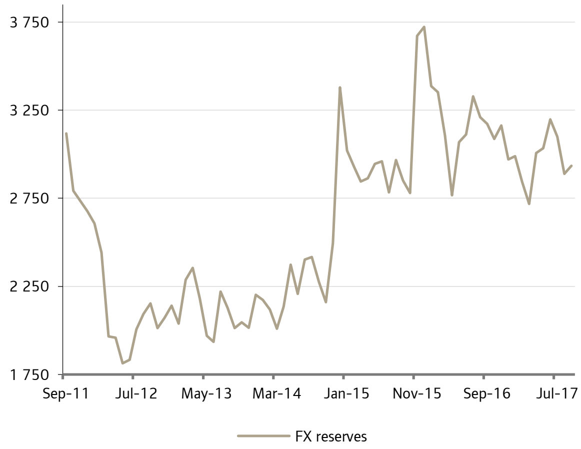
While the C/A deficit could narrow gradually over the coming years, it will probably remain above 7.0% of GDP at the end of 2019. Despite this relatively large deficit, the government is nevertheless likely to continue financing it through FDI, which would also include privatization receipts. We see FX reserves rising marginally, to USD3.2bn (equivalent to 2.4 months of import cover) as at Dec 18.

Current account



Source: National Bank of Ethiopia; Standard Bank Research

Official FX reserves (USD m)

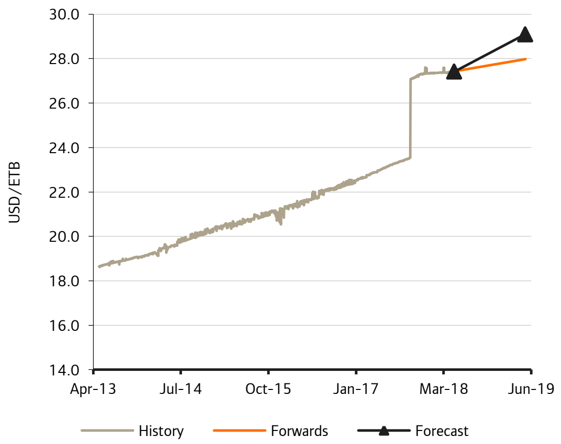


Source: National Bank of Ethiopia; Bloomberg

FX outlook: not expecting another sharp devaluation

We see the USD/ETB trading at around 29.1 levels by the end of 2018. Following the 15% snap devaluation of the ETB in Oct 17 by the NBE, the local unit has been broadly stable. Interestingly, while the devaluation was intended to foster export competitiveness and diversification, we struggle to see how this will materialize, considering the rationing of FX and capital controls currently in place. Furthermore, in the event that the authorities continue to monetise the fiscal deficit, upside pressure on USD/ETB could arise. However, we don't expect another devaluation of a similar magnitude to that of Oct 17, we suspect the NBE will revert to its preferred policy of weakening the ETB by around 5.0% annually. Moreover, the NBE recently liberalized some exchange rate controls, now allowing exporters to access foreign credit and retain up to 30% of their export proceeds in FX (previously 10%).

USD/ETB: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: consolidation could prove difficult

The government expects to have a rather restrictive fiscal policy over the next few years, which we believe could prove a challenge.

Firstly, despite the political climate cooling off somewhat following the swearing in of the new Prime Minister, recurrent expenditure pertaining to security and defence spending could remain elevated. In fact, the public-sector wage increment to enhance the retention of key personnel in 2017 also raised recurrent expenditure.

The Debt Sustainability Analysis (DSA) that was recently conducted jointly by the IMF and World Bank indicated that Ethiopia is at high risk of debt distress. Of course, this assessment was largely because of weak export earnings which coincided with higher non-concessional borrowing. To this effect, while the authorities brushed off debt sustainability concerns, they have pledged to restrain public expenditure and external borrowing by state-owned enterprises (SOEs). However, the government's industrialization plans will probably keep expenditure for capital intensive projects at the forefront over the coming year, while the unpredictable risk of another drought will also prompt the government to increase expenditure and minimize the impact of social costs for those requiring food assistance.

More importantly, in addition to increasing privatization receipts the government may need to scale back on public expenditure on infrastructure projects, especially as export receipts are taking time to grow. Given the renewed spotlight on debt sustainability, and favouring fiscal restraint, the government may scale back on non-concessional external borrowing, and perhaps look towards building a Public Private Partnership (PPP) regulatory framework to explore alternative avenues to spend on infrastructure projects.

Central government budget

% of GDP	FY2016/17	FY2017/18
Total revenue (+ grants)	10.8%	10.3%
Grants	0.1%	0.1%
Total expenditure	14.2%	13.7%
Recurrent	3.6%	3.5%
Capital	5.1%	4.6%
Regional transfers	5.5%	5.6%
Overall balance (+ grants)	3.4%	3.5%
Net external borrowing	1.2%	1.0%
Net domestic borrowing	1.9%	2.4%

Source: National Bank of Ethiopia; Ministry of Finance and Economic Cooperation

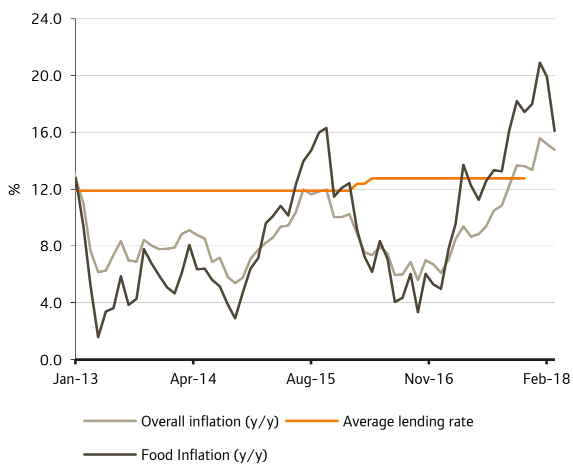
Eurobond 24s mid – price

Source: Bloomberg

Monetary policy outlook: sticky inflation

The NBE's MPC are still likely to maintain this slightly tighter monetary policy stance over the coming year, which would complement the fiscal expenditure restraint authorities endeavour to adopt. Headline inflation remained elevated but eased to 13.7% y/y in Apr 18, from 15.6% y/y in Feb 18, due mainly to a decline in the growth of the food sub-index which subsided to 16.1% y/y from 20.9% y/y during the period. We see headline inflation in low double digits until Q4:18, with the most notable risk to our outlook still perhaps hinging on food inflation developments. Furthermore, non-food inflation increased to 10.8% y/y in Apr 18, from 8.4% y/y in Jan, probably on second-round effects of the ETB devaluation in Oct 17. Importantly, even if rainfall in the Meher season was adequate and lowered food prices, for inflation expectations to wane the government would have to stop monetizing its deficit.

Inflation and interest rates



Source: National Bank of Ethiopia; Central Statistics Agency

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	84.8	87	89.1	91.2	93.4	95.1	97.1
Nominal GDP (ETB bn)	867	1 061	1 298	1 528	1 807	2 192	2 583
Nominal GDP (USD bn)	46.3	53.8	62.7	69.1	74.4	76.4	83.6
GDP / capita (USD)	546.1	618.5	703.7	758.1	796.2	803.0	860.8
Real GDP growth (%)	10.6	10.3	10.4	8.0	10.9	8.5	9.0
Coffee production ('000 MT)	374.0	391.6	397.5	402.8	396.0	404.7	415.0
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-2.7	-2.6	-2.4	-3.1	-3.6	-3.6	-3.2
Budget balance (incl. Grants) / GDP (%)	-2.0	-1.8	-2.0	-3.1	-3.4	-3.5	-2.8
Domestic debt / GDP (%)	18.8	21.1	23.9	25.1	24.9	26.5	27.0
External debt / GDP (%)	24.2	26.0	30.4	31.2	30.9	33.6	34.4
Balance Of Payments							
Exports (USD bn)	3.1	3.2	3.0	2.9	2.8	3.1	3.3
Imports (USD bn)	11.5	13.7	16.5	16.7	15.6	16.0	16.5
Trade balance (USD bn)	-8.4	-10.5	-13.5	-13.9	-12.8	-12.9	-13.2
Current account (USD bn)	-2.8	-4.0	-8.7	-6.6	-6.5	-6.5	-6.2
- % of GDP	-5.9	-7.4	-13.9	-9.6	-8.7	-8.5	-7.4
Financial and Capital account (USD bn)	3.2	3.9	6.8	5.3	6.3	6.6	6.1
- FDI (USD bn)	1.2	1.5	2.3	2.6	2.8	3.0	3.3
Basic balance / GDP (%)	-3.3	-4.7	-10.2	-5.8	-5.0	-4.6	-3.5
FX reserves (USD bn) pe	1.9	3.4	3.7	3.0	3.1	3.2	3.1
- Import cover (months) pe	2.0	3.0	2.7	2.2	2.4	2.4	2.3
Sovereign Credit Rating							
S&P	nr	B	B	B	B	B	B
Moody's	nr	B1	B1	B1	B1	B1	B1
Fitch	nr	B	B	B	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	8.1	7.4	10.1	7.3	9.9	12.8	8.8
Consumer inflation (%) pe	7.8	7.1	10.0	6.7	13.6	8.7	9.3
M2 money supply (% y/y) pa	26.6	29.0	24.8	21.2	30.4	32.1	29.3
M2 money supply (% y/y) pe	27.3	29.1	21.7	25.1	32.5	30.2	29.5
Policy rate (%) pa	5.0	5.0	5.0	5.0	5.5	7.0	7.0
Policy rate (%) pe	5.0	5.0	5.0	5.0	7.0	7.0	7.0
USD/ETB pa	18.7	19.7	20.7	22.1	24.3	28.4	30.9
USD/ETB pe	19.1	20.3	21.2	22.4	27.6	29.1	31.9

Source: National Bank of Ethiopia; Central Statistics Agency; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available; nr – not rated

Ghana: still a compelling duration trade

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	4.3	1.1	4.6	4.5	7.0	7.5	8.5	8.6	7.0	7.5	6.7	6.8
CPI (% y/y) pa	18.9	18.7	16.9	15.5	13.1	12.6	12.1	11.7	10.4	9.8	9.7	9.5
M2 (% y/y) pa	22.5	23.5	27.2	23.8	30.7	30.2	29.5	23.4	16.7	18.7	17.4	16.7
CA/GDP (%) pa	-7.7	-7.1	-6.7	-6.5	-6.1	-5.4	-4.8	-4.7	-4.3	-3.8	-3.4	-3.3
FX reserves (USD bn) pe	2.7	2.4	2.0	3.4	4.5	4.6	3.8	4.5	4.8	5.3	5.7	5.8
Import cover (months) pe	2.5	2.2	1.9	3.2	4.3	4.4	3.6	4.3	4.2	4.7	5.0	5.1
3-m rate (%) pe	22.5	22.8	20.0	19.0	16.0	11.9	12.5	11.5	11.7	11.4	11.3	11.0
5-y rate (%) pe	24.7	24.0	23.5	19.0	17.5	18.0	18.0	17.9	17.5	16.0	15.0	14.0
USD/GHS pe	3.83	3.83	3.95	4.22	4.53	4.39	4.42	4.49	4.45	4.62	4.69	4.65

Source: Bank of Ghana; Ghana Statistical Service; Bloomberg; Ministry of Finance; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: still strong

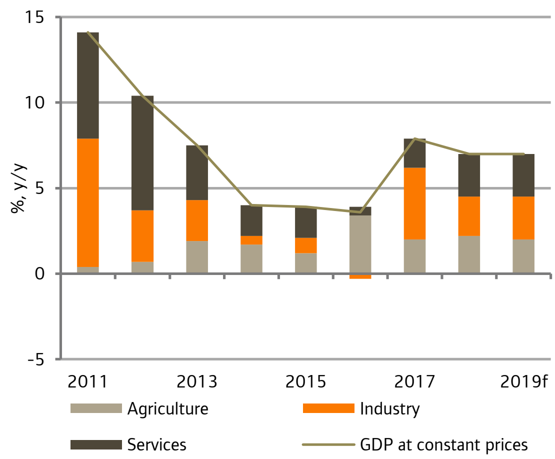
We expect growth at a brisk 7.0% y/y in both 2018 and 2019 due mainly to strong oil-sector growth. The industrial non-oil economy is also set to deliver above-average growth over the next 3-y due to structural reform in the financial and power sectors. Furthermore, steady progress in public finance management should improve tax revenue collection, which should enable increased infrastructure spending.

After strong readings throughout 2017, the Stanbic Bank Ghana PMI remained above the 50 mark (which demarcates expansion from contraction). The PMI's pace of increase moderated slightly to 54.5 in Apr, from 55.2 in Mar, still indicating solid improvement in private sector business conditions. Most respondents indicated that, YTD, new orders have remained healthy, and output levels have therefore been strong.

However, private sector credit growth (PSC) reached only 13.8% y/y in Feb, from 17.5% y/y 12-m prior. Changes to capital requirements in the banking sector may have forced commercial banks to adopt a defensive posture towards credit extension. The Bank of Ghana has mandated all banks to increase the minimum capital requirement to GHS400m by year-end from GHS120m currently.

We estimate that the entire sector needs a capital injection of USD800m to USD1.0bn to become fully compliant. There is a strong possibility that this new requirement will trigger consolidation in the sector. Once the new requirements have been complied with, we expect credit growth to rise meaningfully, thus potentially boosting economic growth.

Composition of GDP growth by sector



Source: Bank of Ghana; Ghana Statistical Service; Standard Bank Research

GDP by sector

(%) contribution	2015	2016	2017
Crops	14.6	16.5	16.0
- Cocoa	2.1	2.5	2.2
Livestock	1.2	1.5	1.4
Forestry and logging	2.2	1.9	1.5
Fishing	1.1	1.2	1.3
Mining and Quarrying	6.4	9.3	10.0
- Oil	6.0	8.3	8.3
Manufacturing	4.7	4.5	4.5
Electricity	0.4	0.4	0.5
Water and Sewerage	0.6	0.7	0.8
Construction	14.8	13	12
Trade;	5.8	6.2	6.0
Hotels and Restaurants	5.2	5.1	5.4
Transport and Storage	11.6	11.3	11.4
Information and communication	2.4	2.5	2.6
Financial and Insurance Activities	10.3	8.0	8.2
Real Estate and Professional Services	3.8	3.6	3.7
Public Administration & Defence	5.8	5.5	5.6
Education	3.9	3.8	3.9
Health and Social Work	1.1	1.0	1.1
Community, Social services	4.1	4.0	4.1
GDP	100.0	100.0	100.0

Source: Ghana Statistical Service, Standard Bank Research

Balance of payments: funding still strong

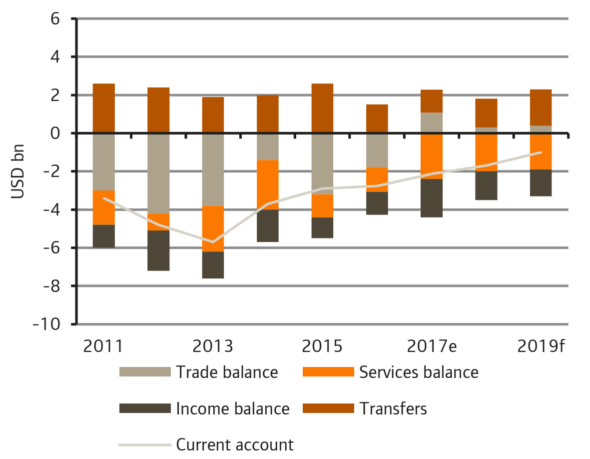
The rising oil price trajectory, coupled with moderately rising import demand, implies that the C/A deficit will continue to narrow this year. We expect the deficit at USD1.7bn (3.3% of GDP) and USD1.0bn (1.7% of GDP) this year and next respectively. However, the strong rally in prices of cocoa (a commodity that accounted for 25% of export earnings last year) YTD should keep the trade balance in surplus.

Imports will probably rebound moderately this year, after declining 2.0% y/y in 2017. But we don't expect a strong rebound until 2019 when banking sector reforms will have been concluded. In the first 2-m of this year, the trade surplus reached USD513.3m from USD498.8m a year ago. After a slow year in 2017, it is plausible that the pace of remittances would increase moderately, but enough to offset higher income and services outflows.

Gross FX reserves should continue rising this year as commodity prices remain elevated and portfolio inflows remain strong. Although moderating this year, it is reasonable to expect that foreign direct investment (FDI) inflows will grow in 2019. Given foreign interest in the Ghanaian banking sector, we expect around USD400m in capital inflows triggered by the recapitalisation of the sector this year, bolstering the BOP.

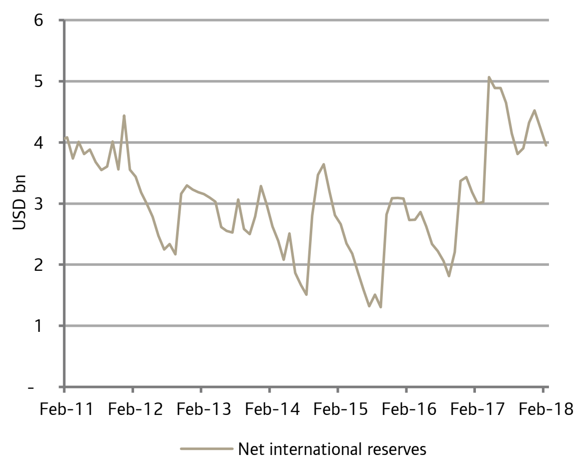
The issuance of USD2.0bn in Eurobonds earlier this month, partly used to buy back the '22s and '23s, has bolstered gross international FX reserves. Net international reserves reached USD3.9bn as at end Feb from USD5.1bn in Apr 17. We expect net FX reserves to rise steadily to USD5.8bn by year-end due to strong export proceeds and financial inflows.

Current account



Source: Bank of Ghana; Ghana Statistical Service; Standard Bank Research

FX reserves



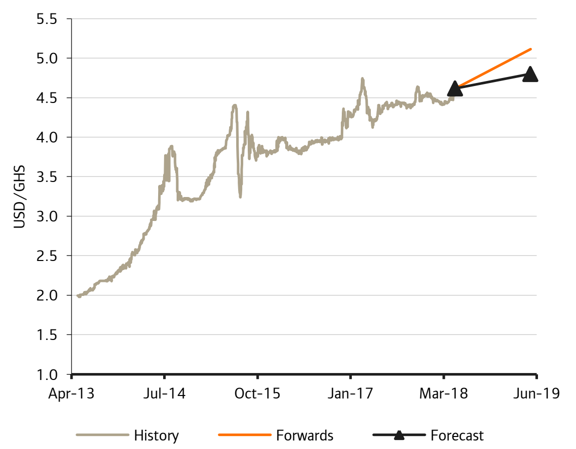
Source: Bank of Ghana; Standard Bank Research

FX outlook: range-bound

We see USD/GHS trading inside the forward curve this year. We expect the pair to close the year around 4.65, and we do not expect the pressure, which has taken the rate from near 4.4 over the last month, to become disorderly. Sure, one can get nervous about the heavy positioning of foreign portfolio investors in that market, with the USD6.0bn in bond holdings basically as high as gross foreign assets as well as being more than usable FX reserves as at the end of Feb. However, most investors seem comfortable with the trajectory of the twin deficits and they also realize that technical factors, along with a more favourable inflation trajectory, point to lower yields. We therefore believe that Ghana will continue attracting decent levels of foreign portfolio inflows.

The changes to minimum capital for banks should also result in most banks being able to provide more liquidity due to larger net open positions (NOP).

USD/GHS: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: supporting the duration trade

We keep our exposure to duration in Ghana. Given the country's specific technical idiosyncrasies, the auctions offer the best avenue to buy Ghanaian bonds. These auctions can at times offer a premium amounting to 50 bps above the secondary market. Nonetheless, in recent auctions the BOG managed to issue paper at yields below those prevailing in the secondary market. In addition to favourable inflation expectations, the increase in banking sector capital will probably place downward pressure on the yield curve as banks look to utilize the new capital injection. Furthermore, increased participation of local private pension funds in the debt markets has resulted in significant demand for paper, which would drive yields lower as well.

Will the potential conclusion of the IMF funded programme at the end of this year cause enough trepidation to cause a disorderly sell-off in the bond market? We doubt it. In our view, the authorities delivered stronger than expected fiscal consolidation in 2017, given the fact that they could have disowned the IMF programme while shifting the blame to the previous administration for significant fiscal slippage. Instead, just over one year after the presidential elections, the IMF has approved the 5th and 6th review of the ECF programme, disbursing USD191m under the USD955.2m program. In fact, the board has commended the government for fiscal discipline.

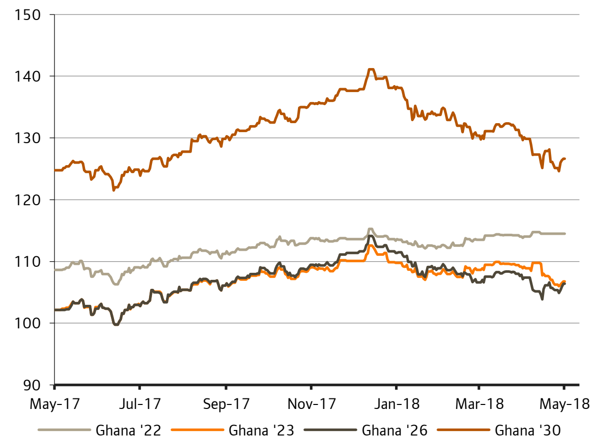
Despite the commitment to fiscal discipline, we still think that tax reform will be slow. Sure, there have been a number of signs suggesting an increased focus on accurate and timely filing of tax returns; for example, linking these to drivers' licence and international passport issuance. However, the impact on non-oil tax revenues will remain minimal in the short term. The fiscal deficit on a cash basis stayed below 6.0% of GDP in 2017 due to the fact that less than a third of the originally budgeted arrears were actually cleared.

Budget

	FY2016	FY2017	FY2018
% of GDP			
Total revenue (+ grants)	17.3	20.6	20.4
Tax Revenue	15.5	16.0	16.4
- Oil Revenue	0.4	1.2	1.5
Grants	0.7	0.8	0.5
Total expenditure	26.6	25.8	23.0
- Salaries, etc	8.7	8.3	8.0
- Interest	6.9	6.7	6.1
Capital expenditure	4.6	3.1	3.4
Primary Basic Balance	-2.4	0.2	2.2
Budget Deficit (incl Grants)	-9.3	-5.2	-2.6
Domestic Financing	8.6	6.3	3.7
External Financing	1.8	-0.3	0.4

Source: Finance Ministry; Standard Bank Research

Eurobond prices - mid

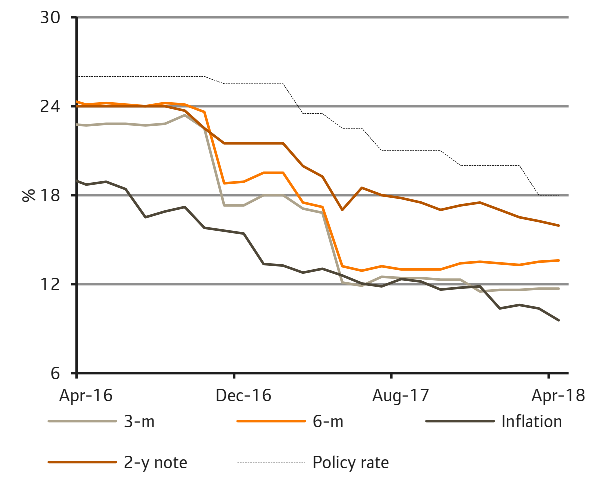


Source: Bloomberg

Monetary policy outlook: still an easing bias

We expect the BOG to ease further this year, possibly cutting the policy rate by 300 bps. The bank's easing bias is certainly warranted, given the strong disinflation underway, with headline inflation dropping to 9.6% y/y in Apr from 10.4% y/y in Mar. Most of the recent decline in headline inflation is due to declining non-food inflation (which reached 10.6% y/y from 11.8% y/y in Mar). We expect the inflation trajectory to remain to the downside, with headline inflation bottoming out at 9.4% y/y in Dec, before rising to 12.0% y/y by end Q1:19. The BOG is looking to improve the transmission mechanism of its main policy levers. To that end, it introduced the Ghana Reference Rate (GRR) in early Apr, which forms the basis for pricing loans lent to the private sector. The GRR is made up of the policy rate (40% weight), the 91-d treasury bill rate (40%) and the overnight rate (20%).

Inflation and interest rates



Source: Bank of Ghana; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	26	26	27	28	29	29	30
Nominal GDP (GHC bn)	93	113	137	167	201	235	282
Nominal GDP (USD bn)	44	41	36	43	46	51	58
GDP / capita (USD)	1 714	1 556	1 343	1 514	1 597	1 750	1 961
Real GDP growth (%)	7.5	4.0	3.9	3.6	7.9	7.0	7.0
Gold production ('000 FO)	3 520	3 344	3 200	3 300	3 795	4 175	4 383
Cocoa bean production ('000 MT)	861	880	875	870	870	887	905
Oil production (k bpd)	980	100	111	116	145	165	170
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-10.7	-10.9	-8.6	-10.0	-6.0	-3.1	-3.2
Budget balance (incl. Grants) / GDP (%)	-10.0	-10.2	-7.1	-9.3	-5.2	-2.6	-2.9
Domestic debt / GDP (%)	28.1	30.5	28.2	31.9	32.0	30.0	31.0
External debt / GDP (%)	28.0	36.7	42.5	41.4	37.0	36.5	35.0
Balance Of Payments							
Exports of goods (USD bn)	13.8	13.2	10.3	11.1	13.8	14.0	14.8
Imports of goods (USD bn)	-17.6	-14.6	-13.5	-12.9	-12.7	-13.7	-14.4
Trade balance (USD bn)	-3.8	-1.4	-3.2	-1.8	1.1	0.3	0.4
Current account (USD bn)	-5.7	-3.7	-2.9	-2.8	-2.1	-1.7	-1.0
- % of GDP	-12.9	-9.1	-8.1	-6.5	-4.7	-3.3	-1.7
Capital & Financial account (USD bn)	6.0	3.9	2.9	2.8	3.2	3.0	2.5
- FDI (USD bn)	3.0	3.4	2.9	3.5	3.7	3.0	3.2
Basic balance / GDP (%)	-6.1	-0.7	0.0	1.7	3.4	2.6	3.8
FX reserves (USD bn) pe	4.0	3.2	2.9	3.4	4.5	5.8	7.3
Import cover (mths, incl. income) pe	2.7	2.6	2.6	3.2	4.3	5.1	6.1
Sovereign Credit Rating							
S&P	B+	BB-	BB-	BB-	B-	B-	B-
Moody's	B1	B2	B3	B3	B3	B3	B3
Fitch	BB-	BB	BB	BB	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	11.8	15.8	17.1	17.5	12.4	9.9	12.8
Consumer inflation (%) pe	13.6	17.0	17.7	15.4	11.8	9.4	13.5
M2 money supply (% y/y) pa	21.3	27.5	25.1	24.2	28.5	17.4	18.1
M2 money supply (% y/y) pe	18.2	29.6	26.6	24.7	19.8	16.3	17.0
BOG prime rate (%) pa	15.5	18.5	23.6	25.9	22.7	20.0	18.5
BOG prime rate (%) pe	16.0	21.0	26.0	25.5	20.0	15.0	16.0
3-m rate (%) pe	19.0	25.0	22.8	19.0	11.5	11.0	12.0
1-y rate (%) pe	19.0	25.0	22.5	20.5	14.8	12.5	13.0
2-y rate (%) pe	18.0	23.0	22.0	20.9	18.0	14.5	14.5
5-y rate (%) pe	19.0	22.0	22.0	19.0	17.9	14.0	14.5
USD/GHS pa	2.1	2.8	3.8	3.9	4.4	4.6	4.8
USD/GHS pe	2.4	3.2	3.8	4.2	4.5	4.7	4.9

Source: Bank of Ghana; Bloomberg; International Monetary Fund; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated; na — not available

Kenya: growth is still recovering

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	6.0	5.9	5.7	5.8	4.7	5.0	4.4	5.4	5.4	5.5	5.7	5.8
CPI (% y/y) pe	5.6	5.4	6.3	6.5	10.3	9.2	7.1	4.5	4.2	5.2	7.3	8.0
M3 (% y/y) pe	11.0	7.9	8.1	3.8	6.4	6.0	7.8	9.5	9.8	10.7	12.5	14.2
CA/GDP (%) pe	-5.6	-5.6	-5.3	-5.1	-6.0	-6.3	-6.6	-6.8	-6.1	-6.0	-5.9	-5.5
FX reserves (USD bn) pe	7.4	7.2	7.7	7.0	7.7	8.0	7.5	7.1	8.8	9.1	8.7	8.4
Import cover (months) pe	4.7	4.7	5.1	4.5	5.1	5.4	5	4.7	5.9	5.7	5.5	5.3
3-m rate (%) pe	8.4	7.1	7.8	8.6	8.8	8.3	8.1	8.1	8.0	7.9	7.9	8.1
5-y rate (%) pe	13.9	14.3	14.1	14.4	13.4	12.6	12.7	12.5	12.4	12.3	12.1	12.3
USD/KES pe	101.6	101.1	101.3	102.5	103.1	103.7	103.2	103.3	101.3	100.7	101.5	102.5

Source: Central Bank of Kenya; Kenya National Bureau of Statistics; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average

GDP growth: recovering apace

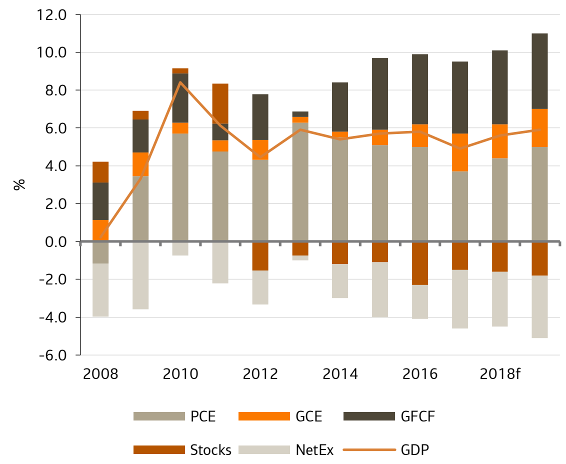
We retain our GDP growth forecasts for 2018 and 2019 at 5.6% y/y and 5.9% y/y. The economy was put to the test by strong headwinds in 201. However, GDP growth expanded 4.9% y/y, just a tad over our 4.8% y/y forecast.

Though 2017 GDP was the weakest since 2012, it is relatively positive in the context of Sub-Saharan Africa. The Kenyan economy was underpinned by both its diverse export base and growth drivers.

However, real output is way below potential, and thus reforms must foster robust and inclusive growth in the medium term. Weak agricultural output owing to the drought in H1:17, and prolonged political uncertainty in H2:17 which weighed down investment spending, were the two main headwinds. Following a meeting between President Kenyatta and Raila Odinga, the political climate seems to have cooled off. Additionally, better weather conditions should bode well for cash crops such as black tea over the coming year. However, despite some resilience in the services sector in 2017, average growth in the manufacturing sub-sector subsided to 0.2% y/y, from 2.7% y/y in 2016, while growth in the agrarian sector slowed to an average of 1.6% y/y, from 4.7% y/y during the same period.

Parliamentary passage of the Financial Markets Conduct Authority (FMCA) Bill would probably satisfy the IMF's requirement for a significant modification of the interest rate capping law, one of the conditions for completion of the program. Of course, the parliamentary process and establishing the Authority are likely to take some time. Given that the Authority would be empowered to potentially change the interest rate cap, the status qou will likely prevail for some time, perhaps even 4- 6 months. Hence, the likelihood that credit growth will accelerate in the near term is pretty slim.

Composition of GDP growth by demand



Source: Kenya National Bureau of Statistics; Standard Bank Research

GDP by sector

% contribution	2005	2014	2017
Agriculture	25.50%	22.00%	21.20%
Mining & quarrying	0.45%	0.92%	1.08%
Manufacturing	9.87%	10.80%	9.77%
Electricity & water supply	2.38%	2.40%	2.54%
Construction	3.02%	4.83%	5.59%
Wholesale & retail trade	9.04%	7.69%	7.56%
Accommodation & restaurant	1.33%	1.13%	1.24%
Transport & storage	10.40%	6.59%	7.05%
Information & communication		3.59%	4.05%
Financial & insurance	3.74%	6.00%	6.13%
Public administration	3.96%	3.92%	3.86%
Real Estate	5.62%	8.12%	8.53%

Source: Kenya National Bureau of Statistics

Balance of payments: C/A deficit to narrow

We expect the C/A deficit to narrow to 5.5% of GDP in 2018, from 6.8% of GDP in 2017, largely as we foresee exports rising but imports not growing as rapidly as in 2017, and net current transfers being supported by the government's tax amnesty law.

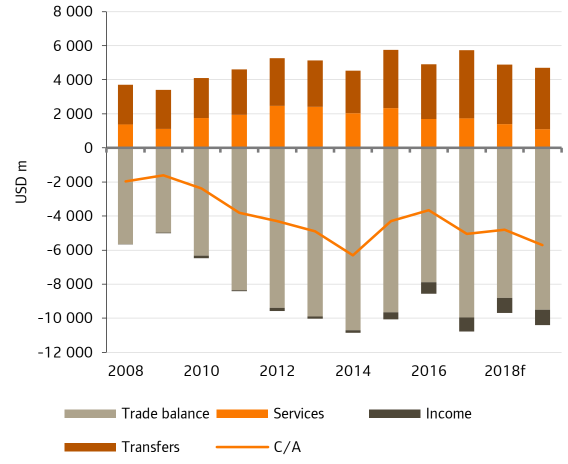
Tea production was up 24.0% y/y as at Feb 18, while average prices were also higher, at USD2.97 in the 2-m to Feb, compared to an average of USD2.94 in H2:17. Nevertheless, tea prices are likely to decline this year as volumes rise due to adequate rains boosting production.

Moreover, diaspora remittances increased by around 48.0% y/y in Q1:18, primarily due to citizens rushing to repatriate funds from abroad before the 30 Jun tax amnesty deadline. Once the deadline lapses, a 10% penalty will be imposed by the Kenya Revenue Authority (KRA), hence net current transfers are likely to remain supportive of the C/A before then.

Looking at imports of goods, admittedly the government will require less imports of food this year, in comparison to 2017, while its pledge to reduce the fiscal deficit could see capital goods imports for infrastructure projects decline. However, a risk to this view is the, now increased, likelihood of a larger oil import bill due to the recent sharp rise in international oil prices. That said, this may only become worrisome for the C/A deficit once there is a sustained pick-up in domestic demand.

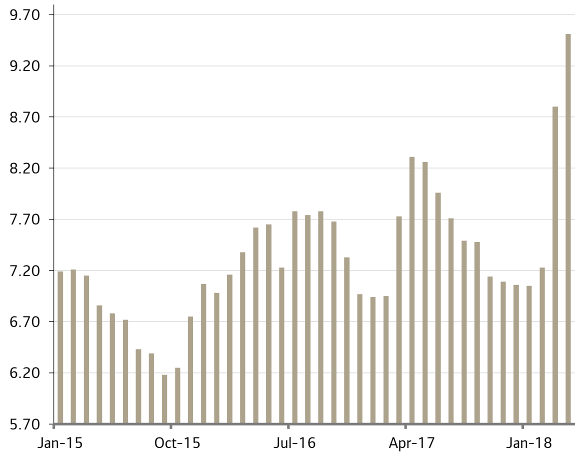
FX reserves rose quite rapidly to USD9.5bn (6.36 months of import cover) at the end of Apr 18, from USD7.1bn (4.75 months) in Jan 18, courtesy of the Eurobond proceeds as well as external commercial loans from multilateral partners. Foreign commercial borrowing and FDI, which could increase, given renewed political stability, will probably continue financing the C/A deficit.

Current account developments



Source: Central Bank of Kenya; Standard Bank Research

FX reserves (USD bn)

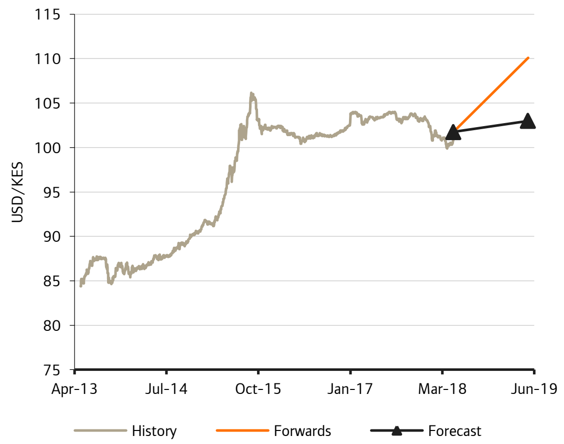


Source: Central Bank of Kenya

FX outlook: range-bound

We expect USD/KES to trade within a range of 102.50-103.0 by year-end. We have been consistently more optimistic than the market, recommending selling a 6-m USD/KES NDF in Oct 17. The local unit has indeed benefited from improved inflows from the tea, tourism and the floriculture sectors, which has dwarfed a post-election recovery in USD demand from corporates. The CBK has been keen buyers of USD at levels around 100.0 of late, while importers have been eager to capitalize on the decline in USD/KES. We still see KES stability. An immediate repeal of the interest rate cap would probably have boosted PSC growth, resuscitating import demand and likely exerting upside pressure on USD/KES. However, the process of passing the FMCA Bill and establishing the Authority will probably take time, reducing the risk of near term upside pressure on USD/KES.

USD/KES: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: ambitious revenue forecasts

Fiscal policy developments are now the market’s most notable concern. The recent pricing on Kenya 10 and 30-y Eurobonds largely reflected the fiscal imbalances (which subsequently prompted the market to demand a higher risk premium).

In a supplementary budget submitted to parliament, the government forecast the fiscal deficit inclusive of grants to decline to 5.7% of GDP for FY2018/19, from an expected 7.2% in FY2017/18. The government was adamant that one-off expenditures, associated with general elections and the drought in 2017, had delayed their plans to consolidate public finances. Interestingly, most of the consolidation is expected to come via increased revenue collection in FY2018/19. The government plans to overhaul the income tax law, reduce customs duty leakages, and also potentially increase VAT on petroleum products in order to achieve what seems like an ambitious revenue target.

Furthermore, certain development project plans could be brought forward, and perhaps only projects associated with the government’s Big 4 agenda could be prioritised over the coming fiscal year. But, with the government dedicated to making its Big 4 agenda a reality, development expenditure absorption could improve, making it even more crucial for revenue collections to be robust.

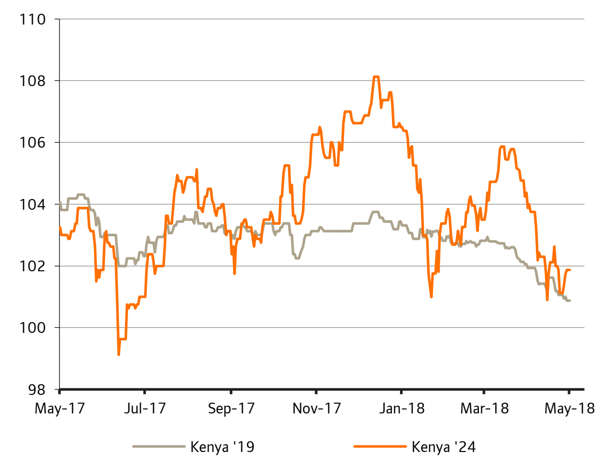
We favour the tax-free Infrastructure Bonds (IFBs). While we were willing to acknowledge that investors could opt to take profits closer to the budget reading in Jun 18 (since it would likely shed light on the repeal of the interest rate capping law), we doubt that any upward pressure on KES yields would endure. After all, the FMCA Bill suggests that the status quo will prevail for some time, focussing attention on the fiscal consolidation.

Central government budget

% of GDP	FY2016/17	FY2017/18
Total revenue	18.2	18.7
Total expenditure	27.4	26.8
Wages	4.4	4.6
Interest	3.5	3.6
Development expenditure	8.4	6.9
Overall balance (+ grants)	-9.2	-7.7
Overall balance (- grants)	-8.9	-7.2
Net domestic borrowing	4.0	3.8
Net external borrowing	4.5	3.4
Donor support (grants)	0.4	0.5

Source: Ministry of Finance

Eurobond prices - mid



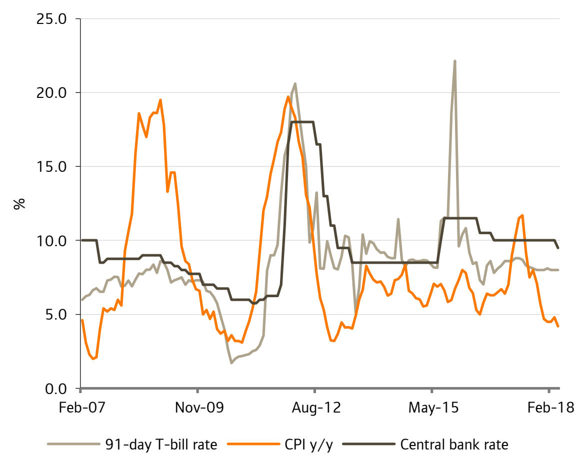
Source: Bloomberg

Monetary policy outlook: still an easing bias

We still see the MPC easing by at least another 50 bps, perhaps in Jul. The MPC cut the CBR by 50 bps in Mar, to 9.5%, arguing that the economy needed a boost. The committee was probably confident that the interest rate capping law would be reviewed. We infer this much because a cut to the policy rate could result in a perverse outcome, a view the MPC evidently shares.

Headline inflation eased to 3.8% y/y in Apr 18 from 4.8% y/y in Jan and 7.1% y/y in Sep 17. Favourable base effects were responsible for the decline in the headline index. However, core inflation increased to 4.0% y/y from 3.5% y/y in Apr. The second-round effects of higher oil prices are likely what has been driving core inflation higher. Fuel prices as well as the fuel adjustment on electricity tariffs will probably increase given higher oil prices.

Inflation and interest rates



Source: Central Bank of Kenya; Kenya National Bureau of Statistics

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	42.8	43.0	44.2	45.5	46.70	48.0	49.4
Nominal GDP (UGXbn)	4 745	5 402	6 284	7 194	7 749	8830	10 045
Nominal GDP (USDbn)	55.1	61.4	63.5	70.8	75.0	87.0	97.0
GDP / capita (USD)	1 287	1 428	1 436	1 558	1 606	1 813	1 963
Real GDP growth (%)	5.9	5.4	5.7	5.9	4.9	5.6	5.9
Coffee production ('000 Tonnes)	39.8	40.2	32.2	39.6	33.20	35.50	39.30
Tea production ('000 Tonnes)	432.4	445.1	399.2	471.2	423.6	465.5	473.0
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-9.6	-9.5	-8.4	-8.4	-9.2	-7.7	-6.2
Budget balance (incl. Grants) / GDP (%)	-6.9	-7.0	-7.9	-7.9	-8.9	-7.2	-5.7
Domestic debt / GDP (%)	26.2	23.0	26.1	27.5	28.4	29.5	28.7
External debt / GDP (%)	25.1	27.6	25.5	27.3	29.5	31.5	33.0
Balance of Payments							
Exports of goods (USDbn)	6.3	5.8	5.9	5.7	5.8	6.1	6.3
Imports of goods (USDbn)	15.2	15.9	15.6	13.6	16.2	15.5	16.4
Trade balance (USDbn)	-8.8	-10.1	-9.7	-7.9	-10.4	-9.4	-10.1
Current account (USDbn)	-4.9	-6.0	-4.3	-3.6	-5.1	-4.8	-5.9
- % of GDP	-8.8	-9.7	-6.8	-5.1	-6.8	-5.5	-6.3
Financial account (USDbn)	5.1	5.4	5.1	4.1	6.0	6.5	7.4
- FDI (USDbn)	0.63	0.65	0.52	0.39	0.55	0.75	0.92
Basic balance / GDP (%)	-7.70	-8.63	-5.96	-4.53	-6.07	-4.65	-5.14
FX reserves (USDbn) pe	6.2	7.4	7.1	7.0	7.1	8.4	8.9
- Import cover (months) pe	4.9	5.6	4.5	4.5	4.7	5.3	4.9
Sovereign Credit Rating							
S&P	B+	B+	B+	B+	B+	B+	B+
Moody's	nr	nr	nr	nr	nr	nr	nr
Fitch	B+	B+	B+	B+	B+	B+	B+
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.7	6.9	6.6	6.3	7.8	6.2	6.4
Consumer inflation (%) pe	7.2	6.0	7.4	6.4	4.5	8.0	5.0
M3 money supply (% y/y) pa	23.2	15.6	15.4	7.7	7.4	11.8	14.3
M3 money supply (% y/y) pe	13.3	19.1	13.7	3.6	9.5	14.2	16.6
CBK policy rate (%) pa	8.8	8.5	10.1	11.0	10.0	9.1	9.0
CBK policy rate (%) pe	8.5	8.5	11.5	10.0	10.0	9.0	9.0
3-m rate (%) pe	9.4	8.6	10.4	8.6	8.1	8.1	8.6
1-y rate (%) pe	10.5	10.6	12.8	11.0	11.1	11.3	11.6
2-y rate (%) pe	10.1	10.8	12.3	12.6	11.7	11.6	11.9
5-y rate (%) pe	11.5	11.9	13.8	14.4	12.5	12.3	12.7
USD/KES pa	86.1	88.0	99.0	101.6	103.3	101.5	103.6
USD/KES pe	86.3	90.4	102.3	102.5	103.3	102.5	104.5

Source: Central Bank of Kenya; Kenya National Bureau of Statistics; Ministry of Finance; Bloomberg; Standard Bank Research

Notes: pe — period end; pa — period average; nr — not rated

Malawi: favourable policy environment

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	2.7	2.7	2.7	2.7	5.1	5.1	5.1	5.1	4.2	4.2	4.2	4.2
CPI (% y/y) pa	22.9	21.7	22.5	20.0	16.7	12.8	12.0	7.7	8.6	11.7	11.4	11.2
M2 (% y/y) pa	26.4	27.5	17.4	19.9	15.7	18.1	19.9	18.4	20.8	17.9	12.8	12.3
CA/GDP (%) pa	-7.7	-7.7	-7.7	-7.7	-13.6	-13.6	-13.6	-13.6	-14.0	-14.0	-14.0	-14.0
FX reserves (USD bn) pe	0.63	0.60	0.60	0.61	0.55	0.65	0.75	0.76	0.67	0.68	0.69	0.70
Import cover (months) pe	3.0	2.9	2.9	2.9	2.7	3.1	3.9	3.9	3.2	3.3	3.3	3.4
3-m rate (%) pe	27.0	29.0	29.0	24.0	23.9	21.3	14.5	14.5	14.0	14.5	14.7	14.9
1-y rate (%) pe	28.5	29.0	29.0	26.0	25.9	23.0	16.0	15.5	15.0	15.5	15.7	15.9
USD/MWK pa	684	712	721	728	725	725	725	726	726	730	740	770

Source: Reserve Bank of Malawi; National Statistical Office; Ministry of Finance; International Monetary Fund; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average

GDP growth: lower agricultural output dims outlook

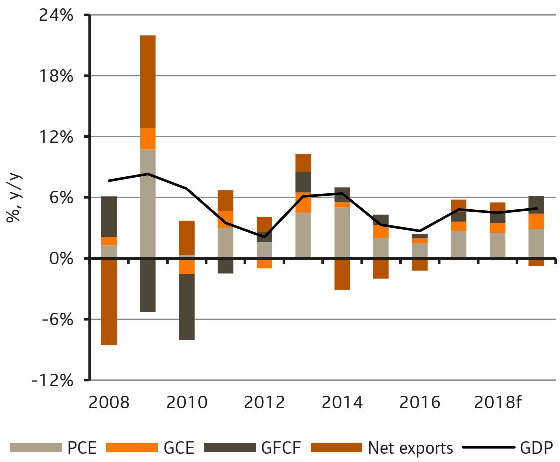
We expect GDP growth of around 4.2% y/y in 2018, and thereafter rising to 4.5% y/y in 2019. Strong performance of major sectors during 2017, more specifically an improvement in the agricultural sector, eased pressures on economic growth. Upward momentum brought about by end the of the drought is likely to sustain growth in the sector over the next 2-y, albeit with the forecast subsidence.

However, uneven rainfall, sporadic dry spells, and the spread of fall armyworms could restrain crop production. Given how pivotal the agricultural sector is to the overall economy, it should therefore be no surprise that we have revised downward our GDP growth projections, from 4.5% y/y for 2018 to 4.2% y/y.

Private sector credit growth has shown early signs of responding to the rate cuts in H2:17, which should support overall aggregate demand. But, the impact of the looser monetary conditions on private sector credit will be limited by the public sector's increasing borrowing requirements. Inflation has also fallen significantly, potentially providing a boost to real household income. It is worthwhile noting that the economy has benefited from the greater macroeconomic stability brought about by the adjustments initiated by the IMF programme.

The currency has also been relatively stable for nearly 2-y, which has sustained improvements in the inflation outlook. The more stable MWK is partly a function of improving foreign financing conditions. Naturally, such an improvement in foreign financing, indicating a normalisation of relations with development partners, would allow the government to increase both recurrent and capital expenditure in the budget, adding to overall economic growth by boosting GCE.

Composition of GDP growth by demand



Source: Reserve Bank of Malawi; National Statistical Office; Standard Bank Research

GDP decomposition by sector

	2015	2016	2017f	2018f
Agriculture, forestry & fishing	28.6	27.9	28.1	27.7
Mining and Quarrying	0.9	0.9	0.9	0.8
Manufacturing	9.6	9.4	9.3	9.4
Electricity and Water	1.3	1.2	1.2	1.2
Construction	2.8	2.8	2.8	2.8
Wholesale & Retail	16.0	15.9	16.0	15.8
Transportation & Storage	2.7	2.7	2.7	2.8
Accommodation & Food	1.9	2.0	2.0	1.9
Information & Communication	4.3	4.4	4.3	4.3
Financial & Insurance Activities	5.2	5.2	5.5	5.4
Real Estate Activities	7.7	7.7	7.5	7.3
Professional & Scientific	0.3	0.3	0.3	0.3
Public Administration & Defence	2.0	2.1	2.0	2.1
Education	2.6	2.7	2.7	2.8
Human Health & Social works	2.6	2.7	2.8	2.7
R+S+T+U Other services, net	4.9	5.1	5.0	5.0
Plus: Taxes less Subsidies on products	6.7	6.7	6.7	6.8
GDP	**100.0**	**100.0**	**100.0**	**100.0**

Source: Reserve Bank of Malawi; Standard Bank Research

Balance of payments: downside risks persist

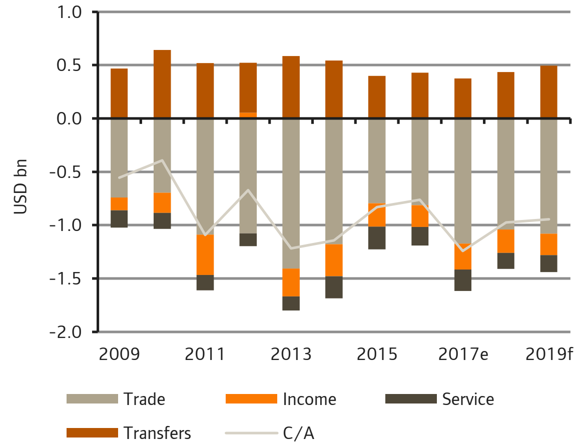
We expect the C/A deficit to remain elevated, in excess of 12.0% of GDP in both 2018 and 2019. Approval of a funded Extended Credit Facility (ECF) programme should provide the necessary support to the BOP over the next 2-y. We suspect that IMF involvement could even moderate the pace at which FX reserves decline, with import coverage hovering around 3-m through to the end of 2019. Over the near-term, tobacco sales will likely keep net exports elevated.

Lower crop production, and potentially the spread of the fall army worm, could exert some pressure on the trade balance by increasing the grain import requirement. That said, restoration of the ECF Program should prevent a marked deterioration in the overall BOP. Similarly, the previous IMF programme was instrumental in providing balance of payments support during a period when the country was experiencing an El Niño-induced drought, which also reduced agricultural production.

The previous programme also acted as a catalyst in mending relations between the government and development partners. This precipitated the recovery of developmental aid, which is one factor that has been supporting the BOP. Capital flows are still likely to be predominantly in the form of FDI, mainly retained earnings, as well as government borrowing.

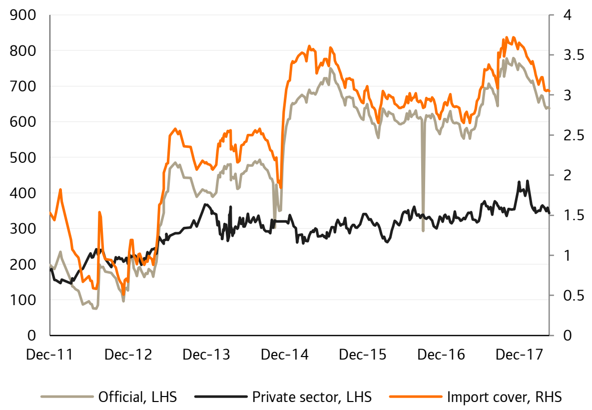
The fact that there is an election next year is a downside risk for the balance of payments. Any policy lapses or new scandals, particularly exposing fiscal mismanagement, would risk alienating development partners. This could lead to aid being suspended again. The restoration of an IMF programme mitigates this risk to some extent, since policymakers will be encouraged to adhere to fiscal targets set with the IMF. The first review under this ECF programme will be conducted only months before elections, which limits the scope for the government to ramp up spending.

Current account developments



Source: Reserve Bank of Malawi; Standard Bank Research

FX reserves

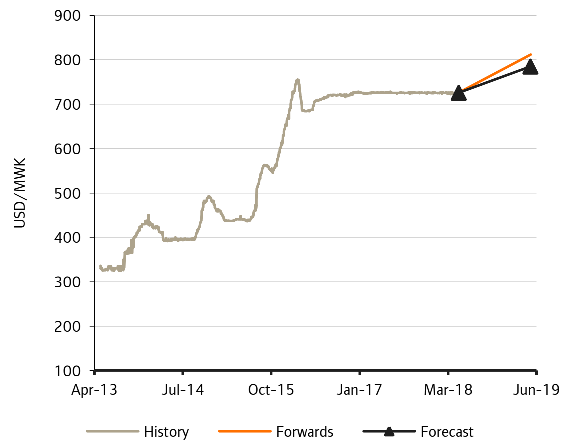


Source: Reserve Bank of Malawi; Standard Bank Research

FX outlook: holding steady

The USD/MWK is likely to gradually resume the upward trend that has been characteristic of the pair for the past 10-y, with the pair closing the year at 770. While it is not likely that BOP dynamics will support an appreciation, the pair has remained generally stable over the past 2-y. The MWK even managed to find support outside the tobacco marketing season, which was probably a function of the IMF programme. However, there are risks to our view. Firstly, we are at the beginning another tobacco marketing season, where flows could support the MWK over the season, which usually ends by Aug. This could not only prolong the stability of the exchange rate; it could also see the MWK appreciate slightly in the near term. Secondly, with an election just short of a year away, there is always a risk that fiscal policy lapses or misappropriation of funds could trigger a faster pace of depreciation than we expect.

USD/MWK: forwards versus forecasts



Source: Bloomberg

Fiscal policy and bond outlook: limited fiscal space

Spending patterns in the Mid-Year Budget Review (MYBR) showed that the FY2017/18 budget could turn out to be consumptive rather than developmental. This tilt towards consumption spending would not be surprising, since elections will be held in early 2019. It is worth noting, however, that the resumption of an IMF programme is likely to moderate pre-election spending.

We acknowledge the fiscal risks going into an election year but note that spending overruns from the MYBR were populist. It is encouraging that recurrent spending slippages were not widespread. The Ministry of Agriculture exceeded its mid-year spending target by over 200% because it bailed out the state produce trader, Agricultural Development and Marketing Corporation (ADMARC). ADMAC failed to recover proceeds from the sale of maize in FY2016/17, and required an MWK45.2bn injection from the national treasury. Inefficient budget execution could slow capital spending. Poor budget allocation processes and controls have been previously highlighted by the IMF as an area of improvement for Malawi.

Revenue and grants underperformed interim targets by 19%, limiting fiscal space to increase spending ahead of the elections. Despite the normalisation of relations with donors, only 37% of grants was disbursed, since Malawi did not meet the conditionality for disbursement. While the MYBR highlighted some slippages in recurrent spending, on the back of revenue underperformance, the size of the budget was reduced by MWK9.3bn (0.2% of GDP).

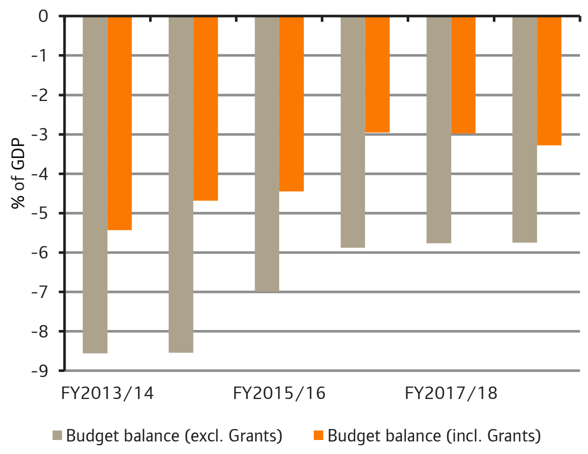
Although the RBM is likely to pause its easing cycle for the time being, it is still expected to maintain a tight liquidity stance to spur further downward momentum in non-food inflation. Tighter liquidity conditions will make it difficult for yields, across the curve, to decline further.

Central government budget

% of GDP	FY2015/16	FY2016/17	FY2017/18
Total revenue	17.1	19.1	18.9
Total expenditure	20.0	22.1	22.2
Recurrent	16.2	17.2	16.2
- development	3.7	4.9	5.9
Overall balance (+ grants)	-5.9	-5.8	-5.7
Overall balance (- grants)	-3.0	-3.0	-3.3
Net domestic borrowing	3.0	1.5	2.8
Net foreign borrowing	1.5	1.3	0.5

Source: Ministry of Finance

Budget balance

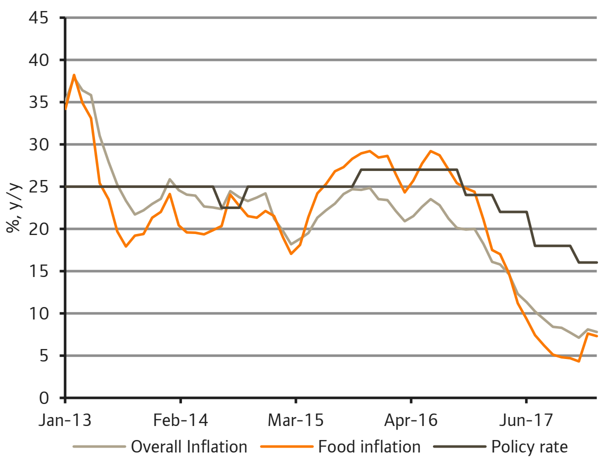


Source: Reserve Bank of Malawi; Standard Bank Research

Monetary policy outlook: on pause, for now

Even though there may well be a case for the RBM to cut the policy rate again, we believe that over the near term, the MPC will extend the pause in its easing cycle. The recent upward drift in inflation, with inflation rising to 9.9% y/y in Mar, is partially attributed to a change in the structure of the CPI basket, in which non-food inflation carries a larger weight. Non-food inflation has been particularly sticky. Risks to the outlook are still evolving. While the RBM does not expect upside surprises to food inflation, the fall armyworm infestation and generally uneven rainfall still pose risks to food supply. But the RBM still pointed out that the carryover of stock held in reserves mitigates this risk. Exchange rate stability that could extend well into H2:18 would also help to keep inflation subdued. Balancing this, potential fiscal spending overruns ahead of elections, and further increases of electricity tariffs, pose upside risks to the outlook.

Inflation and interest rates



Source: Reserve Bank of Malawi; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	15.4	15.9	16.3	16.7	17.0	17.3	17.5
Nominal GDP (MWK bn)	1 924	2 535	3 213	3 818	4 483	5 153	5 969
Nominal GDP (USD bn)	5.1	6.0	6.1	5.4	6.2	6.9	7.6
GDP / capita (USD)	331	380	375	322	364	402	437
Real GDP growth (%)	6.1	6.4	3.3	2.7	5.1	4.2	4.5
Tobacco auction sales (million kgs)	169	185	193	194	158	161	166
Tea production (million kgs)	47	46	38	28	32	32	36
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-10.6	-8.6	-8.5	-7.0	-5.9	-5.8	-5.7
Budget balance (incl. Grants) / GDP (%)	-0.9	-5.4	-4.7	-4.4	-3.0	-3.0	-3.3
Domestic debt / GDP (%)	19.8	14.9	16.8	18.9	19.5	20.0	21.6
External debt / GDP (%)	30.8	33.1	37.0	33.2	33.5	35.0	34.8
Balance of Payments							
Exports (USD bn)	1 276	1 510	1 417	1 469	728	1 450	1 495
Imports (USD bn)	-2 682	-2 688	-2 212	-2 283	-2 322	-2 490	-2 575
Trade balance (USD bn)	-1 406	-1 178	-795	-814	-1 174	-1 040	-1 080
Current account (USD bn)	-1 217	-1 144	-404	-416	-839	-975	-945
- % of GDP	-23.8	-19.0	-6.6	-7.7	-13.6	-14.0	-12.4
Financial account (USD bn)	740	591	773	685	900	885	840
- FDI (USD bn)	450	604	293	330	367	450	460
Basic balance / GDP (%)	-15.0	-9.0	-1.8	-1.6	-7.6	-7.6	-6.3
FX reserves (USD bn) pe	400	589	639	607	759	700	600
- Import cover (months) pe	1.8	3.1	3.1	2.9	3.4	3.3	2.8
Sovereign Credit Rating							
S&P	nr	nr	nr	nr	nr	nr	nr
Moody's	nr	nr	nr	nr	nr	nr	nr
Fitch	nr	nr	nr	nr	nr	nr	nr
Monetary & Financial Indicators							
Consumer inflation (%) pa	27.8	24.7	21.8	21.8	12.3	10.8	11.3
Consumer inflation (%) pe	24.9	23.7	24.7	20.0	7.1	10.6	11.6
M2 money supply (% y/y) pa	31.6	21.6	21.4	22.8	18.0	16.0	13.9
M2 money supply (% y/y) pe	34.0	16.6	25.5	19.9	18.4	12.0	15.0
Policy interest rate (%) pa	25.0	25.0	26.0	25.5	20.0	14.8	15.0
Policy interest rate (%) pe	25.0	25.0	27.0	24.0	16.0	16.0	14.0
3-m rate (%) pe	32.3	26.9	23.6	24.0	14.5	14.9	13.5
USD/MWK pa	377.1	420.0	525.4	711.3	725.1	741.6	780.5
USD/MWK pe	430.0	464.8	667.8	728.0	725.5	770.0	820.0

Source: Reserve Bank of Malawi; National Statistical Office; Ministry of Finance; International Monetary Fund; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available; nr – not rated

Mauritius: recovering construction sector

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	4.0	3.8	3.5	4.1	3.6	4.3	3.5	3.8	3.9	3.6	4.1	4.2
CPI (% y/y) pa	0.9	1.1	0.9	2.3	1.3	6.4	3.5	4.2	6.7	2.4	3.9	3.5
M2 (% y/y) pa	7.7	8.7	8.9	9.1	9.6	8.0	11.4	9.3	8.9	9.8	5.6	8.0
CA/GDP (%) pa	-7.5	-7.4	-7.6	-4.3	-6.0	-6.3	-6.4	-6.5	-5.0	-5.4	-5.1	-6.8
FX reserves (USD bn) pe	4.5	4.7	4.8	5.0	5.0	5.3	5.5	6.0	6.2	6.4	6.5	6.6
Import cover (months) pe	8.4	8.8	9.0	9.2	8.3	8.7	9.1	9.9	9.8	10.0	10.2	10.4
3-m rate (%) pe	2.2	1.9	2.5	2.8	2.5	2.0	1.8	2.4	2.8	3.1	2.9	2.8
5-y rate (%) pe	4.5	4.5	4.6	3.9	3.4	4.0	4.1	4.3	4.7	4.3	4.0	4.2
USD/MUR pa	35.23	35.62	35.48	35.97	35.82	34.48	33.92	33.57	33.45	33.36	35.20	33.93

Source: Bank of Mauritius; Statistics Mauritius; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: around 4.0% y/y

We still expect growth around 4.0% y/y in the next 2-y. Specifically, we expect 4.0% y/y growth in 2018, slightly higher than the authorities' 3.9% y/y forecast for 2018, and 4.1% y/y in 2019.

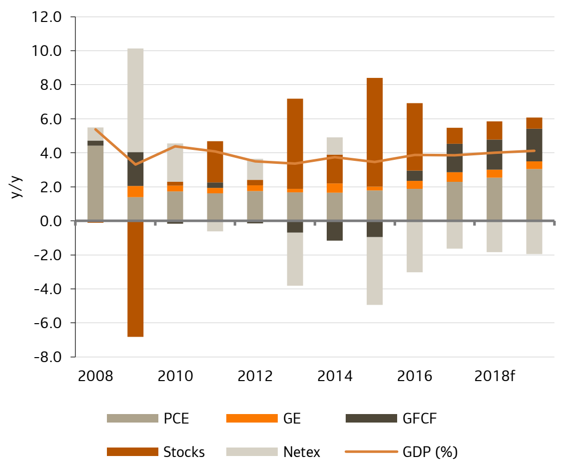
GDP growth printed at 3.8% y/y in 2017, lower than our revised forecast of 3.9% y/y, and higher than 2016 GDP growth of 3.7% y/y. In 2017, growth was driven by financial services, tourism and retail trade. Moreover, the construction sector recovered in 2017 after a prolonged slump that led to a cumulative 26.6% contraction between 2011 and 2016. We expect the sector to continue to recover in 2018.

We still expect the main sectors of growth to be financial services, tourism and retail trade. The tourism sector will likely continue to register high growth. For instance, in Q1:18 tourism arrivals rose by 5.3% y/y, compared to 3.6% y/y growth in Q1:17. But this is much lower than the 12.5% y/y in Q1:16 and 10.9% y/y in Q1:15. We also expect growth in the agricultural sector to be in positive territory in 2018, as opposed to the contraction of 0.2% y/y in 2017. This will likely be attributable to sugarcane production, as we expect the government to address the abandonment of cane lands. The government plans to make a provision of MUR50m for utilising these cane lands.

Growth in 2018 and 2019 will probably be driven by domestic demand. Private expenditure will also likely find a boost from the tax credits for low income earners that were introduced in the budget for FY2017/18 to provide financial support to some employees in full-time employment and earning less than MUR10k per month. Although GFCF recorded a cumulative contraction of 15.5% y/y between 2012 and 2015, it grew by 1.6% y/y in 2016 and 5.6% y/y in 2017. We expect the positive trend to continue in the next 2-y.

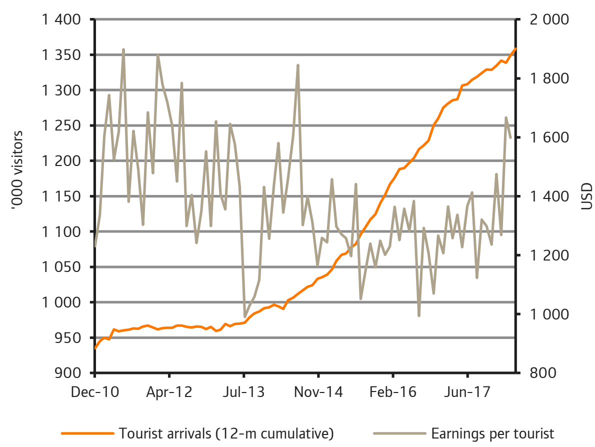
Net exports will likely continue detracting from growth despite stronger global growth likely boost external demand.

Composition of GDP growth by demand



Source: statistics Mauritius; Standard Bank Research

Tourism trends



Source: Statistics Mauritius; Standard Bank Research

Balance of payments: widening C/A

FX reserves are likely to continue increasing this year, perhaps reaching USD6.62bn in Dec. They increased to USD5.98bn in 2017, covering 9.9-m of imports (according to our estimates), from USD4.96bn in 2016, covering about 9.3-m of imports.

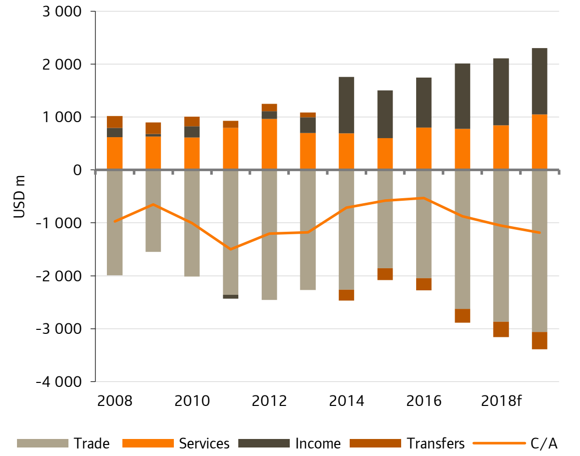
Nevertheless, the C/A deficit will likely widen to 6.7% of GDP in 2018 and 6.8% of GDP in 2019, from 6.5% of GDP in 2017 and 4.4% of GDP in 2016. The C/A deficit worsened in 2017 due to deteriorating exports of goods and increasing imports of goods and services. Mineral fuels, lubricants & related products contributed the most to increasing imports largely due to higher oil prices.

Capital inflows are, however, still sufficiently robust to enable FX reserves to continue rising. But, FDI inflows will likely decrease to USD8.0bn in 2018, from USD10.8bn in 2017.

Mauritius registered an increased balance of payment surplus of USD874m in 2017, compared to USD761m in 2016. The capital and financial account recorded a higher net inflow in 2017, compared to 2016. We expect this to continue in 2018, with the capital and financial account likely to record USD1.93bn, compared to USD1.7bn in 2017.

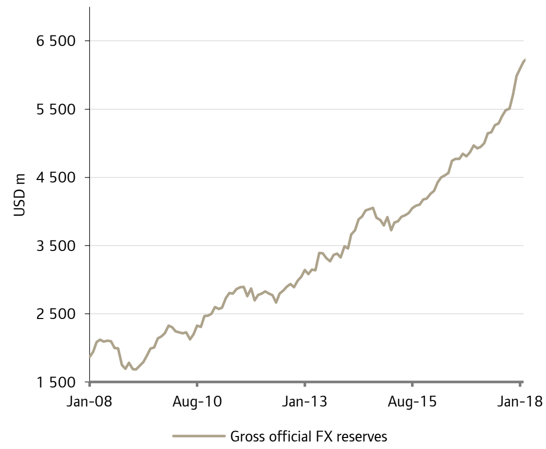
The downside risks to our view of a stronger BOP could be the renegotiated double tax agreement with the Indian government. As we get closer to the full transition period (Mar 19), it is likely that investors may be considering restructuring their investments. Of course, all investments before Mar 17 were exempted, which could motivate investors to hold on to their Mauritius assets for a longer period.

Current account



Source: Bank of Mauritius; Standard Bank Research

FX reserves

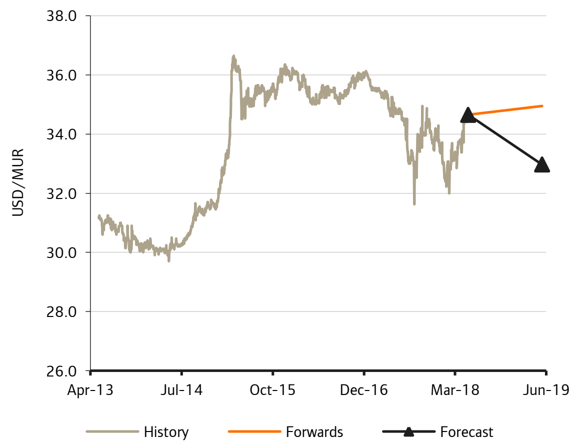


Source: Bank of Mauritius

FX outlook: A stronger MUR

The MUR has depreciated against the USD with some volatility this year. Both measures that the BOM uses in computing the trade-weighted MUR exchange rate have been a bit volatile in recent months. The measure computed using trade weights based on goods trade and tourism depreciated by 1.66% between Jan and Apr 18 while the one based on just goods trade depreciated by 1.69%. We believe that the BOM will attempt to keep the nominal trade-weighted MUR stable. We suspect that the weakening trend against the USD in recent months will be short-lived, with USD/MUR falling to 32.38 in a year's time, led by the EUR/USD pair which is expected to move towards 1.30 levels in 12-m. Of course, the BOM will probably still look to keep the MUR stable on a trade-weighted basis, essentially meaning that the USD/MUR rate will continue to follow EUR/USD.

USD/MUR: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: balancing recurrent budget

The fiscal deficit is not likely to deviate significantly from the budgeted 3.2% of GDP in FY2017/18. Based on the monthly statement of government operation Jul 17 to Jan 18, revenue increased by 16% y/y, compared to an increase of 5% y/y in the same period in FY2016/17. Revenue was high, regardless of the introduction of major tax reforms in the FY2017/18 budget, with most of the contribution attributable to grants and taxes on international trade and transactions.

Government expenditure in the 7-m ending Jan 18 inc reased by 4% y/y, compared to 9% y/y in the same period in FY2016/17, attributable to declining expenditure on good and services, social benefits and compensation of employees. Furthermore, in the pre-budget FY2018/19 circular, the finance ministry reiterated its commitment to bringing public sector debt to 60% of GDP by FY2020/21, from their estimate of 66.1% in FY2017/18, which will require the fiscal deficit to be curtailed. The key message in the pre-budget FY2018/2019 circular was the containment of recurrent expenditure. Fiscal containment needs to be reached along with higher economic growth, faster job creation and uplifting the quality of life. The Ministry of Finance acknowledges that the policy measures will definitely need to be innovative to accommodate this.

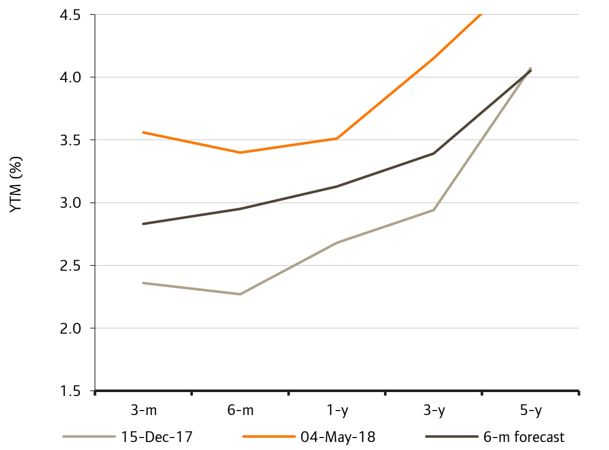
It is highly probable that T-bill and bond yields will fall, and the magnitude will depend on liquidity and upside inflationary pressures. However, based on the data discussed in the minutes of the 28 Feb MPC meeting, excess liquidity in the banking system declined to MUR7.7bn on 19 Feb from MUR11.2bn on Dec 17. The MPC noted that this was a factor pushing T-Bill yields higher. If the BOM continues to reduce liquidity successfully, it would limit the pace at which yields fall. But then again, the BOM has been unsuccessful in consistently reducing excess liquidity from the market since 2015.

Central government budget

	FY2016/17	FY2017/18
Total revenue	20.4	21.9
Total expenditure	24.5	26.5
- Interest	2.4	2.5
- Wages	6.4	6.3
- Capital expenditure	1.6	3.9
Net lending	0.2	1.3
Overall balance (- grants)	-4.2	-4.7
Overall balance (+ grants)	-3.5	-3.2
Net lending to parastatals	0.4	0.5
Net external borrowing	-1.2	-0.2
Net domestic borrowing	4.9	4.5
Donor support (grants)	0.6	1.4

Source: Ministry of Finance and Economic Development

Changes in the yield curve

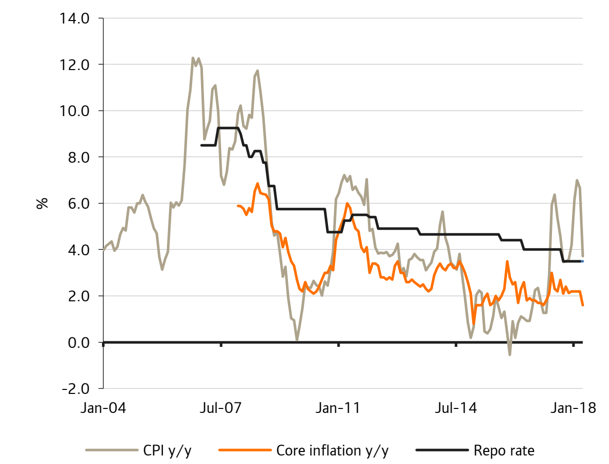


Source: Bank of Mauritius; Standard Bank Research

Monetary policy outlook: unchanged

While the MPC decided to keep the policy rate at 3.5% in Feb 18, one MPC member proposed a 25 bps hike, arguing that rising inflation expectations and changes in monetary policy outlook abroad justified it. Headline inflation averaged 5.0% y/y in the 12-m ending Apr 18 compared to 1.5% y/y for the 12-m ending Apr 17. However, there are still no signs of sustained underlying inflationary pressures. The upside pressure on inflation was due to vegetable prices on account of a domestic supply shock. The stability of core inflation, barely deviating from 2.0% y/y in the 12-m to Mar 18, indicates the absence of underlying inflation pressures. Furthermore, in the minutes of Feb 18 the MPC noted that the economy was growing below potential, implying that the policy rate is likely to remain unchanged. Given that Statistics Mauritius updated the base periods and their weighing system from 2012 to 2017 due to changes in household consumption patterns, it will take some time for the dynamics of the rebased series to be established.

Inflation and interest rates



Source: Bank of Mauritius; Statistics Mauritius

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	1.26	1.26	1.26	1.26	1.27	1.27	1.27
Nominal GDP (MUR bn)	372.4	392.1	409.9	434.4	460.9	502.4	536.9
Nominal GDP (USD bn)	12.1	12.8	11.6	12.2	13.4	14.8	16.7
GDP / capita (USD)	9 625	10 121	9 223	9 647	10 584	11 661	13 177
Real GDP growth (%)	3.4	3.7	3.5	3.9	3.8	4.0	4.1
Sugar production ('000 Tonnes)	404.7	400.2	366.1	386.3	355.2	362.3	376.0
Tourism arrival ('000)	993	1 038	1 152	1 275	1 342	1 462	1 555
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-4.1	-3.2	-3.7	-3.6	-4.2	-4.7	-4.2
Budget balance (incl. Grants) / GDP (%)	-3.7	-3.0	-3.1	-3.5	-3.5	-3.2	-3.0
Domestic debt / GDP (%)	40.3	42.2	44.3	49.7	51.4	47.5	47.7
External debt / GDP (%)	12.7	16.0	13.3	14.8	12.8	12.5	10.4
Balance of Payments							
Exports (USD bn)	6.27	6.27	5.48	5.21	5.38	5.69	6.43
Imports (USD bn)	7.84	7.84	6.74	6.46	7.23	7.62	8.47
Trade balance (USD bn)	-1.57	-1.57	-1.26	-1.24	-1.85	-1.93	-2.04
Current account (USD bn)	-1.18	-0.71	-0.58	-0.53	-0.88	-1.00	-1.14
- % of GDP	-9.73	-5.57	-4.99	-4.35	-6.54	-6.77	-6.84
Financial account (USD bn)	1.72	1.46	1.15	1.27	1.70	1.93	2.00
- FDI (USD bn)	2.19	0.55	0.33	12.97	10.83	7.63	7.06
Basic balance / GDP (%)	8.32	-1.27	-2.14	102.01	74.33	44.87	35.35
FX reserves (USD bn) pe	3.49	3.92	4.26	4.97	5.98	6.62	7.13
- Import cover (months) pe	5.3	6.0	7.6	9.2	9.9	10.4	10.1
Sovereign Credit Rating							
S&P	nr	nr	nr	nr	nr	nr	nr
Moody's	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1
Fitch	nr	nr	nr	nr	nr	nr	nr
Monetary & Financial Indicators							
Consumer inflation (%) pa	3.5	3.2	1.3	1.0	3.7	4.3	2.5
Consumer inflation (%) pe	4.1	0.2	1.3	2.3	4.2	3.5	2.6
M2 money supply (% y/y) pa	6.81	8.01	10.62	8.79	9.04	8.35	8.90
M2 money supply (% y/y) pe	5.78	8.74	10.17	9.08	9.27	8.02	9.30
BOM policy rate (%) pa	4.75	4.65	4.61	4.20	3.83	3.50	3.50
BOM policy rate (%) pe	4.65	4.65	4.40	4.00	3.50	3.50	3.50
3-m rate (%) pe	3.10	2.50	2.90	2.80	2.40	2.80	3.00
5-y rate (%) pe	6.75	4.70	4.85	3.93	4.25	4.15	4.25
USD/MUR pa	30.71	30.70	35.19	35.63	34.41	34.00	32.09
USD/MUR pe	30.05	31.75	35.85	35.97	33.57	33.93	31.11

Source: Bank of Mauritius; Statistics Mauritius; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated

Morocco: 2018 likely a lot slower

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	1.6	1.2	1.7	0.9	3.8	4.2	3.8	4.1	3.2	3.2	3.2	3.2
CPI (% y/y) pa	1.0	1.9	1.8	1.8	1.3	0.3	0.2	1.2	2.1	2.0	1.8	0.8
M3 (% y/y) pa	5.3	5.1	5.5	5.1	6.0	5.3	5.2	5.7	5.1	4.8	4.0	3.7
CA/GDP (%) pa	-2.3	-7.1	-0.9	-7.0	-5.4	-9.1	1.6	-2.6	-5.6	-9.2	1.7	-2.9
FX reserves (USD bn) pe	24.9	25.2	26.2	25.0	24.9	22.0	24.4	26.1	26.5	26.9	27.3	27.7
Import cover (mths) pe	6.6	6.7	7.0	6.7	6.0	5.3	5.9	6.3	5.7	5.8	5.9	5.9
BCT policy rate (%) pa	2.42	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.25
USD/MAD pe	9.62	9.80	9.71	10.19	10.06	9.65	9.41	9.33	9.20	9.44	9.45	9.20

Source: Bank Al-Maghrib; Haut-Commissariat au plan; Office des Changes; Standard Bank Research
Note: pa – period average; pe – period end

GDP growth: a downward revision

It has been quite clear for some time that economic activity in 2018 would slow markedly since Morocco was unlikely to see as exceptional good harvest, as 2017. However, agricultural output may not turn out as bad as we fear. After a dry spell between Oct and Dec 17, rains returned, providing some hope for the spring crops.

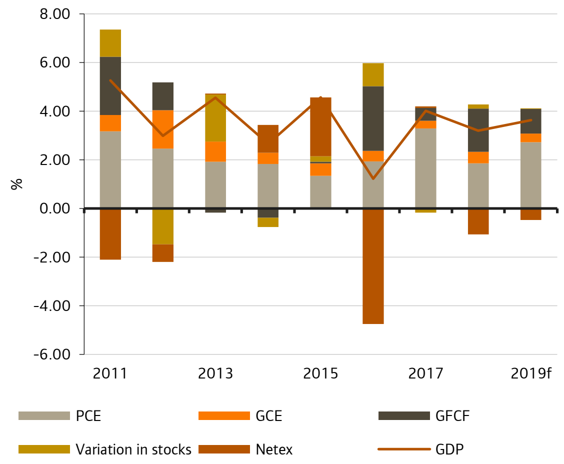
However, PCE growth will most likely be restrained. It decelerated to 3.4% y/y in Q4:17, from c.4.5% y/y the first 3 quarters of 2017. Household income from the agricultural sector, the largest employer, may therefore be depressed.

The tourism sector remains resilient. In the first 2-m of 2018, tourist arrivals increased by 11.7% y/y. Meanwhile, preliminary indications for the secondary sector are mixed, with electricity and phosphate production in Jan and Feb increasing 6.2% y/y and 11.5% y/y respectively, while production of cement fell by 6.9% y/y. Overall, however, we expect industrial production to expand at a marginally higher rate this year than 2017.

Despite this and the somewhat better outlook for agriculture, we lower our forecast for GDP growth in 2018, to 3.2% y/y, from 3.3% y/y, previously. Net exports though are likely to perform worse than we initially thought, depressing overall GDP growth in 2018. Growth in goods imports continues unabated, supported by capital goods required for major, infrastructure projects. Depressed prices will probably subdue phosphate exports.

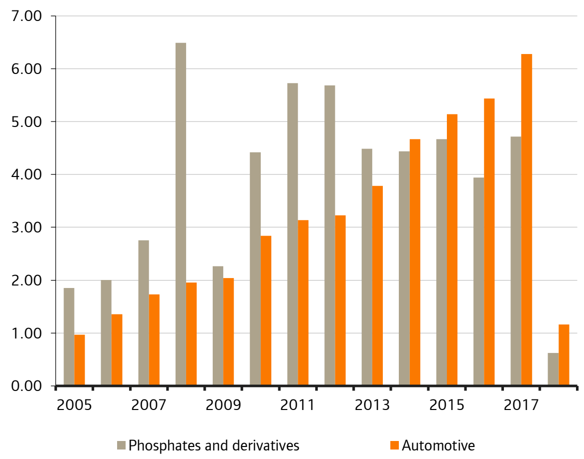
We leave our forecast for GDP growth in 2019 unchanged at 3.6% y/y, with the risk for that year tilted to the upside.

Composition of GDP growth by demand



Source: Haut-Commissariat au plan; Bank Al-Maghrib; Standard Bank Research

Phosphates vs. automotive exports, USD bn



Source: Bank Al-Maghrib ; Office des Changes

Balance of payments: a stable C/A deficit

The C/A deficit narrowed to USD4.2bn in 2017 (3.8% of GDP). In absolute terms, this will probably be the lowest figure for some time. We will leave our projection for the C/A deficit in 2018 at USD4.7bn, and reduce it to USD4.6bn in 2019, from USD4.8bn previously, mainly on a revised FX outlook and an expected deceleration in imports of capital goods and energy purchases.

Preliminary data for Q1:18 shows that growth in exports slowed down significantly to 6.6% y/y, after growing by 10.0% y/y in 2017 as a whole. Growth in exports of automobile and aeronautic industries remained healthy, but was negated by a downturn in exports of phosphates and lacklustre agricultural products exports. Subsidence of the latter two is worrisome, as they were the driving force of exports in 2017. Apart from high-tech industries, it is likely that this year's exports will be mainly maintained by expansion in services, as tourist receipts grew by 20.2% y/y in Q1:18.

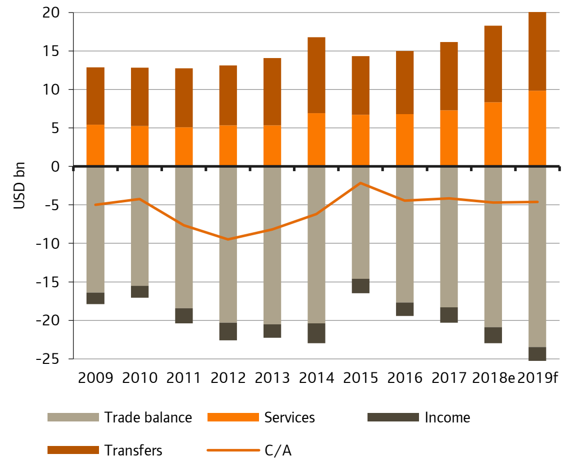
Imports in Q1:18 grew by 8.2% y/y, propelled by a surge in purchases of food - specifically wheat - capital and consumer goods. We expect imports of goods to slow down later this year but still remain above the rate of export growth, resulting in an 11.5% y/y increase in the trade deficit.

Inward transfers will likely remain robust throughout the year, given the improvement in economic activity in Europe. In fact, in Q1:18 remittances grew by 13.5% y/y.

FDI dropped by 22% y/y in Q1:18 but this will probably prove temporary. We expect FDI inflows to rise to USD1.9bn and USD2.0bn in 2018 and 2019 respectively, from USD1.7bn in 2017.

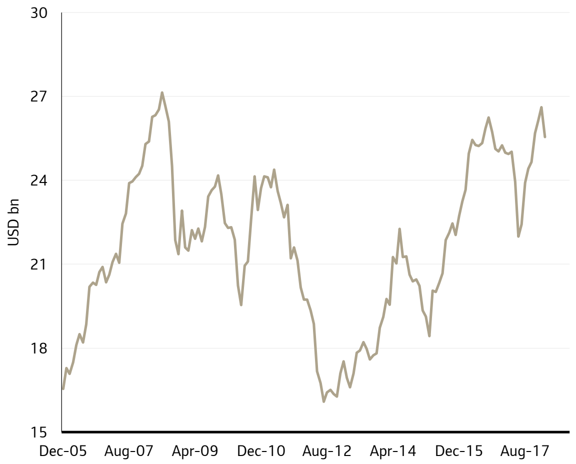
FX reserves will likely be around 6-m of import cover.

Current account



Source: Haut-Commissariat au plan; Office des Changes; Standard Bank Research

Gross international reserves

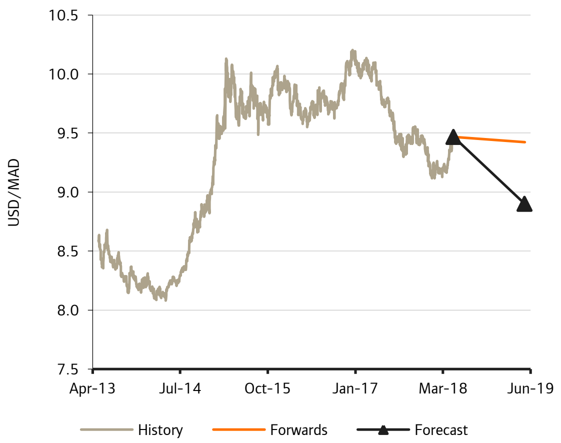


Source: Haut-Commissariat au plan

FX outlook: a stable currency basket

The bank's currency basket (60% EUR + 40% USD) remains rock solid at around 10.46. It is testament to the country's strong economic fundamentals that, even though the BAM announced that widening the basket had allowed a fluctuation band from 0.6% to 5% in Jan 18, the actual average daily volatility since then has been just 0.9%. Clearly, the authorities are under no pressure to liberalise the existing FX regime. Granted, floating the currency would help to alleviate the external imbalances quicker. As the IMF rightly points out, the conditions for a liberalisation of the FX regime are currently very favourable, given a low pass-through from FX to consumer prices. Yet, the authorities remain wary of another run on the currency, similar to last summer. Given our view on the EUR/USD exchange rate, a stable currency basket would imply the dirham strengthening against the dollar to 9.2 by YE:18 and to 8.6 by YE:19.

USD/MAD: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: only a marginal improvement is expected

As we expected, the 2017 budget deficit narrowed by a full percentage point, to 3.5% of GDP, on a nearly 6% y/y improvement in current revenues and a 32% y/y jump in GCC donor inflows last year. We also mentioned in our Jan publication that the 2018 Act's deficit target of 3.0% of GDP looked too ambitious, given a likely deceleration of economic growth and a reduction in donor inflows this year.

Indeed, the preliminary data for Q1:18 show that the deficit is not keeping up with the target so far, in fact widening by 18% y/y. Direct taxes from both households and corporates are down c.10% y/y, in the latter instance also due to the gradual reduction in the corporate tax rates. This was to a large extent offset by increased customs duties and VAT on imported goods. However, non-tax revenues fell 60% y/y due to lower transfers from state monopolies. All this resulted in current revenues decreasing 2.6% y/y. Meanwhile, current expenses decreased by only 0.9% y/y, mainly because of lower interest payments. Worryingly, both state wages and subsidy payments were up 2.3% y/y and 4.3% y/y respectively.

It is unlikely that Morocco, mindful of its long-term needs, would sacrifice capital expenditure to achieve the targeted deficit goal. Neither can it expect to receive the more than the c.USD700m of GCC grants remaining from the USD5bn agreement reached in 2012. This means that it will probably miss its deficit target this year. We therefore do not change our forecast for the budget deficit of 3.4% of GDP in 2018, tightening to 3.0% of GDP in 2019.

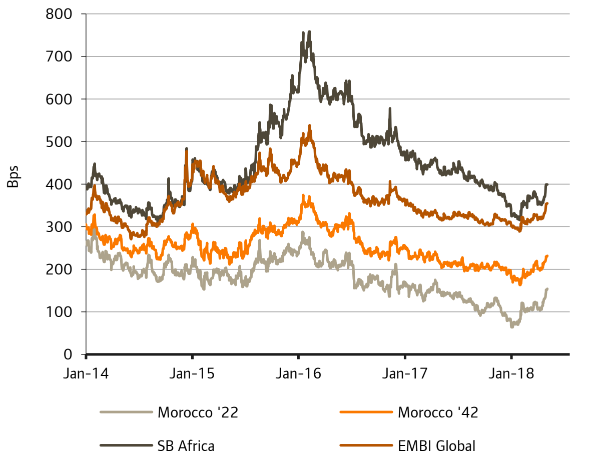
The deficit financing so far has been done almost entirely domestically, which is not surprising, given that local bond yields are well below those for Eurobonds. We therefore don't expect any supply pressure on existing external debt yields (which we expect to follow the path of Treasuries).

Central government budget, % of GDP

	2014	2015	2016	2017	2018 (Act)
Current Revenue	25.7	23.8	23.8	23.8	23.5
- Tax revenue	21.5	20.8	20.9	21.1	21.2
- Non-tax revenue	4.2	2.9	2.9	2.7	2.3
Expenditure	31.0	28.7	28.6	27.8	27.0
Current expenditure	25.2	22.7	22.3	21.6	21.6
- Wages and salaries	11.0	10.5	10.4	9.8	9.7
- Subsidies	3.5	1.4	1.4	1.4	1.2
- Interest on public debt	2.7	2.8	2.7	2.5	2.4
Capital expenditure	5.8	6.0	6.3	6.3	5.4
Special Treasury accounts balance	0.6	0.7	0.3	0.5	0.5
Budget deficit (excl. grants)	-6.1	-4.6	-5.2	-4.4	-3.6
Grants	1.4	0.4	0.7	0.9	0.6
Overall balance (+ grants)	-4.7	-4.2	-4.5	-3.5	-3.0
Change in arrears	-0.2	-0.5	0.5	-0.1	0.0
Domestic financing	4.0	4.7	3.6	3.3	1.2
External financing	1.0	0.0	0.3	0.3	1.8

Source: Ministère de l'Economie et des Finances; Standard Bank Research

Eurobonds: spread over Treasuries



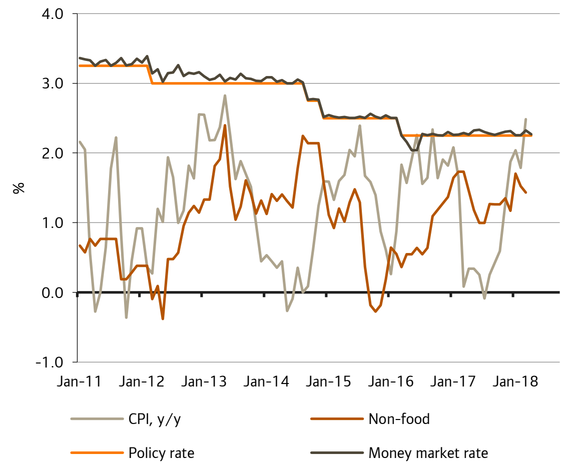
Source: Bloomberg; Standard Bank Research

Monetary policy outlook: stable policy rate

The acceleration in inflation that started in Nov 17 continued in Q1:18. Inflation in Mar was 2.5% y/y. The reason for the acceleration is food and fuel prices that have been advancing at a pace of 3%-4% y/y lately. Elevated food inflation is probably temporary, resulting from base effects due to last year's plentiful harvest. But fuel price increases may persist, depending on the trajectory of international energy prices. Nevertheless, there is no evidence of generalised inflationary pressures in the economy. Non-food inflation is essentially stable, while the core CPI is growing at just 1% y/y. We expect inflation to average 1.7% y/y in 2018, from a forecast of 1.5% y/y previously, the same as our forecast for 2019.

Since the current inflation spurt is probably temporary, and the economy is likely to decelerate this year, the central bank will likely maintain its accommodative monetary policy stance.

Inflation and interest rates



Source: Bank Al-Maghrib

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	33.4	33.8	34.1	34.5	34.8	35.2	35.6
Nominal GDP (MAD bn)	894	920	983	1,010	1,068	1,119	1,184
Nominal GDP (USD bn)	106.2	109.4	100.8	103.0	110.0	120.1	135.1
GDP / capita (USD)	3,181	3,236	2,957	2,986	3,161	3,411	3,795
Real GDP growth (%)	4.6	2.7	4.6	1.2	4.0	3.2	3.6
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-5.7	-6.1	-4.6	-5.2	-4.2	-4.1	-3.7
Budget balance (incl. Grants) / GDP (%)	-5.1	-4.7	-4.2	-4.5	-3.5	-3.4	-3.0
General gov. debt / GDP, domestic (%)	47.5	48.4	49.7	50.9	50.5	49.4	47.9
General gov. debt / GDP, foreign (%)	14.5	15.3	14.3	14.1	14.3	15.4	15.8
Balance of Payments							
Exports of goods and services (USD bn)	35.3	35.2	33.1	34.2	38.7	43.3	50.0
Imports of goods and services (USD bn)	50.5	48.7	41.0	45.1	49.7	56.0	63.5
Trade balance, goods and services (USD bn)	-15.2	-13.5	-7.9	-10.9	-11.0	-12.7	-13.6
Current account (USD bn)	-8.2	-6.2	-2.1	-4.5	-4.2	-4.8	-4.6
- % of GDP	-7.7	-5.7	-2.1	-4.3	-3.8	-4.0	-3.4
Capital & Financial account (USD bn)	9.5	8.5	6.0	6.2	5.1	6.2	5.9
- FDI (USD bn)	3.1	3.0	2.7	1.6	1.7	1.9	2.0
Basic balance / GDP (%)	-4.8	-2.9	0.5	-2.7	-2.3	-2.5	-1.9
FX reserves (USD bn) pe	18.7	20.2	22.7	25.0	26.1	27.7	29.3
- Import cover (months) pe	4.4	5.0	6.7	6.7	6.3	5.9	5.5
Sovereign Credit Rating							
S&P	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-
Moody's	Ba1	Ba1	Ba1	Ba1	Ba1	Ba1	Ba1
Fitch	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-
Monetary & Financial Indicators							
Consumer inflation (%) pa	1.9	0.4	1.6	1.6	0.8	1.7	1.7
Consumer inflation (%) pe	0.4	1.6	0.6	1.8	1.9	0.4	2.8
M3 money supply (% y/y) pa	4.4	4.3	6.2	5.3	5.6	4.4	5.8
M3 money supply (% y/y) pe	3.1	6.2	5.7	4.7	5.5	3.1	6.2
Policy rate (%) pa	3.00	2.90	2.50	2.29	2.25	2.25	2.25
Policy rate (%) pe	3.00	2.50	2.50	2.25	2.25	2.25	2.25
USD/MAD pa	8.41	8.42	9.75	9.81	9.71	9.32	8.77
USD/MAD pe	8.18	9.08	9.92	10.19	9.33	9.20	8.59

Source: Bank Al-Maghrib; Haut-Commissariat au plan; Office des Changes; Ministère de l'Economie et des Finances; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available; nr – not rated

Mozambique: merely muddling through

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	6.1	4.7	3.2	1.0	3.8	4.7	2.7	3.7	3.4	3.4	3.6	3.5
CPI (% y/y) pa	13.4	17.6	22.8	25.6	20.5	19.2	13.5	7.1	3.3	2.4	4.9	6.6
M2 (% y/y) pa	23.9	19.2	11.5	5.5	0.9	4.5	8.7	11.3	13.2	11.2	11.1	11.7
CA/GDP (%) pe	-50.0	-49.8	-41.0	-35.5	-30.7	-21.8	-18.7	-19.5	-16.4	-16.0	-15.6	-17.3
FX reserves (USD bn) pe	2.1	2.1	2.0	2.0	2.0	2.4	2.4	3.3	3.3	3.6	3.5	3.6
Import cover (months) pe	3.1	3.2	3.0	3.0	3.6	4.2	4.2	5.8	4.8	5.3	5.1	5.3
3-m rate (%) pe	10.3	12.1	18.0	24.3	25.5	25.3	24.7	22.5	16.7	13.2	10.3	10.2
1-y rate (%) pe	11.1	12.8	13.5	28.8	29.5	27.5	26.6	23.8	16.6	13.0	10.1	10.4
USD/MZN pa	48.0	58.3	73.2	74.3	69.4	61.8	61.3	60.1	61.2	59.8	59.8	59.7

Source: Instituto Nacional de Estatística; Banco de Moçambique; Ministry of Finance; Standard Bank Research
Notes: pa - period average; pe - period end

GDP growth: hopefully to bottom out

We foresee subdued economic activity, with GDP growth perhaps bottoming out at 3.5% y/y in 2018 (the government has forecast 5.3% y/y), from 3.7% y/y in 2017, 3.8% y/y in 2016, and an annual average of 7.8% y/y between 2001 and 2015. In 2019 we see GDP growth at 3.7% y/y as the expected final investment decisions for the Area 1 and Area 4 Rovuma Basin projects, worth respectively around USD25bn and USD30bn, take place, alleviating BOP pressures and boosting the economy as the construction of the onshore LNG plant begins.

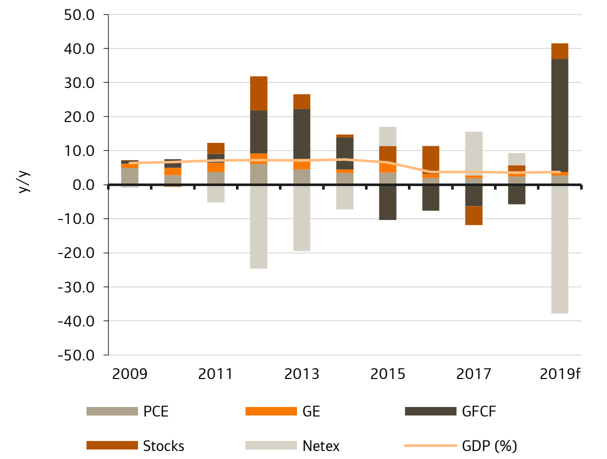
In Mar the IMF published its Article IV Consultation Report on Mozambique, saying that in the absence of further policy action (the baseline scenario), the current policy mix, marked by a loose fiscal policy and a restrictive monetary stance, could cause GDP growth to slow from 3.0% y/y in 2018 to a historical low of 2.2% y/y by 2022, before accelerating to 9.9% y/y in 2023 as Rovuma Basin liquefied natural gas exports (LNG) commence.

Aggregate demand will likely remain subdued this year as the net export improvement eases, compared to last year's stellar performance supported by the ramp-up in coal production and higher commodity prices. Investment will likely contract further, with private consumption constrained by low disposable income despite easing inflation. Limited borrowing options are also likely to restrain government expenditure.

This year's expected cuts in the policy rate, as inflation falls, could lift growth in 2019, pending LNG-related foreign direct investment.

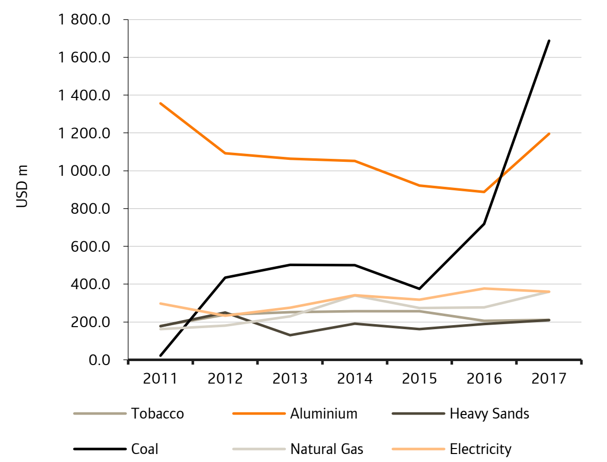
From the supply side, we expect GDP growth to remain driven by primary activities (which account for roughly one-third of GDP) on the expected positive performances by agriculture and mining – but with the rest of the economy underperforming.

Composition of GDP growth by demand



Source: Instituto Nacional de Estatística; Standard Bank Research

Principal exports



Source: Banco de Moçambique; Standard Bank Research

Balance of payments: delayed LNG investment could prove another shock

Notwithstanding the impressive improvement of the past two years, the BOP remains fragile and subject to shocks. Given the structural nature of the C/A deficit and limited potential to grow exports before the expected LNG boom, growing imports could create BOP pressures.

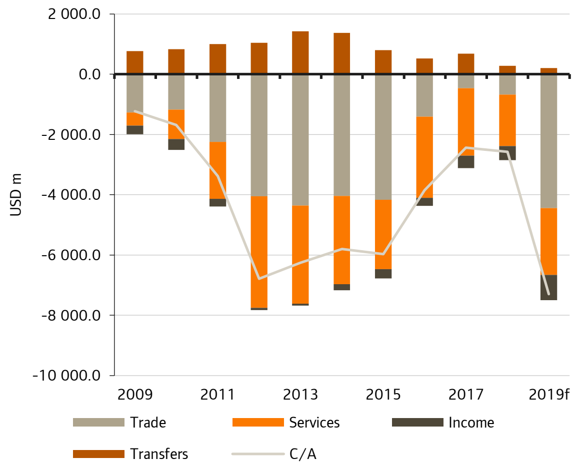
Given our view of limited potential to grow exports in the near term, BOP shocks would be avoided by growing imports were funded by foreign direct investment (FDI) inflows (which could pan out, with LNG final investment decisions expected next year). Otherwise, the USD/MZN would need to rise, and monetary policy would have to be re-tightened.

The BOP improved further in 2017, with a 36.6% y/y contraction in the C/A deficit, to USD2.4bn or 19.5% of GDP, mainly driven by a 41.8% y/y increase in goods exports due to higher commodity prices and a 135% y/y increase in coal exports to USD1.7bn (or 36% of total exports). This followed another 35.6% y/y C/A contraction in 2016, to USD3.8bn, or 35.5% of GDP, which was driven by a 37.5% y/y contraction in goods imports to USD7.9bn.

Historically, Mozambican trade deficits have been funded by donor support and FDI inflows, with the first falling substantially after the revelation of hidden loans in Apr 16 and the suspension of an IMF-funded program, and the second depressed due to delays in commencement of LNG projects.

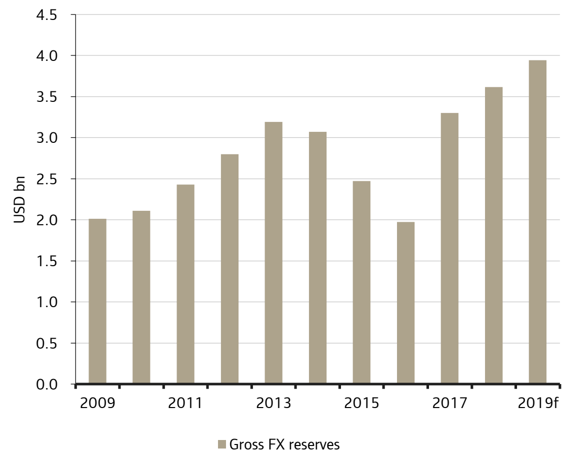
Subdued import demand allowed the central bank to increase gross FX reserves to USD3.3bn in 2017 from USD2.0bn in 2016, improving the import cover ratio of goods and services to 7.3-m (excluding the large projects imports) from 4.7-m .

Current account



Source: Banco de Moçambique; Standard Bank Research

FX reserves at year-end



Source: Banco de Moçambique; Standard Bank Research

FX outlook: volatility, then further strength

Economic activity is expected to remain subdued, and the impact of monetary easing on increasing disposable income, consumption and import demand will probably come with a substantial time lag, coinciding perhaps next year with LNG-related FDI inflows. Therefore, we see USD/MZN staying around current levels, possibly falling next year to 55, supported by LNG FDI inflows. Low import demand due to subdued economic activity, with growing exports led by isolated large projects with limited growth spill-over effects to the rest of the economy, allowed for some relief for the FX market from the severe liquidity pressures of 2016. The USD/MZN pair fell to 59.0 by the end of 2017 from 71.2 at the end of 2016. After the BM introduced a regulatory change that allowed exporters to keep export earnings in foreign currency, the pair rose to 63.0. It has since fallen to around 60.0.

USD/MZN: forwards vs forecasts

Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: consolidation needed

With municipal elections in Oct this year and legislative and presidential elections in Oct 19, limited fiscal adjustment will take place.

In its recent country assessment published in Mar, with a debt sustainability analysis (DSA), the IMF indicated that external public and publically guaranteed (PPG) debt is in distress. Furthermore, total PPG debt is unsustainably high, potentially increasing to 146% of GDP by 2022 from 122% of GDP this year.

We do not expect holders of the Eurobond and the MAM and Proindicus loans to agree on a debt restructuring per the terms proposed by the government in Mar. The absence of an IMF program is also seen as an impediment to confidence, clearly with negative consequences.

There is evidence pointing to the crowding out of private sector credit, mounting domestic arrears and increasing financial vulnerability of state-owned entities (SOEs) that compromise macroeconomic stability. Nonetheless, contrary to the IMF's forecasts, we see debt to GDP declining in the next 2-y.

The 2018 government budget sees revenues easing to 22.5% of GDP from the 2017 preliminary estimates of 27.1% of GDP, of which 2.4 percentage points of GDP represents the USD352m earned in the one-off capital gains tax on the ENI/Exxon-Mobil transaction accounted for in 2017.

Overall expenditure is targeted at 28.1% of GDP in 2018, almost flat on 2017, which causes the fiscal deficit to increase from 1.2% of GDP to 5.6% of GDP. If we consider the arrears on payments of goods and services and VAT reimbursements owed to the private sector, the deficit is even wider.

Central government budget

% of GDP	2016	2017	2018
Total revenue	24.2	27.1	22.5
Total expenditure	29.8	28.3	28.1
- wages	11.3	10.8	9.3
- interest	2.4	2.3	3.3
- development	7.3	6.3	8.2
Net lending	2.0	3.3	1.4
Overall balance (- grants)	-5.6	-1.2	-5.6
Overall balance (+ grants)	-3.4	0.3	-3.9
Net domestic borrowing	0.7	1.4	0.9
Changes in balances	-0.9	-6.2	0.0
Net external borrowing	3.7	4.5	3.0
Donor support (grants)	2.2	1.5	1.8

Source: Ministry of Economy and Finance; Standard Bank Research

Mozam '23 price - mid

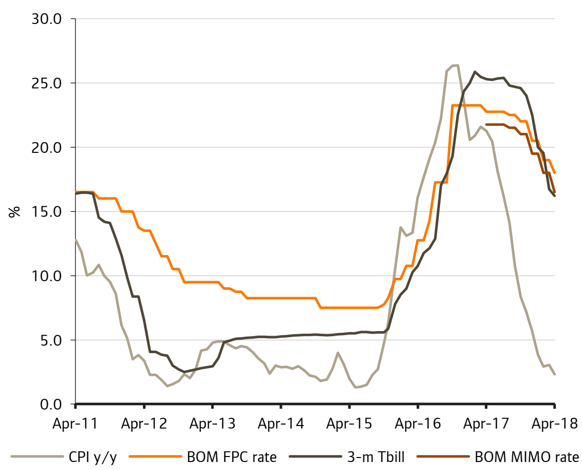
Source: Bloomberg

Monetary policy outlook: still easing

The BM will likely cut rates more aggressively this year as inflation continues to fall – despite the risks to the outlook, including higher oil prices. We have updated our expectations of MIMO policy rate cuts from 600 bps published in our Jan edition to 900 bps, which sees the MIMO rate closing the year at 10.5%.

Per last year's change in monetary policy regime, with the implementation of the MIMO rate in Apr 16, the BM will likely look at medium-term inflation as an important variable to guide its interest rate decisions. Countrywide inflation was at a low of 2.33% y/y in Apr and a 12-m average of 9.01% y/y, and is expected to close the year much lower than the government's expected 11.9% y/y average, on a relatively stable metical and subdued aggregate demand.

Inflation and interest rates



Source: Banco de Moçambique; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	24.4	25.0	25.7	26.4	28.9	29.6	30.4
Nominal GDP (MZN bn)	482.2	531.8	591.7	687.1	789.3	897.2	990.3
Nominal GDP (USD bn)	16.1	17.3	15.2	10.8	12.5	14.9	17.7
GDP / capita (USD)	661	691	592	410	433	503	580
Real GDP growth (%)	7.1	7.4	6.6	3.8	3.7	3.5	3.7
Coal (MT)	5.9	6.3	6.6	6.1	11.1	15.3	18.1
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-10.8	-12.4	-5.0	-5.6	-1.2	-5.6	-6.0
Budget balance (incl. Grants) / GDP (%)	-4.6	-7.8	-1.9	-3.4	0.3	-3.9	-5.0
Domestic debt / GDP (%)	6.2	6.5	11.7	24.7	27.1	24.8	25.3
External debt / GDP (%)	46.9	54.5	74.2	106.3	81.3	82.0	75.9
Balance of Payments							
Exports (USD bn)	4.8	4.6	4.1	3.8	5.4	5.8	6.0
Imports (USD bn)	12.4	11.6	10.6	7.9	8.1	8.2	12.7
Trade balance (USD bn)	-7.6	-7.0	-6.5	-4.1	-2.7	-2.4	-6.7
Current account (USD bn)	-6.3	-5.8	-6.0	-3.8	-2.4	-2.6	-7.3
- % of GDP	-38.8	-33.5	-39.2	-35.5	-19.5	-17.3	-41.3
Financial account (USD bn)	6.2	5.8	5.9	3.9	2.5	2.6	7.3
- FDI (USD bn)	6.2	4.9	3.9	3.1	2.3	1.5	6.0
Basic balance / GDP (%)	-0.5	-5.2	-13.8	-6.9	-1.2	-7.0	-7.0
FX reserves (USD bn) pe	3.2	3.1	2.5	2.0	3.3	3.6	3.9
- Import cover (months) pe	3.1	3.2	2.8	3.0	4.9	5.3	3.7
Sovereign Credit Rating							
S&P	B+	B	B-	CC	SD	SD	SD
Moody's	B1	B1	B2	Caa3	Caa3	Caa3	Caa3
Fitch	B+	B+	B	CC	RD	RD	RD
Monetary & Financial Indicators							
Consumer inflation (%) pa	4.3	2.6	3.6	19.9	15.1	4.3	7.3
Consumer inflation (%) pe	3.5	1.9	10.6	23.7	5.6	6.4	7.3
M3 money supply (% y/y) pa	22.8	19.0	24.2	23.6	3.2	9.2	12.3
M3 money supply (% y/y) pe	16.3	22.2	26.1	10.1	4.6	10.6	13.8
BOM policy rate (%) pa	9.0	8.1	7.8	16.0	21.3	14.0	9.8
BOM policy rate (%) pe	8.3	7.5	9.8	23.3	19.5	10.5	9.5
3-m rate (%) pe	5.2	5.4	7.8	24.3	22.5	10.2	9.2
1-y rate (%) pe	7.2	7.3	7.6	28.8	23.8	10.4	9.4
USD/MZN pa	29.9	30.8	38.9	63.4	63.2	60.1	56.1
USD/MZN pe	30.0	31.6	45.0	71.2	59.0	59.3	55.2

Source: Mozambique National Statistics Institute; Bank of Mozambique; Ministry of Economy and Finance; Standard Bank Research
Notes: pa - period average; pe - period end

Namibia: growth rebound seems imminent

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	4.4	-0.9	-0.7	0.0	-1.3	0.2	-1.0	-1.0	0.5	3.8	3.2	5.3
CPI (% y/y) pa	6.0	6.7	6.9	7.3	7.7	6.4	5.5	5.2	3.5	3.7	4.0	4.2
M2 (% y/y) pa	8.7	10.0	6.6	4.5	3.1	4.9	8.2	9.1	8.8	10.2	11.7	12.1
CA/GDP (%) pa	-6.5	-15.2	-14.2	-15.0	-2.0	-3.9	-0.9	-2.4	-2.6	-4.0	-4.7	-4.0
FX reserves (USD bn) pe	1.62	1.41	1.90	1.81	1.67	2.19	2.50	2.60	2.65	2.67	2.72	2.75
Import cover (months) pe	3.4	3.0	4.0	3.8	3.7	4.9	5.6	5.8	5.4	5.4	5.6	5.1
3-m rate (%) pe	8.2	8.0	8.3	8.9	9.2	8.0	7.9	7.8	7.7	7.6	7.5	7.4
5-y rate (%) pe	9.9	9.6	9.3	10.2	9.8	9.8	9.5	9.4	9.3	9.2	9.1	9.0
USD/NAD pa	14.7	14.7	13.7	13.7	13.4	13.1	13.6	12.4	11.8	12.3	12.4	12.5

Source: Namibia Statistics Agency; Bank of Namibia; Ministry of Finance; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: recovery very likely

A recovery in GDP is likely in 2018, after the 0.8% y/y contraction in 2017. We expect GDP growth of 3.2% y/y in 2018, accelerating to 4.2% y/y in 2019.

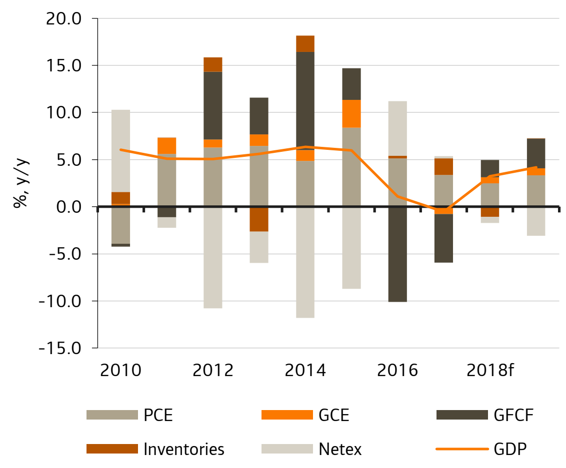
The most notable sector dampening growth in the past 2-y has been the construction sector that contracted by 25.6% y/y in 2017 and 26.3% y/y in 2016, subtracting 1.8 and 1.3 percentage points (ppts) respectively from growth. However, this downward momentum may reverse or just moderate. After contracting at an average of 22.7% q/q in H1:17, output of the sector grew by an average of 26.8% q/q in H2:17.

Wholesale and retail trade also contracted in 2017, detracting 1.0 ppts from overall growth. But, unfavourable base effects were much in evidence. Output from the sector fell 19.6% q/q in Q1:17 but grew by an average of 6.6% q/q for the rest of that year. The 19.6% q/q decline was the fastest q/q decline in output of the sector in the last 10-y.

Mining output is staging a recovery, coinciding with a faster pace of recovery in global growth. Of course, output of the sector will also be boosted by new mine developments that have been completed, with production coming on stream. Coupled with agricultural production, this sector is likely to underpin GDP growth on a multi-year basis.

Among the expenditure components, it is the reversal in investment spending that will likely ensure that GDP growth accelerates in the next 2-y. Similarly, we expect consumer spending to stabilise, at worst, over the next 2-y. That will probably prompt an acceleration of imports, thereby leading to net exports detracting from overall GDP growth.

Composition of GDP by demand



Source: Bank of Namibia; Namibia Statistics Agency; Standard Bank Research

Contribution to GDP by sector

	2012	2014	2017
Agriculture	5.0	3.2	3.9
Mining and quarrying	11.2	9.5	9.0
Manufacturing	11.1	10.3	10.0
Construction	3.6	5.8	3.8
Wholesale and retail trade	11.2	13.1	12.6
Financial intermediation	5.7	6.6	6.9
Real estate activities and business services	8.6	8.3	8.6
Public administration	10.8	10.1	11.3
Education	7.9	8.0	8.0

Source: Namibia Statistics Agency

Balance of payments: widening C/A deficit

The fast pace of increase in FX reserves is likely to moderate over the next 2-y, largely on a likely widening of the C/A deficit. We expect the C/A deficit to widen to 4.0% of GDP in 2018 and 5.5% of GDP in 2019.

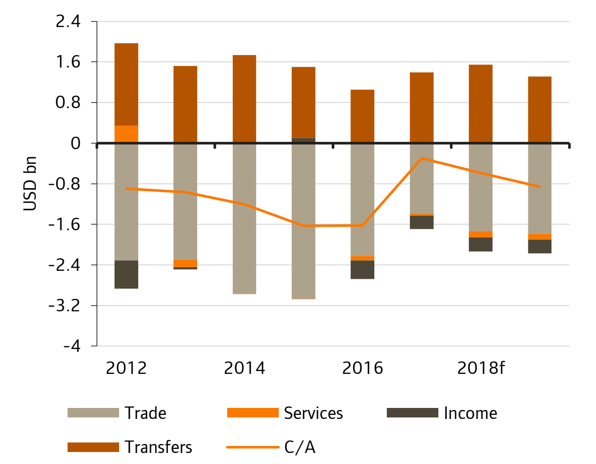
Imports are likely to accelerate over the next 2-y, bolstered in part by the improvement in GDP growth. The completion of major investment projects in the mining sector depressed imports in 2017. Now that this is in the base, normal patterns will resume, putting an upward bias to imports. But as the economic recovery gathers momentum, imports will likely accelerate, too, leading to a wider trade deficit. Exports are likely to continue accelerating, assisted by a faster pace of global growth. Even then, it looks likely that imports will grow faster.

The only other significant component of the C/A balance is current transfers. This will largely be determined by Southern African Customs Union revenues. These will likely drop marginally in 2018, before some increase in 2019. To be sure, the current transfers in 2019 might turn out to be lower than we forecast. Both the Namibian and South African governments expect SACU revenues to fall over the next 2-y.

Foreign direct investment inflows will likely continue inching higher, but remain below USD1.0bn. Portfolio flows will probably be volatile. There will probably be minimal inflows, with the net flow figure determined by the magnitude of outflows. We anticipate outflows to predominate.

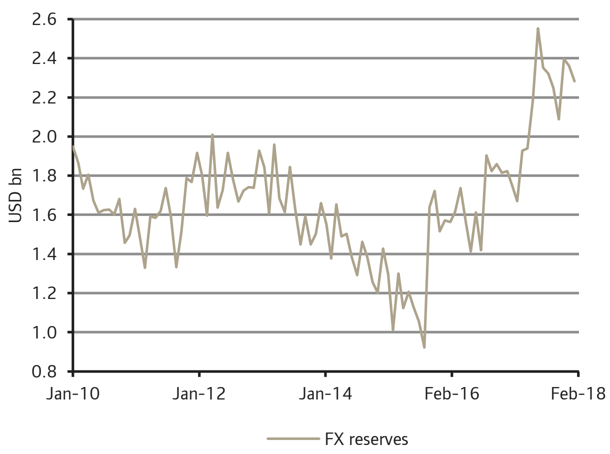
The government budget made provision for just over USD800m in external financing. All in all, total capital inflows will just be enough to allow FX reserves to rise over the next 2-y. However, import coverage will likely fall to 5.1 in 2018, from 5.8 in 2017.

Current account developments



Source: Bank of Namibia; Standard Bank Research

FX reserves



Source: Bank of Namibia

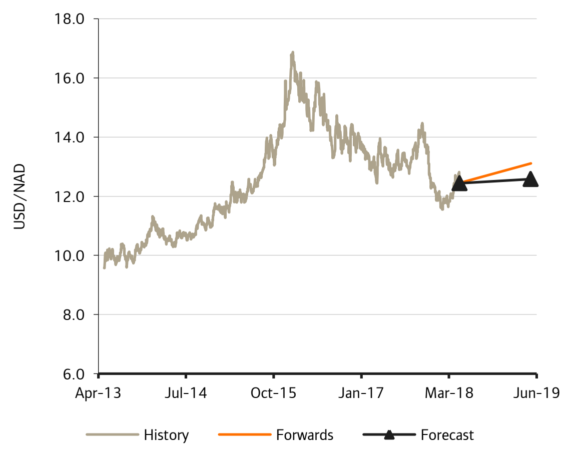
FX outlook: still quite constructive

We retain our constructive rand outlook in the medium term. Hence, we still forecast USD/NAD at12.50 by end-2018 and 12.70 by end-2019 despite further near-term dollar strength potentially keeping the rand slightly weaker than we initially anticipated. At this stage, the medium-term risks are biased to the stronger side of our rand forecasts.

Nonetheless, the recent market adjustments have compelled us to adjust our near-term outlook to 12.30 by end-Q2:18 (from 12.00) and to an average of 12.26 for 2018.

Our head of G10 strategy Steven Barrow expects the dollar to strengthen slightly further in the near term, taking EUR/USD to around 1.15 by Aug 18, after which he maintains his forecast for a bearish trend towards 1.20 by end-2018 and 1.36 by end-2019.

USD/NAD: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: conservative

The government is committed to the fiscal consolidation it commenced in 2016. In presenting the FY2018/19 budget, the Finance Minister pointed to the lapses along the way that led first to an accumulation of arrears, then additional spending and, ultimately, the ratings downgrades.

Even though the government acknowledged that fiscal restraint has dampened economic activity, it still intends to ensure that the fiscal deficit falls to 4.5% of GDP in FY2018/19, from 5.4% of GDP in FY2017/18. By FY2020/21, the government aims to have the deficit at 2.3% of GDP.

The government expects GDP growth of 1.2% y/y in 2018 and 2.1% y/y in 2019. In the medium term, it forecasts an average of 3.1% y/y. Judged against the average 5.0% y/y growth of the 10-y period to 2015, these forecasts disclose very conservative projections for revenues, driving home the message that expenditure needs to be restrained, too.

Another important focus of the government is to ensure that the debt level stabilises as a percentage of GDP. Thereafter, it will look to lower it further. The government expects total debt to average 45.8% of GDP in the next three financial years.

Perhaps motivated by this desire to keep debt contained, the government will rely mainly on net domestic borrowing to finance the deficit.

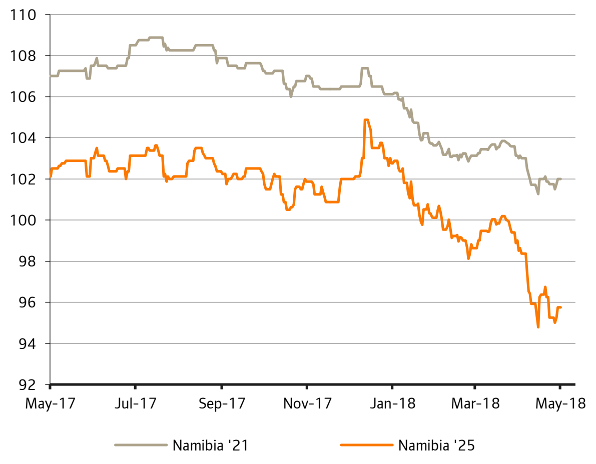
The Eurobond prices will likely stabilise in the next few weeks before rising further. The correction in emerging markets will likely end in the next few weeks, before prices head back up.

Central government budget

% of GDP	FY2017/18	FY2018/19
Total revenue and grants	33.1	30.7
Total expenditure	38.5	35.2
Operational	33.1	30.7
Development	0.5	0.7
Budget deficit (excl grants)	-5.4	-4.5
Budget deficit (incl grants)	-5.4	-4.5
Domestic debt	28.3	23.8
Foreign debt	15.1	16.1
Total debt	43.4	39.9

Source: Ministry of Finance

Eurobond prices - mid

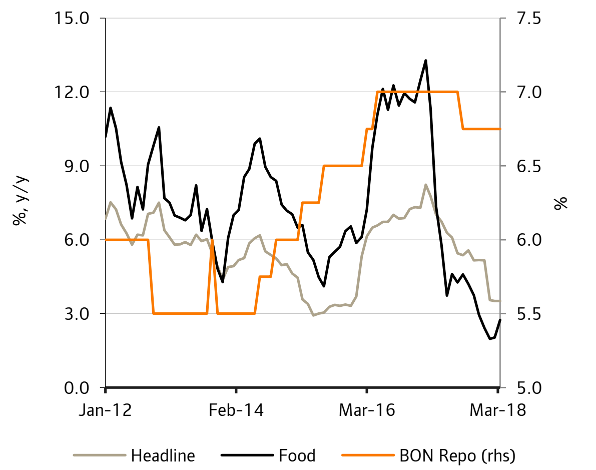


Source: Bloomberg

Monetary policy outlook: easing still intact

There is a strong likelihood that headline inflation, at 3.5% y/y in Mar, will be mostly below 5.0% y/y for the rest of the year. Even then, we see it drifting to an average of 4.1% y/y in Q4:18 and 5.0% y/y in 2019. The drop in inflation from an average of 6.1% y/y in 2017 is attributable to a moderation in the pace of growth in the food sub-index, together with the housing, water, electricity, gas & other fuel sub-index. The latter dropped to 3.3% y/y in Mar, from an average of 9.2% y/y in 2017, whereas food inflation dropped to 2.7% y/y, from an average of 5.7% y/y over the same period. In opting to leave the policy rate unchanged at its meeting in Apr, the MPC emphasised a desire to protect FX reserves as a factor motivating the decision. The committee may well opt to leave the policy rate unchanged, irrespective of any further cut by the South African Reserve Bank. But the bias is towards the committee lowering the rate again.

Inflation and interest rates



Source: Bank of Namibia; Namibia Statistics Agency

Table 1: Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	2.1	2.1	2.2	2.2	2.2	2.3	2.3
Nominal GDP (NAD bn)	122.8	138.7	147.5	159.1	168.1	180.0	196.4
Nominal GDP (USD bn)	12.7	12.8	11.5	10.8	12.6	14.7	15.6
GDP / capita (USD)	6 059	6 095	5 249	4 920	5 739	6 382	6 766
Real GDP growth (%)	5.6	6.4	6.0	1.1	-0.5	3.2	4.2
Diamonds ('000 carats)	1 800	1 950	1 765	1 601	1 650	1 600	1 600
Uranium (MT)	5 400	4 000	3 713	4 132	6 000	6 500	7 650
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-0.3	-3.8	-6.2	-8.2	-6.2	-5.4	-3.8
Budget balance (incl. Grants) / GDP (%)	-0.3	-3.8	-6.2	-8.2	-6.2	-5.4	-4.2
Domestic debt / GDP (%)	15.5	15.4	16.9	20.8	25.7	28.3	25.6
External debt / GDP (%)	8.8	8.8	8.5	18.8	17.5	15.1	16.9
Balance of Payments							
Exports (USD bn)	3.7	3.8	3.3	3.5	4.0	4.8	4.9
Imports (USD bn)	-6.0	-6.8	-6.3	-5.7	-5.4	-6.5	-6.7
Trade balance (USD bn)	-2.3	-3.0	-3.1	-2.2	-1.4	-1.7	-1.8
Current account (USD bn)	-1.0	-1.2	-1.6	-1.6	-0.3	-0.6	-0.9
- % of GDP	-7.6	-9.4	-14.1	-15.0	-2.4	-4.0	-5.5
Financial account (USD bn)	0.8	1.3	2.2	1.0	0.9	1.0	1.1
- FDI (USD bn)	0.7	0.5	0.4	0.3	0.6	0.8	1.0
Basic balance / GDP (%)	-1.7	-5.6	-10.9	-12.1	2.2	1.4	0.9
FX reserves (USD bn) pe	1.5	1.2	1.5	1.8	2.6	2.8	3.0
- Import cover (months) pe	3.0	2.1	2.9	3.8	5.8	5.1	5.4
Sovereign Credit Rating							
S&P	nr	nr	nr	nr	nr	nr	nr
Moody's	Baa3	Baa3	Baa3	Baa3	Ba1	Ba1	Ba1
Fitch	BBB-	BBB-	BBB-	BBB-	BB+	BB+	BB+
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.6	5.4	3.4	6.7	6.2	3.8	5.0
Consumer inflation (%) pe	4.9	4.6	3.5	7.3	5.2	4.1	5.2
M2 money supply (% y/y) pa	10.5	9.9	12.5	7.4	6.0	10.7	14.8
M2 money supply (% y/y) pe	11.4	9.4	10.5	4.5	9.1	15.0	14.5
BON bank rate (%) pa	5.3	5.7	6.5	6.8	6.6	6.3	6.3
BON bank rate (%) pe	5.5	6.0	6.5	7.0	6.3	6.3	6.3
3-m rate (%) pe	5.8	5.9	7.5	8.9	7.8	7.4	6.9
5-y rate (%) pe	7.9	7.6	10.7	10.2	9.4	9.0	8.6
USD/NAD pa	9.7	10.8	12.8	14.7	13.3	12.3	12.6
USD/NAD pe	10.5	11.6	15.5	13.7	12.4	12.5	12.7

Source: Namibia Statistics Agency; Bank of Namibia; Ministry of Finance; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated; na — not available

Nigeria: politics takes a backseat as oil proves supportive

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	-0.7	-1.5	-2.3	-1.7	-0.9	0.7	1.4	1.9	2.0	3.6	4.2	4.3
CPI (% y/y) pa	11.3	15.3	17.5	18.5	17.9	16.5	16.0	15.7	14.3	12.0	10.8	10.7
M2 (% y/y) pa	6.4	10.3	18.6	20.9	12.0	4.3	0.1	0.6	6.3	12.3	12.7	11.6
CA/GDP (%) pe	-0.6	0.0	0.1	0.6	1.0	2.0	2.3	3.0	0.3	1.8	2.1	3.2
FX reserves (USD bn) pe	27.3	26.4	24.9	25.8	30.3	30.3	32.5	38.8	46.2	48.6	49.2	51.0
Import cover (mths) pe	9.3	9.0	8.5	8.8	10.7	10.7	11.5	13.7	13.9	14.6	14.8	15.3
3 mth rate (%) pe	8.3	11.4	12.2	14.5	18.5	19.5	18.9	12.5	14.0	13.0	12.5	11.5
5 yr rate (%) pe	11.6	13.6	14.1	15.6	16.7	16.0	16.4	14.4	13.5	13.0	12.9	12.5
USD/NGN pa	199	210	310	315	315	360	363	361	361	361	362	364

Source: Central Bank of Nigeria; Federal Ministry of Finance; National Bureau of Statistics; International Monetary Fund; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available

GDP growth: still recovering

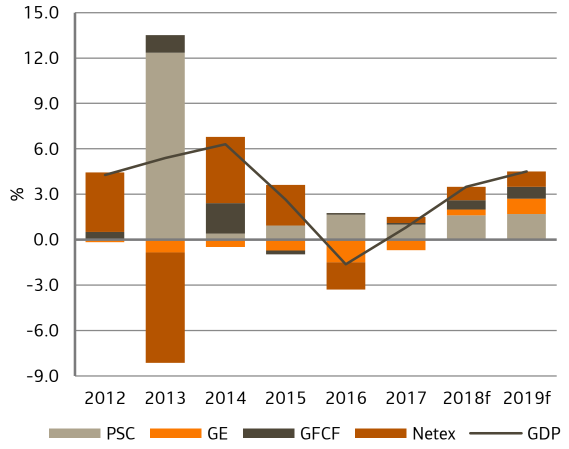
Given higher oil prices, we increase our growth forecast to 3.5% y/y in 2018 (from 2.5% y/y) and 4.5% y/y in 2019 due to our expectation that trade-related activity will pick up moderately.

So far this year, the PMI readings for Nigeria imply a definite improvement in the business environment. The Stanbic IBTC Bank PMI reached a series high of 58.8 in Mar, and averaged 57.4 in Q1:18, from 54.2 in 2017. Most respondents indicated a slow and steady improvement in output volumes due to increased demand. Interestingly, the employment sub-index implies that the upswing in unemployment over the course of the last 2-y may have peaked.

The oil sector is set to benefit from supportive prices and stable production which should average about 1.9m bpd. As a consequence, any outperformance of the oil sector should result in increased FX liquidity for trade-related activity. The more accommodative monetary policy stance by the central bank should also affect private sector credit extension positively. PSC growth declined to 5.7% y/y last year, from 12.7% y/y in 2016.

In our view, fiscal operations by the central government ahead of the 2019 general elections will have only a moderately positive impact on economic growth. Sure, the higher oil price environment will certainly bolster government expenditure; however, it may not have that much influence on private consumption expenditure and gross fixed capital formation. We also do not expect the uncertainty usually associated with election cycles to adversely affect the economy over the course of the next 9-m despite persisting concerns about President Buhari's health and as the opposition remains fragile.

Composition of GDP by demand



Source: National Bureau of Statistics; Standard Bank Research

GDP by sector (%) contribution

	2014	2016	2016
Agriculture	20.1	18.0	17.5
Mining and Quarrying (Oil)	10.9	7.7	7.4
Manufacturing	9.8	9.0	9.2
Electricity, Gas, Steam and Air	0.6	0.6	0.6
Water Supply, Sewerage, Waste	0.1	0.1	0.1
Construction	3.6	4.0	4.1
Trade	17.6	18.9	18.9
Accommodation	0.9	0.5	0.6
Transportation and Storage	1.3	1.5	1.6
Information and Communication	10.8	14.7	14.9
Arts, Entertainment and Recreation	0.2	0.3	0.3
Financial and Insurance	3.4	3.8	3.9
Real Estate	8.4	8.8	8.8
Professional and Scientific Services	3.8	4.0	4.4
Administrative and Support Services	0.0	0.0	0.1
Public Administration	3.0	2.9	2.5
Education	2.0	1.8	1.8
Human, Health and Social Services	0.7	0.8	0.8
Other Services	2.9	2.6	2.5
GDP	100.0	100.0	100.0

Source: National Bureau of Statistics; Standard Bank Research

Balance of payments: higher C/A surplus

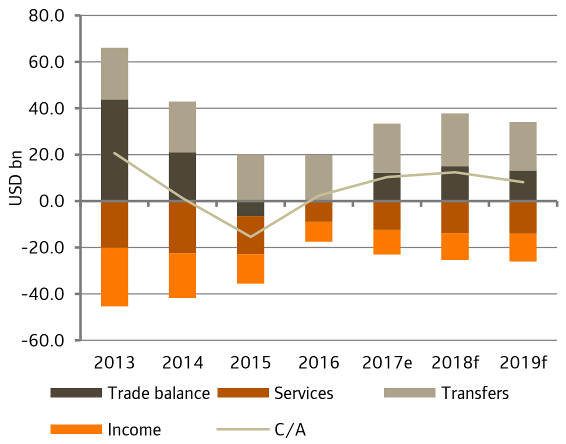
Given the drastic change in the oil price trajectory since our Jan edition, we now expect the C/A surplus to rise materially to USD12.4bn (3.2% of GDP) by year-end. With consensus estimates now pointing to Brent around USD65/bbl by the end of this year, and the possibility of trading up to USD80/bbl in coming weeks, oil exports should rise by at least 20.0% y/y, with a commensurate rise in imports. This should allow the trade balance to remain in surplus, reaching USD15.0bn, from an estimated USD12.2bn last year.

We now expect FX reserves to rise to USD51.0bn due to higher export proceeds but also as a result of increased financial flows into the fixed income and equity markets as well as proceeds from Eurobond issuance. The Ministry of Finance will likely issue another USD2.0bn Eurobond in the coming months. Although a deterioration in global risk appetite has resulted in some capital outflows in recent weeks, we suspect that with commodity prices remaining high, further outflows should be limited.

For the most part, the investors and exporters' foreign exchange (IEFX) window continues to serve its purpose. Around USD15.0bn of financial flows have come in into the country since the inception of the IEFX window in Apr 17, while the externalization of capital via extension of trade credits and deposits in offshore banks appears to have subsided.

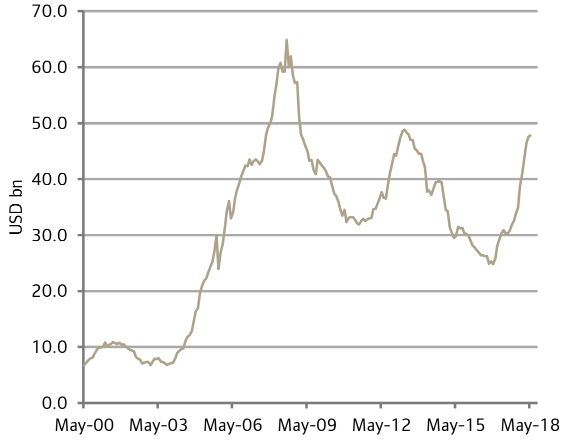
Foreign direct investment will only recover slowly, after rising by 17.1% y/y in Q1:18. That said, the Nigerian Investment Promotion Commission (NIPC) reports that investment announcements rose 188.3% y/y to USD17.3bn in Q1:18. Amongst these is a USD9.0bn offshore oil production investment by Shell.

Current account



Source: Central Bank of Nigeria; National Bureau of Statistics; International Monetary Fund; Standard Bank Research

FX reserves

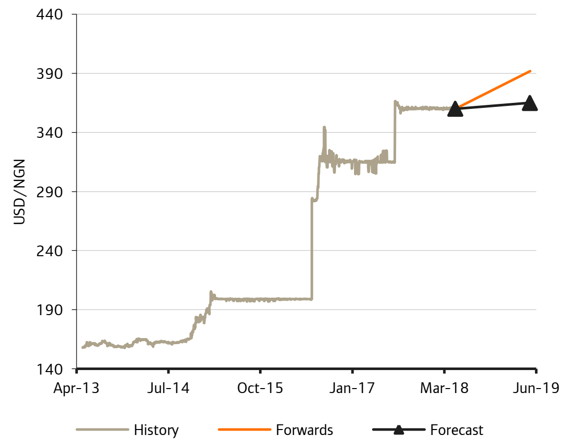


Source: Central Bank of Nigeria

FX outlook: willing buyer, willing seller

Perhaps investors have underestimated the reliance the IEFX mechanism has had on the CBN. Right from inception, it was clear, given that flows through the IEFX window were from two main sources (foreign investors and the central bank), there would be a waiting period to access FX once sentiment turned less supportive. Given where oil prices currently trade, we do not expect severe FX shortages such as those in 2016. However, periods of risk-off sentiment in broader EM may trigger temporary shortages of FX in the IEFX due to the administrative bottlenecks at the central bank. In our view, these periods of unresponsiveness by the CBN should not be interpreted as an unwillingness to sell. The CBN has in fact communicated that, given that it has been deliberately building FX reserves, it would not hesitate to supply these during temporary periods of shortage. In the meantime, it continues to reduce the spread between the NIFEX and NAFEX.

USD/NGN: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: flat yield curve

We still like both the carry and duration, especially at yields close to and above 13.5%.

As expected, both short- and long-end yields have collapsed in the last 3-m due to a less aggressive stance on liquidity management by the CBN, coupled with less supply of domestic government paper.

The central bank has probably bought around USD7.0bn from the IEFX market over the course of the last 9-m in a bid to shore up reserves. As a result, this has also served to inject around NGN2.5tr into the economy, liquidity which the CBN has then struggled to sterilize via OMOs. Still, the CBN has actually issued more OMO bills YTD, compared to the same period in 2017. Despite this, the Debt Management Office's intent to reduce domestic issuance by a net NGN1.0tr placed downward pressure on the yield curve. As a result, the yield curve has normalized, with the yield pick-up at the short end only marginally higher than bonds.

In the coming months, the proposed extra budgetary financing amounting to NGN2.0tr will probably limit any substantial move lower of the yield curve. The DMO has sought approval from the National Assembly to issue up to NGN2.0tr in promissory notes to contractors and pensioners as a way of offsetting legacy arrears. These are separate from the NGN2.0tr deficit appropriated in the approved 2018 budget. It plans to fund the deficit equally from both domestic and external sources as the oil price benchmark was revised higher, to USD51/bbl.

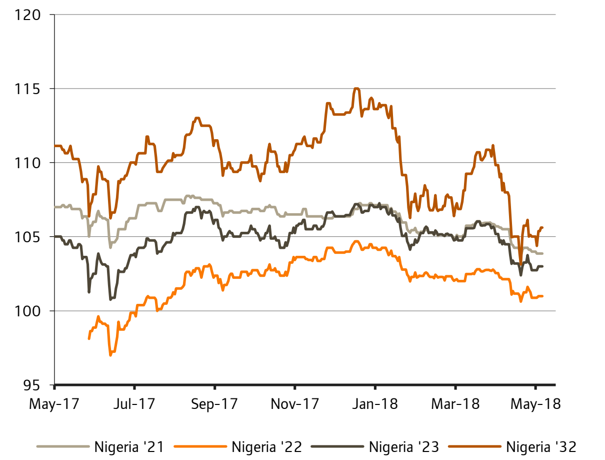
The potential for further issuance along the Eurobond curve will probably do little to affect spreads adversely, especially with oil prices remaining elevated. The DMO will probably issue Eurobonds amounting to USD2.0bn in the coming months.

Budget

	2016	2017	2018
% of GDP			
Revenue	3.8	4.1	5.0
Capital expenditure	1.6	1.7	1.9
Recurrent expenditure	2.6	2.5	2.5
Statutory transfers	0.5	0.5	0.4
Service debt	1.3	1.4	1.5
Supplementary budget	0.0	0.0	0.0
Total expenditure	5.9	6.1	6.5
Oil price assumption (US$/bbl)	38.0	42.5	51.0
Oil production assumption (m bbl)	2.2	2.2	2.30
Exchange rate assumption	197.0	305.0	305
External Financing	0.9	1.0	0.6
Domestic Financing	1.0	1.0	0.6
Fiscal deficit	-2.2	-2.0	-1.5

Source: Federal Ministry of Finance; Standard Bank Research

Eurobond prices - mid

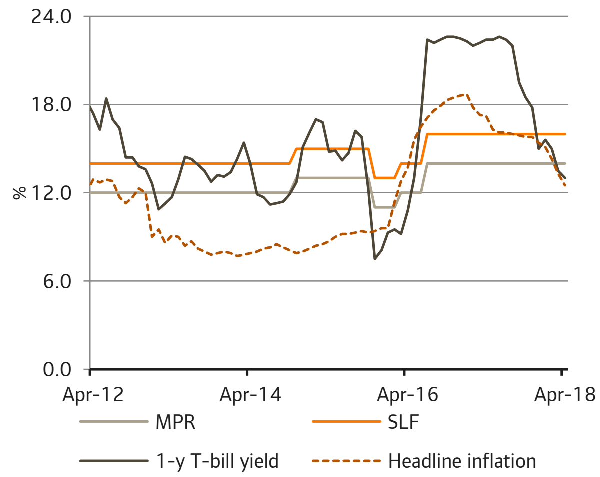


Source: Bloomberg

Monetary policy outlook: easing bias

We still argue that the central bank's policy rate does not serve as a very good monetary policy anchor. The policy rate hasn't actually changed in over 2-y, but short-end yields have swung from a high of 22% to a low of 6% over that time, reflecting extreme changes in liquidity conditions. In our view, the CBN will continue utilizing its more effective monetary policy tools, such as OMOs, in a bid to manage inflation and keep the exchange rate steady. That said, we expect that the monetary policy committee will strike a slightly dovish tone at upcoming meetings due to the disinflation underway. We expect headline inflation to continue moderating, to 11.1% y/y by year-end, off favourable base effects from food inflation. As a result of the easier stance on monetary policy, growth in M2 should resume, placing moderate pressure on core inflation from Q4:18.

Inflation and interest rates



Source: Central Bank of Nigeria; FMDQ; National Bureau of Statistics; Standard Bank Research

Annual indicators	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	175	175	179	181	183	185	186
Nominal GDP (NGNbn)	81 010	90 137	95 178	102 575	120 372	138 966	161 808
Nominal GDP (USDbn)	508.9	545.6	481.2	397.9	344.0	383.9	443.3
GDP / capita (USD)	2 909	3 116	2 694	2 195	1 883	2 080	2 378
Real GDP growth (%)	5.5	6.2	2.8	-1.5	0.8	3.5	4.5
Crude oil production (mbpd)	1.93	1.95	1.92	1.75	1.8	1.8	2.0
Central Government Operations							
FG Budget balance / GDP (%)	-1.3	-1.1	-1.1	-2.2	-2.5	-2.5	-2.5
Domestic debt / GDP (%)	8.9	8.2	8.3	11.1	10.5	10.5	10.0
External debt / GDP (%)	1.8	1.8	2.0	2.9	5.5	6.2	6.1
Balance Of Payments							
Exports of goods (USDbn)	95.1	82.6	45.9	34.7	46.1	54.9	57.0
Imports of goods (USDbn)	51.4	61.6	52.3	35.2	33.9	39.9	43.9
Trade balance (USDbn)	43.8	21.0	-6.4	-0.5	12.2	15.0	13.1
Current account (USDbn)	20.7	1.2	-15.4	2.3	10.3	12.4	8.1
- % of GDP	4.1	0.2	-3.2	0.6	3.0	3.2	1.8
Capital & Financial account (USDbn)	6.8	13.1	9.4	-5.0	2.7	-0.2	-14.1
- FDI (USDbn)	4.4	3.1	1.6	3.1	3.0	4.0	4.5
Basic balance / GDP (%)	4.9	0.8	-2.9	1.4	3.9	4.3	2.8
FX reserves (USDbn) pe	43.6	34.5	28.5	25.8	38.8	51.0	45.0
Import cover (mths, incl. income) pe	10.2	6.7	6.5	8.8	13.7	15.3	12.3
Sovereign Credit Rating							
S&P	BB-	BB-	B+	B+	B	B	B
Moody's	Ba3	Ba3	Ba3	B1	B1	B2	B2
Fitch	BB-	BB-	BB-	BB-	B+	B+	B+
Monetary & Financial Indicators							
Consumer inflation (%) pa	8.5	8.1	9.0	15.6	16.6	11.9	11.9
All items less farm produce (%) pa	7.8	6.9	8.2	15.2	13.6	10.0	11.0
Food inflation (%) pa	9.7	9.5	9.9	14.9	19.5	16.0	12.0
M2 money supply (% y/y) pa	9.4	6.5	17.3	14.0	4.2	10.7	10.2
M2 money supply (%y/y) pe	-1.2	13.3	19.0	18.4	1.2	12.0	10.4
Policy interest rate (%) pa	12.0	12.2	12.8	13.2	14.0	13.5	12.3
Policy interest rate (%) pe	12.0	13.0	11.0	14.0	14.0	13.0	12.0
3-m rate (%) pe	11.8	14.0	3.5	14.5	12.5	11.5	11.0
1-y rate (%) pe	12.8	16.5	7.7	17.0	14.0	11.8	11.5
3-y rate (%) pe	13.1	15.2	8.6	15.5	14.0	12.5	12.0
5-y rate (%) pe	13.1	15.3	10.9	15.6	14.4	12.5	12.0
USD/NGN pa	159.2	165.2	197.8	257.8	349.9	362.0	365.0
USD/NGN pe	160.3	183.5	199.3	315.0	362.0	365.0	365.0

Source: Central Bank of Nigeria; Federal Ministry of Finance; National Bureau of Statistics; International Monetary Fund; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated; na — not available

Rwanda: broad macro balance and growth acceleration

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	9.0	7.5	5.4	2.4	1.7	4.1	8.0	10.5	5.8	7.0	7.2	6.2
CPI (% y/y) pa	4.5	4.9	6.4	7.0	7.7	6.2	3.5	2.2	0.9	1.3	1.7	1.8
M3 (% y/y) pe	16.1	10.1	5.8	7.5	9.8	12.7	16.5	16.8	15.6	16.7	21.5	21.3
CA/GDP (%) pe	-11.7	-11.5	-11.2	-14.5	-10.8	-10.5	-10.3	-10.0	-10.5	-9.7	-9.8	-10.5
FX reserves (USD m) pe	817	935	875	1 001	967	982	997	1 062	1 077	1 092	1 108	1 123
Import cover (months) pe	3.0	3.4	3.2	3.7	3.5	3.5	3.6	3.8	3.6	3.6	3.7	3.7
3-m rate (%) pe	5.8	6.4	7.5	9.0	9.2	8.7	6.9	6.8	5.0	3.8	3.3	3.5
USD/RWF pe	746	762	806	822	825	830	837	845	855	859	866	875

Source: National Bank of Rwanda; National Institute of Statistics of Rwanda; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: upside bias

An acceleration in domestic demand will likely further bolster economic growth over the coming 2-y. We increase our GDP forecast for 2018 and 2019 to 6.6% y/y and 7.3% y/y, from a previous forecast of 5.9% y/y and 6.5% y/y. Growth picked up meaningfully in H2:17, averaging 9.3% y/y, from an average of 2.9% y/y in H1:18. It looks highly probable such that the strong momentum will be sustained.

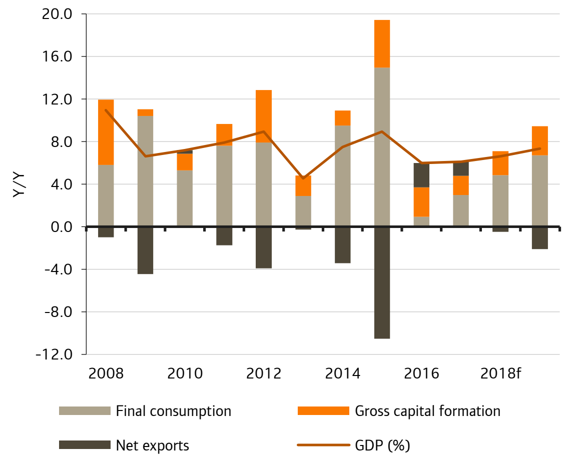
We expect that conditions will continue to support domestic spending in the next 2-y. In part, the strength in domestic spending reflects strong real household income gains. By our reckoning, this is a result of the strong performance of the agricultural sector which grew by 6.5% y/y in 2017, averaging 8.9% y/y in H2:17. Much of this growth was underpinned by food crops rather than export crops.

Nonetheless, household consumption spending averaged only 2.3% y/y in H2:17 from 1.3% y/y in H1:17. In contrast, growth in investment spending accelerated to an average of 21.1% y/y in H2:17, after investment spending contracted by 6.7% y/y in H1:17.

Even though net exports were a positive contributor to growth throughout the year, the acceleration in overall economic growth in H2:17 was due primarily to the acceleration in domestic demand. However, it is highly unlikely that domestic demand can accelerate much more without increasing import demand. It was highly unusual for import demand to remain quiescent despite the domestic-demand-driven acceleration in economic growth. Goods imports were essentially flat in 2017, while services imports grew just 3.7% y/y.

Investment spending poses the most downside risk to our view.

Composition of GDP by demand



Source: National Institute of Statistics of Rwanda; Standard Bank Research

Composition of GDP by sector

	2006	2010	2015	2016	2017
Agriculture	34.2	31.0	27.7	27.2	27.3
- Food crops	19.2	17.8	16.3	15.8	15.8
- Forestry	8.7	7.2	5.9	5.7	5.7
Industry	14.5	14.7	17.2	17.3	17.3
- Manufacturing	6.9	6.0	5.9	5.9	5.9
- Construction	4.6	5.5	7.6	7.5	7.5
Services	42.3	45.9	47.8	48.4	48.4
- Wholesale and retail trade	6.1	7.0	7.8	7.8	7.8
-ICT	1.1	1.3	1.6	1.6	1.6
- Financial services	2.5	2.5	3.0	2.9	2.9
- Real estate services	10.1	10.3	7.9	8.0	8.0
- Public administration	3.9	3.8	4.6	4.9	4.9
- Education	2.4	2.7	2.6	2.6	2.6
Taxes less subsidies	8.6	8.4	7.2	7.1	7.1

Source: National Institute of Statistics of Rwanda

Balance of payments: rising imports likely

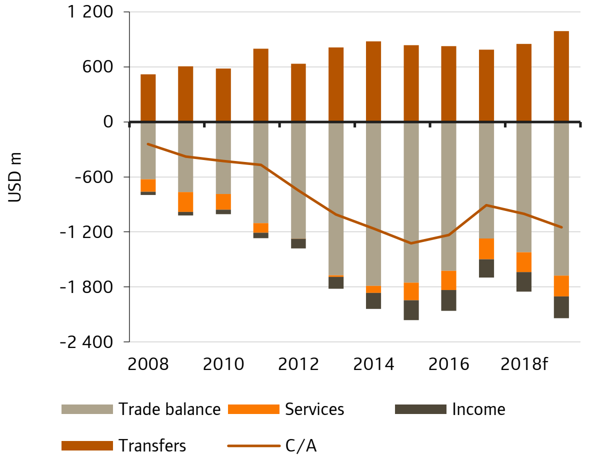
The restraint in imports during 2017 is unlikely to continue. The completion of some projects, reducing the import requirements for machinery and equipment, likely contributed to restraining imports. Major construction projects, including hotels and the Kigali International Convention Centre, were completed. However, over the next 2-y imports are likely to rise further, leading to a wider trade deficit.

The impact of the government's import substitution strategy is not yet evident. But in time it is highly probable that the supply of foodstuffs will largely come from the local market, reducing dependence on imports. Nonetheless, it is remarkable that exports grew by 57.6% y/y in 2017, bolstered by non-traditional exports that exceeded traditional exports for the first time.

Notably, traditional exports like tea, coffee, cassiterite and coltan made a recovery to levels comparable with exports in 2014, just before a multi-year decline ensued. But it was the exports of other minerals, mainly beryllium, iron ore, lead and gemstones, that spurred the strong growth in exports in 2017. Although still small, exports of cement, and wheat and maize flour were significant contributors to exports, especially to the DRC. It would be sustained growth of the export of these products that would attest to the success of the government's diversification strategy.

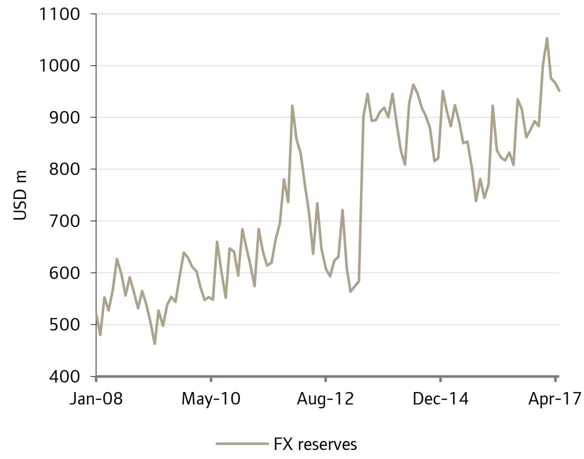
Even though net current transfer inflows are likely to rise, the C/A deficit is likely to widen over the next 2-y, likely in excess of 10% of GDP in both years. Capital inflows will likely be primarily in the form of government borrowing. FDI inflows will likely remain below USD500m over the next 2-y. Overall capital inflows will likely be close to the C/A deficit, ensuring that FX reserves rise moderately, but with import coverage at 3.8-m in 2018 and 3.4-m in 2019.

Current account



Source: Bank of Rwanda; Standard Bank Research

FX reserves

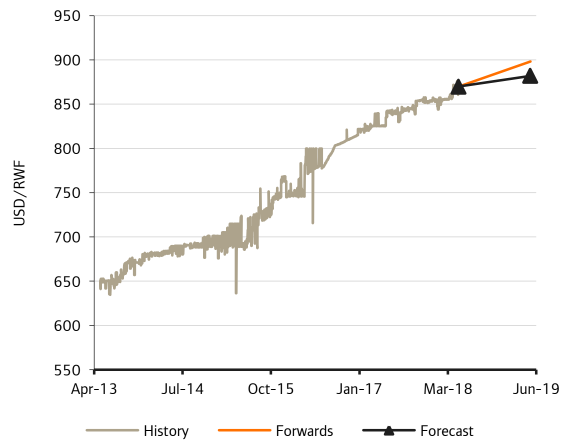


Source: International Monetary Fund

FX outlook: rising trend in USD/RWF to continue

In all likelihood, the rising trend in USD/RWF will continue. We put the pair at 875 at the end of this year and 915 at the end of 2019. It seems as if the pace of depreciation of the RWF is not so rapid that the NBR would be concerned about the pass-through to inflation. Additionally, it seems as if the authorities are confident that the "Made in Rwanda" program will be successful, pointing to advances that have been achieved in promoting domestic production of maize and wheat flour as well as cement. These industries are already contributing to export earnings. Additionally, the depreciation of the RWF on a trade-weighted basis was enough to ensure that the depreciation of the real effective exchange rate gained momentum in 2017. Hence, the NBR will not be concerned about RWF overvaluation.

USD/RWF: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: balanced

The fiscal deficit for FY 2018/19 will likely be in a 4.5% - 5.0% of GDP range.

The fiscal deficit has rarely exceeded 4.5% of GDP in the past 5-y. Domestic revenue collection remains low, generally less than 15% of GDP, with donor support roughly about 4.5% of GDP. These metrics will probably not change much in the medium term. Nonetheless, there is a chance that domestic revenues could surprise to the upside, largely due to strong economic activity.

We do not anticipate notable execution challenges in the next 2-y. Donor inflows have been more or less in line with the budget in recent years. Nonetheless, whenever there is a shortfall, the government typically cuts back spending instead of having a larger fiscal deficit.

Much of the country's external debt is concessional. Concessional debt accounts for close to 70% of total debt. As a result, the Finance Ministry's Debt Sustainability Analysis has shown debt to be well within the requisite metrics for it to be considered at low risk of debt distress. In undertaking the analysis, the Ministry projected long-run GDP of 7.0% y/y and export growth of 6.0% y/y. Additionally, according to the Finance Ministry, the government does not have exposure, via guarantees, to the debt of private sector entities. The only exception is the debt of RwandAir, the national airline.

The Rwanda '23s sold off together with other African Eurobonds during the last 5-m. Given that there is no deterioration of fiscal or BOP metrics in the country, the bonds are likely to stage a recovery, together with the entire market. The yield to maturity could well head back towards 5.5% over the coming 4-m.

Central government budget

% of GDP	FY2016/17	FY2017/18	FY2018/19
Total revenue	18.0	18.6	18.4
Total expenditure	27.2	26.8	27.6
- Wages	4.1	4.1	4.2
- Interest	1.0	1.2	1.1
- Capital expenditure	10.6	9.9	10.2
Overall fiscal deficit	-4.9	-4.2	-4.9
Net domestic borrowing	0.2	0.0	0.6
Net foreign borrowing	4.8	4.4	4.6
Donor support (grants)	4.6	4.4	4.6

Source: Ministry of Finance and Economic Planning

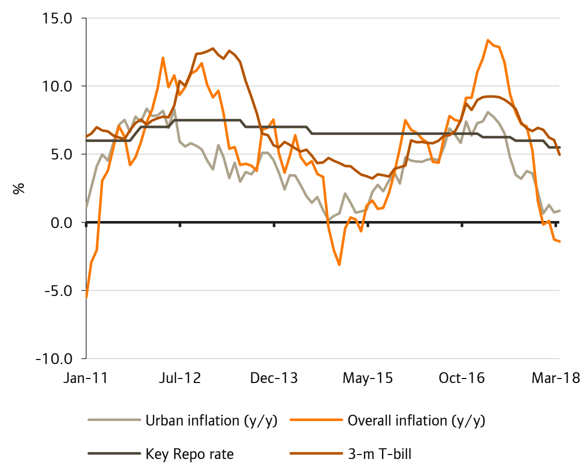
Rwanda '23 price – mid

Source: Bloomberg

Monetary policy outlook: neutral, but easing bias

The chances that the NBR will change the policy stance are slim. At the last quarterly meeting of the MPC, the committee said that inflation would average 5.0% y/y this year. We think that inflation will surprise to the downside. Headline urban inflation averaged 0.9% y/y in Q1:18, from a peak of 8.1% y/y in the current cycle. Even though it will likely head higher over the remainder of this year and next, we expect it to remain contained. Food inflation, peaking at 17.6% y/y in Feb 17, was responsible for pushing inflation that high in early 2017. Likewise, it has been instrumental in bringing it lower, with food deflation averaging 2.1% y/y in the 4-m to Mar 18. That said, core inflation also rose to a peak of 5.6% y/y before reverting to sub-2.0% y/y levels in Q1:17. We do not anticipate upside surprises to inflation.

Inflation and interest rates



Source: National Bank of Rwanda; National Institute of Statistics of Rwanda

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	11.3	11.6	11.8	12.1	12.3	12.6	12.8
Nominal GDP (RWF bn)	4 933	5 466	5 968	6 672	7 597	8 243	9 142
Nominal GDP (USD bn)	7.6	8.0	8.3	8.5	9.1	9.6	10.2
GDP / capita (USD)	668	685	704	705	740	761	795
Real GDP growth (%)	4.5	7.5	8.9	6.0	6.1	6.6	7.3
Coffee production ('000 tons)	18.3	16.4	18.8	18.9	19.1	19.3	19.8
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-13.0	-13.5	-12.5	-9.5	-9.5	-8.5	-8.3
Budget balance (incl. Grants) / GDP (%)	-5.2	-4.3	-5.2	-3.5	-4.9	-4.2	-4.0
Domestic debt / GDP (%)	6.2	7.1	8.3	8.8	9.8	10.1	10.5
External debt / GDP (%)	24.9	26.2	28.5	29.7	30.3	31.9	33.2
Balance Of Payments							
Exports of goods and services (USD m)	1 148	1 192	1 397	1 450	1 858	1 998	2 098
Imports of goods and services (USD m)	-2 837	-3 056	-3 342	-3 285	-3 357	-3 635	-4 000
Trade balance (USD m)	-1 689	-1 864	-1 945	-1 835	-1 498	-1 637	-1 902
Current account (USD m)	-1 010	-1 162	-1 324	-1 235	-910	-1 002	-1 148
- % of GDP	-13.3	-14.6	-15.9	-14.5	-10.0	-10.5	-11.3
Financial account (USD m)	785	857	1 081	1 205	970	1 063	1 144
- FDI (USD m)	258	315	223	259	293	337	380
Basic balance / GDP (%)	-9.9	-10.6	-13.2	-11.5	-6.7	-6.9	-7.5
FX reserves (USD m) pe	945	951	922	1 001	1 062	1 123	1 118
- Import cover (mths) pe	4.0	3.7	3.3	3.7	3.8	3.7	3.4
Sovereign Credit Rating							
S&P	B	B	B+	B+	B+	B+	B+
Moody's	nr	nr	nr	nr	nr	nr	nr
Fitch	B	B+	B+	B+	B+	B+	B+
Monetary & Financial Indicators							
Urban consumer inflation (%) pa	4.2	1.8	2.5	5.7	4.9	1.4	3.2
Urban consumer inflation (%) pe	3.6	2.1	4.5	7.3	0.7	2.7	4.3
M3 money supply (% y/y) pa	12.7	22.8	18.9	10.9	12.8	18.8	19.5
M3 money supply (% y/y) pe	15.5	19.0	21.1	7.5	16.8	21.3	20.0
Policy interest rate (%) pa	7.2	6.7	6.5	6.5	6.1	5.5	5.5
Policy interest rate (%) pe	7.0	6.5	6.5	6.5	6.0	5.5	5.5
3-m rate (%) pe	5.5	4.1	6.0	9.0	6.8	3.5	4.0
1-y rate (%) pe	6.5	6.0	7.6	9.2	7.9	4.6	5.2
USD/RWF pa	650.7	686.8	715.6	783.0	832.2	860.5	896.1
USD/RWF pe	676.0	689.8	745.0	822.0	845.0	875.4	914.9

Source: National Bank of Rwanda; National Institute of Statistics of Rwanda; Ministry of Finance and Economic Development; Bloomberg; Standard Bank Research

Notes: pe — period end; pa — period average; nr — not rated; na — not available

Senegal: strong growth in spite of politics

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	5.8	6.1	7.0	7.9	5.7	6.5	6.7	8.7	7.5	6.2	6.5	7.0
CPI (% y/y) pa	0.7	1.7	1.0	0.7	1.0	1.2	2.0	3.4	1.9	1.2	1.0	1.3
M2 (% y/y) pa	21.1	19.0	18.4	14.9	9.1	10.9	21.1	27.0	10.6	16.8	14.9	18.2
CA/GDP (%) pe	-7.4	-6.5	-5.7	-5.5	-5.6	-5.9	-6.0	-6.1	-6.6	-7.3	-7.9	-8.0
FX Reserves (USD bn) pe	2.0	2.1	1.6	1.4	1.1	1.9	2.1	2.2	2.2	2.4	2.5	2.5
Import Cover (months) pe	5.2	5.5	4.1	3.6	2.4	4.2	4.6	4.8	4.0	4.2	4.4	4.4
Marginal lending rate (%) pe	3.5	3.5	3.5	3.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
USD/XOF pe	597	584	694	612	619	579	570	564	547	547	570	547

Source: Agence Nationale de la Statistique et de la Demographie; Banque Centrale des Etats de l'Afrique de l'Ouest; Ministère de l'Economie et des Finances; Bloomberg; Reuters; Standard Bank Research
Notes: pe — period end; pa — period averagea

GDP growth: most likely up

We see GDP growth of 6.8% y/y in 2018 and 6.5% y/y in 2019 on our expectation for smooth presidential elections in 2019 as well as the ongoing supportive structural reform in business bearing fruit over the next 2-y.

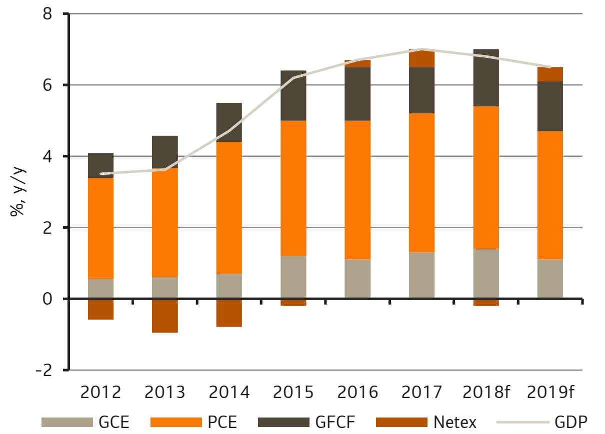
From an expenditure perspective, we expect economic growth to be driven by relatively strong momentum in personal consumption expenditure. We have long held the view that low inflation should spur real wage growth. We expect nominal wages to rise at a faster pace over the course of the next few years as investment spending picks up.

We expect gross fixed capital formation (GFCF) growth to continue rising at a moderate pace over the next 2-y, albeit driven mainly by the public sector. That said, private GFCF will probably grow at a faster pace due to the government's deliberate transition away from dominating infrastructure spend.

From a sector perspective, we expect economic growth to be driven mainly by the tertiary sector. The authorities continue to focus on agro-processing – a sector which we believe will deliver long-term growth to the economy.

The political landscape will probably weigh negatively on business sentiment over the next 12-m. In what may be interpreted by international observers as an attempt to suppress the opposition, the National Assembly adopted a law in Apr, requiring that presidential candidates be 'sponsored' – meaning that a candidate must collect the signatures of at least 0.8% of the electorate before being registered officially.

Composition of GDP growth by demand



Source: Agence Nationale de la Statistique et de la Demographie; Banque Centrale des Etats de l'Afrique de l'Ouest; Standard Bank Research

GDP by sector (%) contribution

	2013	2015	2017
Agriculture	15.5	15.0	15.5
Livestock and hunting	4.9	4.8	4.0
Forestry	1.0	0.9	1.1
Fishing	2.0	2.0	2.3
Mining	2.2	1.8	1.6
Energy/oil products	2.4	2.4	2.3
Utilities	1.0	1.6	1.5
Construction	4.5	5.1	5.0
Manufacturing	8.1	8.5	8.2
Commerce	16.9	16.5	16.1
Transport & communications	12.3	12.4	12.7
Education	4.7	4.5	4.7
Health	1.5	1.6	2.0
Other Services	15.7	15.8	15.4
Public administration	7.3	7.1	7.2
GDP	100.0	100.0	100.0

Source: Agence Nationale de la Statistique et de la Demographie; Banque Centrale des Etats de l'Afrique de l'Ouest; Standard Bank Research

Balance of payments: deficit still wider

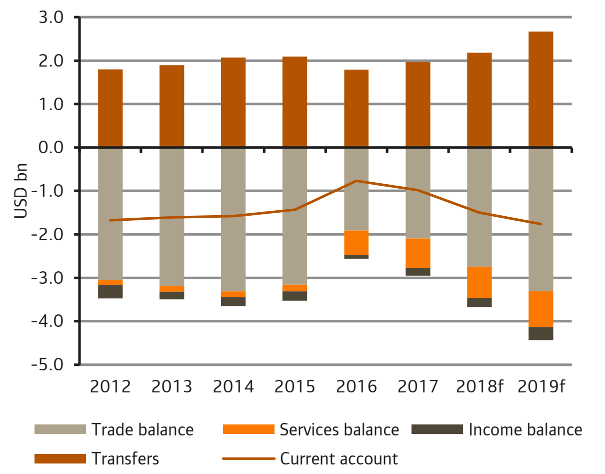
The C/A deficit will likely widen further this year, given the anticipated rise in domestic demand and increase in capital-intensive imports. The deficit will probably rise to USD1.5bn (8.0% of GDP) this year from USD1.0bn (6.1% of GDP) in 2017. That said, funding the BOP should not pose too many problems, as most of the heavy CAPEX-related imports will probably be financed externally.

In the medium term, the C/A will be underpinned by a ramp-up in oil production as the country moves closer to 'first oil'. The Cairn-led SNE venture is said to remain on track for production, after confirming that oil reserves could reach 0.56bn barrels. However, first oil isn't expected until 2021 at the earliest. In the meantime, Cairn has confirmed that the project would be moving as planned, with tenders for a new floating rig expected at the end of May.

Rising oil prices implies that the petroleum import bill will place pressure on the trade deficit. As expected, the trade balance widened slightly in 2017, reaching USD2.1bn from USD1.9bn in 2016. After rising 17.4% y/y last year, the import bill will probably rise by another 25.0% y/y this year due to the upward pressure from fuel imports. The negative income balance should remain in check over the course of the next 2-y, as most multinational businesses are still in the investment phase and not in a position to repatriate dividends.

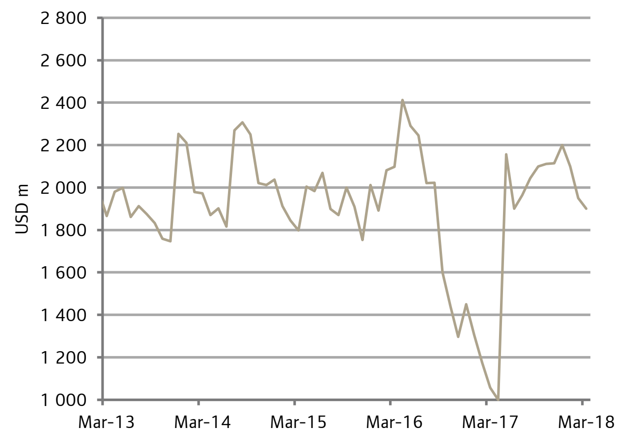
FX reserves will probably move sideways this year despite the widening C/A deficit. In addition to relatively strong FDI inflows, the authorities have become a more frequent issuer of Eurobonds. The USD2.2bn in Eurobonds issued earlier this year should keep reserves supported around USD2.5bn by year-end.

Current account



Source: Agence Nationale de la Statistique et de la Demographie; Banque Centrale des Etats de l'Afrique de l'Ouest

FX reserves



Source: Banque Centrale des Etats de l'Afrique de l'Ouest; Bloomberg

FX outlook: still managing EUR/USD

Despite the USD having strengthened against the US's trading partner currencies, our G10 Strategist Steve Barrow still expects EUR/USD to head higher on a multi-year basis. However, the pair will likely trade broadly flat this year. We therefore keep our long 2-y USD/XAF NDF position.

With the external environment improving, rumours about a potential devaluation or a total de-peg of the XAF and/or XOF from the EUR have died down. We think that this will remain so over the next 12-m. In any case, any currency movement will come with sufficient warning.

We expect USD/XOF to trade at 547 by year-end, before dropping towards the 470 range by the end of 2019.

USD/XOF: forwards versus forecasts

Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: Eurobond spreads more attractive

We are happy with Senegal's medium-term macroeconomic and fiscal outlook, and expect the credit to perform well in the coming years. That said, bond spreads compressed too fast, and were trading at rich levels. Thanks to the overall weakness in EM risk in recent weeks, the spreads on the bonds have now widened, and were trading in line with Côte d'Ivoire (spread over USTs between 312 bps and 454 bps). A further correction over the course of the next 12-m is plausible as elections draw nearer. However, given the fact that the authorities appear to have pre-funded some parts of the 2019 budget deficit, reduced supply should limit significant spread widening.

Despite the authorities' intention to continue along a strict fiscal consolidation path, there will be the temptation to increase spending ahead of the 2019 elections. For one, the political landscape appears a lot more competitive than it was just a year ago, which may push the incumbent into increasing allocations to populist projects (and spending) ahead of the elections.

Having said that, the fiscal deficit will probably not widen substantially, perhaps ending the year closer to 3.8% of GDP as opposed to the 3.5% of GDP proposed in the budget and 3.7% of GDP in 2017. Most of the deficit has been funded via the Eurobond, with a portion of the proceeds used to retire some more expensive external debt.

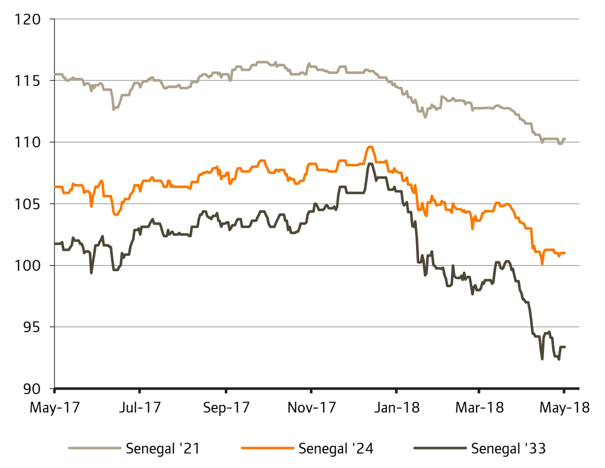
After the first 3-m of the year, revenue collection appeared in line with budget projections, as the authorities collected XOF350bn in tax revenue (5.3% below target). Expenditure was also broadly in line with the budget, albeit 2.7% above budget. We expect election-related expenditure to have ramped up by Q4:18.

Budget

	2016	2017	2018
% of GDP			
Total revenue (+ grants)	26.5	25.2	25.9
Tax Revenue	20.4	21.0	21.5
Non-tax Revenue	3.4	1.6	1.6
Grants	2.7	2.6	2.8
Total expenditure	30.8	28.9	29.4
- Salaries, etc	6.6	6.3	6.2
- Interest	1.9	2.1	2.2
Capital expenditure	12.9	12.8	12.2
Budget Deficit (incl Grants)	-4.3	-3.7	-3.5
Budget Deficit (excl Grants)	-7.0	-6.3	-6.2
Domestic Financing	0.4	-0.3	-0.7
External Financing	4.3	4.1	3.3

Source: Ministère de l'Economie et des Finances; International Monetary Fund; Standard Bank Research

Eurobond prices – mid



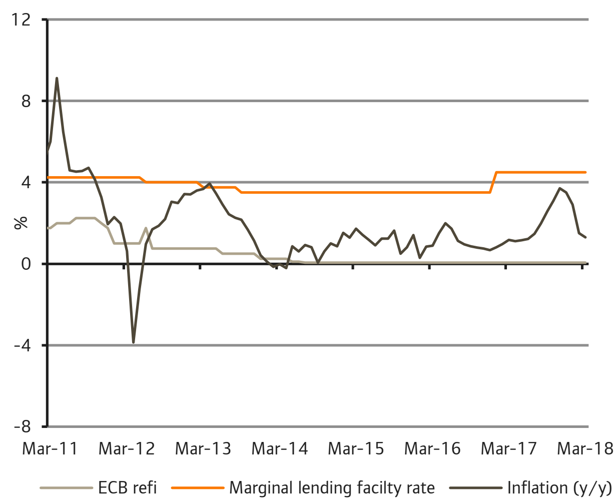
Source: Bloomberg

Monetary policy outlook: a holding pattern

With inflation and inflation expectations so benign, it is hard to expect that the BCEAO will change its monetary policy stance soon. In fact, the move to raise the Marginal Lending Rate by 100 bps to 4.5% earlier in 2017 was quite strange, as there was no sign of any pick-up in inflation expectations. Sure, inflation rose to a high of 3.7% y/y in Nov 17, but then it moderated to 1.5% y/y in Feb 18. The rise in inflation towards the end of 2017 was mainly due to higher food prices due to a bad harvest and challenges with the distribution channels.

We expect headline inflation to average 1.4% y/y this year, as food inflation pressures subside due to improved weather. As expected, money supply growth declined to 10.6% y/y in Q1:18 but we expect it to pick up towards year-end, averaging 15.1% y/y for 2018.

Inflation and interest rates



Source: Agence Nationale de la Statistique et de la Demographie; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	14.1	14.5	14.8	15.2	15.6	15.8	16.1
Nominal GDP (XOF bn)	7 398	7 710	8 077	8 722	9 498	10 274	11 062
Nominal GDP (USDbn)	14.9	15.5	13.6	14.0	16.1	18.6	22.3
GDP / capita (USD)	1 060	1 072	919	923	1 034	1 180	1 388
Real GDP growth (%)	3.6	4.7	6.2	6.7	7.0	6.8	6.5
Central Government Operations							
Budget balance (excl. grants) / GDP (%)	-7.9	-8.1	-7.5	-7.0	-6.3	-6.2	-5.7
Budget balance (incl. grants) / GDP (%)	-5.4	-5.1	-4.5	-4.3	-3.7	-3.5	-3.0
Domestic debt / GDP (%)	12.2	14.2	15.7	15.7	18.5	18.5	17.6
External debt / GDP (%)	35.5	38.9	39.5	40.0	40.0	39.0	37.0
Balance oghf Payments							
Exports of goods (USDbn)	2.9	2.9	2.6	2.7	3.3	4.0	5.1
Imports of goods (USDbn)	-5.8	-5.7	-4.9	-4.6	-5.4	-6.8	-8.4
Trade balances	-3.0	-2.7	-2.3	-1.9	-2.1	-2.7	-3.3
Current account (USDbn)	-1.6	-1.4	-1.1	-0.8	-1.0	-1.5	-1.8
- % of GDP	-10.5	-9.2	-8.1	-5.5	-6.1	-8.0	-7.9
Capital & Financial account (USDbn)	1.9	1.0	1.1	1.5	1.7	1.4	1.9
- FDI (USDbn)	0.2	0.3	0.4	0.5	0.6	0.6	1.6
Basic balance / GDP (%)	-9.1	-7.3	-5.4	-1.9	-2.4	-4.8	-0.7
FX reserves (USDbn) pe	2.3	1.9	1.9	1.4	2.2	2.5	2.7
- Import cover (months) pe	4.8	4.1	4.8	3.6	4.8	4.4	3.8
Sovereign Credit Rating							
S&P	B+	B+	B+	B+	B+	B+	B+
Moody's	B1	B1	B1	B1	Ba3	Ba3	Ba3
Fitch	nr	nr	nr	nr	nr	nr	nr
Monetary & Financial Indicators							
Consumer inflation (%) pa	0.9	-1.5	0.2	1.0	1.9	1.4	1.2
Consumer inflation (%) pe	0.9	-1.6	1.8	0.7	3.5	1.2	1.2
M2 money supply (% y/y) pa	5.3	10.0	16.8	18.4	17.0	15.1	13.6
M2 money supply (% y/y) pe	11.7	6.7	18.7	9.4	14.0	33.4	13.4
Marginal lending facility (%) pe	3.5	3.5	3.5	3.5	4.5	4.5	4.5
USD/XOF pa	495.2	496.0	594.2	621.8	588.8	552.5	495.9
USD/XOF pe	478.7	544.3	609.9	612.0	564.2	546.6	468.5

Source: International Monetary Fund; Ministère de l'Economie et des Finances; Agence Nationale de la Statistique et de la Demographie; Banque Centrale des Etats de l'Afrique de l'Ouest; Bloomberg; Reuters; Standard Bank Research
Notes: pe — period end; pa — period average; nr — not rated; na — not available

South Africa: what a difference a day makes

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	-0.6	0.8	1.0	1.0	1.1	0.9	1.3	1.9	2.0	1.7	1.8	1.6
CPI (% y/y) pa	6.5	6.2	6.0	6.6	6.3	5.3	4.8	4.7	4.1	5.0	5.4	5.1
M2 (% y/y) pa	8.6	5.7	4.5	5.8	6.1	6.2	6.7	7.4	7.1	7.4	8.0	8.2
CA/GDP (%) pa	-4.9	-2	-2.7	-1.7	-2.0	-2.8	-2.1	-2.9	-2.9	-2.9	-3.0	-3.0
FX reserves (USD bn) pe	43.6	45.6	46.6	46.6	46.8	46.8	50.6	45.9	53.6	53.7	54.4	55.3
Import cover (months) pe	5.4	5.3	5.2	5.2	5.0	4.9	5.2	4.6	4.8	4.7	4.9	4.9
3-m rate (%) pe	7.2	7.4	7.4	7.8	7.4	7.6	7.2	7.6	6.9	6.9	6.9	6.9
5-y rate (%) pe	8.68	8.27	8.04	8.27	9.92	7.5	7.3	8.2	7.4	7.4	7.4	7.4
USD/ZAR pe	14.69	14.68	13.72	13.74	13.41	13.07	13.55	12.38	11.84	12.3	12.41	12.5

Source: South African Reserve Bank; Statistics South Africa; Bloomberg; Standard Bank Research
Notes: pe — period end; pa — period average

GDP growth: a modest improvement imminent

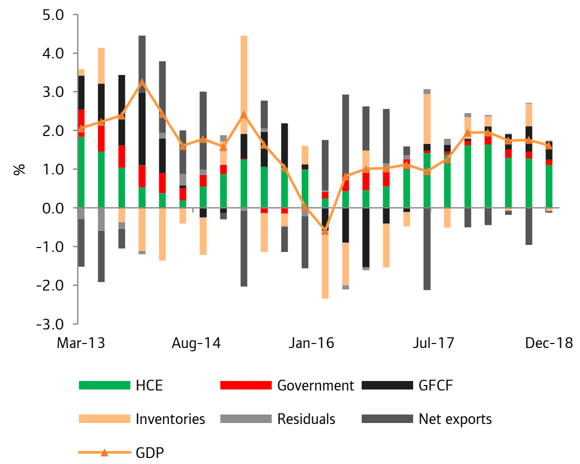
We expect a modest growth recovery, led by further momentum in consumption expenditure, followed by fixed investment. Real GDP growth is expected to average 1.8% in 2018 and 2.2% in 2019, from 1.3% in 2017. This positive outlook is the result of a favourable international economy (including expectations of robust world trade growth) as well as the now much improved domestic political economy.

Persistent momentum in household consumption expenditure (HCE) is expected to lead domestic economic growth, followed by fixed investment. HCE growth will be supported by modest growth in real wages (from lower inflation), monetary policy easing, and our expectation for reasonable household credit extension growth. Improved consumer confidence should also support HCE growth. These factors are expected to more than counter the negative impact of the VAT hike (from 14% to 15%) on HCE growth.

Business confidence is improving and, if sustained, should lead to a recovery in private sector gross fixed capital formation (GFCF) growth. However, this might be subject to the usual delays. Improving business confidence is supported by the election of Cyril Ramaphosa as ANC president, and then State president) and his swift cabinet overhaul and policy adjustment towards reinforcing fiscal consolidation; the Moody's decision to not only preserve SA's investment grade rating but to adjust the rating outlook from negative to stable. Public sector infrastructure spending remains under pressure, and has been cut back again in the 2018 national budget.

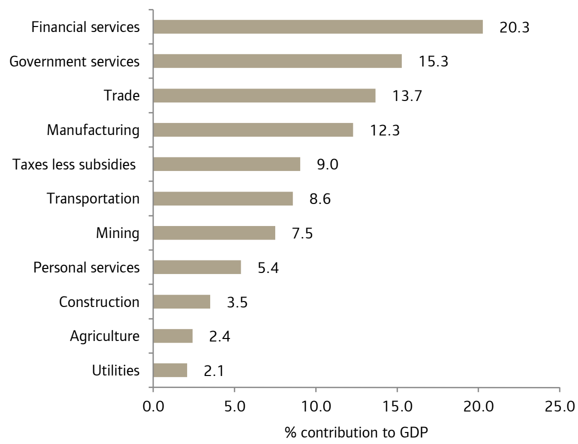
GDP growth, from a sectoral perspective, is expected to be driven mainly by the tertiary sector. We see near-term upside to the momentum in the primary sector, driven by specific impulses but the general outlook for the sector remains sluggish.

Contribution of GDP growth by demand



Source: South African Reserve Bank; Statistics South Africa; Standard Bank Research

Contribution to GDP by sector



Source: Statistics South Africa; Standard Bank Research

Balance of payments: CAD to widen slightly

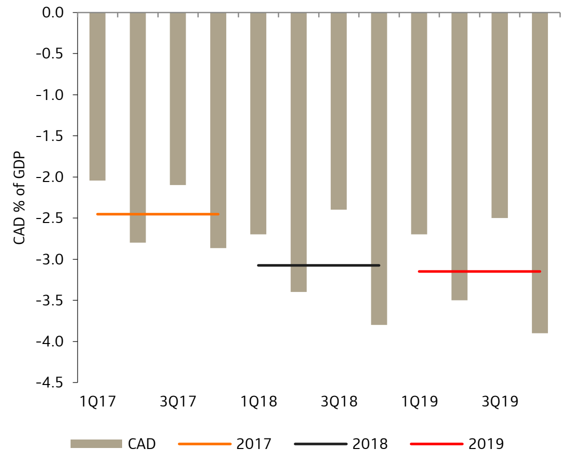
We expect the current account deficit to widen to 3.0% of GDP in 2018 and 3.1% in 2019, from 2.5% in 2017, on the expected narrowing of the trade surplus (from a recovery in imports and possibly a rise in import-intensity of demand). Although expected to widen, the CAD still shows much improvement from the recent historical average of 4.3% of GDP in 2012-2017, which should support the rand.

The forecast risks that we monitor include the terms of trade, which we expected to retreat modestly, and emerging market (EM) risks.

Exports are expected to benefit from a robust global growth, but a slightly overvalued real effective exchange rate poses a slight disadvantage. A recovery in domestic demand in conjunction with expected export growth means that import levels will increase as well. In volume terms, exports are expected to average 2.3% in both 2018 and 2019, while imports are expected to average 3.5% this year and 2.2% next year.

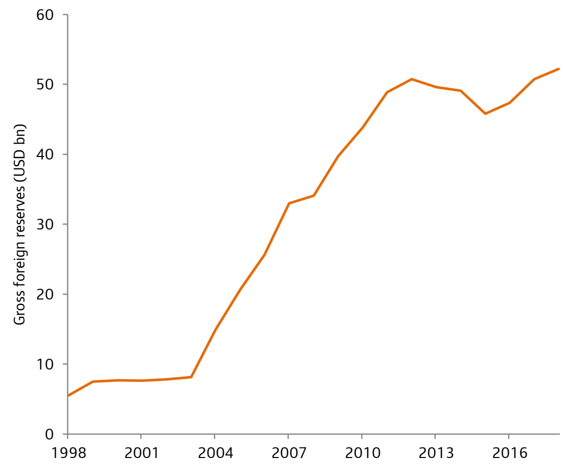
Foreign exchange reserves increased from around USD47.3bn in 2016, to USD50.7bn in 2017, and are expected to increase to USD52bn in 2018. The level of import cover is expected to increase to 5.0 months in 2018, from 4.9 months in 2017.

Current account



Source: South African Reserve Bank; Statistics South Africa; Standard Bank Research

FX reserves



Source: South African Reserve Bank; Bloomberg; Standard Bank Research

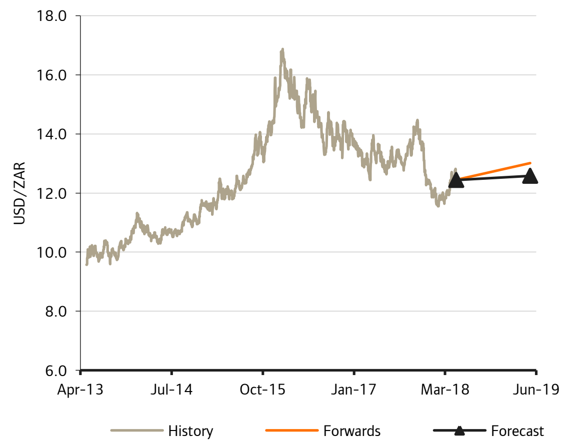
FX outlook: still quite constructive

We retain our constructive rand outlook in the medium term. We still forecast USD/ZAR at12.50 by end-2018 and 12.70 by end-2019 despite further near-term dollar strength potentially keeping the rand slightly weaker than we initially anticipated. At this stage, the medium-term risks are biased to the stronger side of our rand forecasts.

Nonetheless, the recent market adjustments have compelled us to adjust our near-term outlook to 12.30 by end-Q2:18 (from 12.00) and to an average of 12.26 for 2018.

Our head of G10 strategy Steven Barrow expects the dollar to strengthen slightly further in the near term, taking EUR/USD to around 1.15 by Aug 18, after which he maintains his forecast for a bearish trend towards 1.20 by end-2018 and 1.36 by end-2019.

USD/ZAR: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: consolidation

The SA government is executing tough decisions to prove its commitment to fiscal consolidation. One such decision was to increase the VAT rate; another was to prioritise tertiary education spending over infrastructure spending. These changes were necessary, and the pattern of combining spending cuts with tax hikes had to continue. In the longer term, though, sustained higher economic growth, combined with a significant increase in the efficiency of government spending and reduction in fiscal leakage, will be required to break this pattern and ensure fiscal sustainability.

The 2018 Budget seems positive for the currency and bond markets. The bond market in particular received some relief from the fact that debt is forecast to stabilise comfortably below 60% by 2022, the expected decline in the borrowing requirement and the subsequent decline in the pace of bond issuance by the National Treasury.

After the Budget, Moody's kept SA's sovereign credit rating unchanged at the lowest investment grade and changed the rating outlook to stable (from negative). It also cements our view that SA's credit ratings have bottomed, although we do not expect any rating upgrades soon. This positive endorsement should provide further impetus to the improvement underway in investor sentiment.

Regarding our bond outlook, we expect rising US yields and its importance in driving SA bond yields to increase in due course from unusually low levels. It will thus likely exert upward pressure on local bond yields.

Further, we expect that the importance of country/credit risk and forward-looking rates and inflation to subside somewhat from its previous dominance, and the drivers themselves are expected to trend sideways in the near term (with marginal short-term downside risk to the latter).

Central government budget

% of GDP	FY2015/16	FY2016/17	FY2017/18
Total revenue	29.5	29.2	28.8
Total expenditure	33.1	32.7	33.2
Overall balance	-3.7	-3.5	-4.3
Net domestic borrowing	44.2	45.6	48.6
Donor support (grants)	-	-	-

Source: National Treasury; Standard Bank Research

Eurobond prices - mid

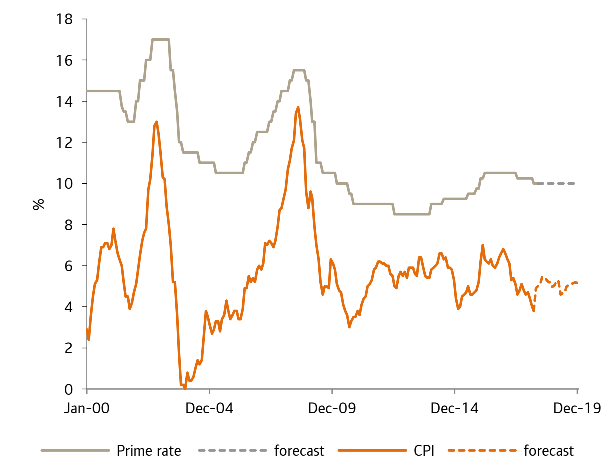
Source: Bloomberg

Monetary policy outlook: steady rates

We had pencilled in a further 25 bps cut at the Jul 18 MPC meeting, but we no longer do. Indeed, we had always maintained that this would be a very close call. We now expect steady rates throughout 2018-2019.

We expect headline CPI inflation to moderate to 5.0% y/y in both 2018 and 2019, from 5.3% y/y in 2017. This takes into account the recent VAT increase from 14% to 15%. The rand, and oil prices, not only pose an upside risk to the inflation trajectory but also potentially reduce the probability of further improvement in inflation expectations (which the SARB are determined to drive to the 4.5% mid-point of the inflation target band). Also, the recent improvement in growth expectations, in our view, will likely reduce the bank's willingness to manage inflation expectations down more gradually. This supports our view of no further rate cuts.

Inflation and interest rates



Source: South African Reserve Bank; Statistics South Africa; Bloomberg; Standard Bank Research

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	53.1	53.9	54.7	55.6	56.5	57.5	58.4
Nominal GDP (ZAR bn)	3 540	3 805	4 051	4 350	4 652	4 973	5 451
Nominal GDP (USD bn)	367	351	317	296	349	381	432
GDP / capita (USD)	6 912	6 506	5 795	5 320	6 183	6 635	7 394
Real GDP growth (%)	2.5	1.8	1.3	0.6	1.3	1.8	2.2
Central Government Operations							
Budget balance / GDP (%)	-4.9	-4.7	-3.8	-4.1	-4.4	-3.7	-3.6
Domestic debt / GDP (%)	39.9	42.2	44.1	45.9	48.7	49.8	50.3
External debt / GDP (%)	4.0	4.3	4.8	4.8	4.7	5.3	5.0
Balance of Payments							
Exports (USD bn)	96.9	93.5	80.7	76.5	88.3	100.9	102.5
Imports (USD bn)	104.1	98.6	84.3	74.1	83.1	96.5	99.7
Trade balance (USD bn)	-7.2	-5.1	-3.6	2.4	5.2	4.3	2.8
Current account (USD bn)	-21.2	-17.8	-14.6	-8.2	-8.6	-11.4	-13.4
- % of GDP	-5.8	-5.1	-4.6	-2.8	-2.5	-3.0	-3.1
Financial account (USD bn)	4.7	5.7	4.1	2.2	1.9	1.8	2.0
- FDI (USD bn)	1.6	-1.9	-4.1	-2.2	-6.0	-4.1	-5.1
Basic balance / GDP (%)	-0.7	1.5	0.6	0.2	-0.3	-1.1	-1.2
FX reserves (USD bn) pe	53.9	52.4	55.9	44.1	46.9	52.2	51.8
- Import cover (months) pe	4.6	4.7	5.7	5.2	4.6	4.9	5.0
Sovereign Credit Rating							
S&P	BBB	BBB-	BBB-	BBB-	BB+	BB+	BB+
Moody's	Baa1	Baa2	Baa2	Baa2	Baa3	Baa3	Baa3
Fitch	BBB	BBB	BBB	BBB-	BB+	BB+	BB+
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.8	6.1	4.6	6.3	5.3	5.0	5.0
Consumer inflation (%) pe	5.4	5.3	5.2	6.8	4.7	4.9	5.2
M2 money supply (% y/y) pa	8.1	10	8.7	6.2	6.6	7.6	7.5
M2 money supply (% y/y) pe	9.7	8.6	9.6	6.6	7.9	8.2	8.0
SARB repo rate (%) pa	5.00	5.63	5.92	6.96	6.88	6.54	6.50
SARB bank rate (%) pe	5.00	5.75	6.25	7.00	6.75	6.50	6.50
3-m rate (%) pe	5.3	5.9	6.2	7.4	7.5	6.9	6.9
5-y rate (%) pe	7.02	6.98	8.31	8.19	8.15	7.41	7.50
USD/ZAR pa	9.65	10.84	12.77	14.70	13.31	12.26	12.62
USD/ZAR pe	10.52	11.55	15.48	13.74	12.38	12.50	12.70

Source: South African Reserve Bank; Statistics South Africa; National Treasury; Bloomberg; Standard Bank Research

Notes: pe — period end; pa — period average

Tanzania: coming to grips with the new normal

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	6.9	8.5	7.0	5.5	5.7	7.8	6.9	7.3	6.8	6.9	7.4	7.5
CPI (% y/y) pe	5.4	5.5	4.5	5.0	6.4	5.5	5.2	4.0	3.9	3.8	4.9	6.3
M3 (% y/y) pe	15.5	12.4	4.3	2.9	4.1	6.1	3.7	8.0	8.3	9.0	9.4	11.0
FX reserves (USD bn) pe	3.9	3.9	4.1	4.3	4.5	5.0	5.7	5.9	5.5	5.4	5.5	5.3
Import cover (months) pe	4.0	4.4	4.2	4.2	4.3	4.9	5.1	5.4	5.6	5.3	5.1	4.9
3-m rate (%) pe	8.2	7.6	7.5	7.1	7.2	5.5	4.6	4.0	2.8	1.9	2.3	3.5
5-y rate (%) pe	18.8	17.0	17.0	18.0	17.7	14.5	13.8	13.6	13.2	11.0	11.8	14.2
USD/TZS pe	2186	2190	2193	2188	2235	2237	2235	2240	2255	2280	2295	2320

Source: Bank of Tanzania; National Bureau of Statistics; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average

GDP growth: mining sector is a downside risk

We expect GDP growth of 7.0% y/y and 7.2% y/y in 2018 and 2019 respectively, from an estimated 6.9% y/y in 2017. The services sector is likely to drive this growth, while the biggest downside risk to our estimates is the mining sector.

The transport and storage sector is benefiting from VAT on ancillary services having been scrapped. This sector grew by an average of 16.4% y/y in the 6-m to Sep 17, from 4.1% y/y in Q1:17, a trend which is likely to persist over the medium term, especially as growth in Tanzania's landlocked neighbours implies rising demand for access to Tanzania's port.

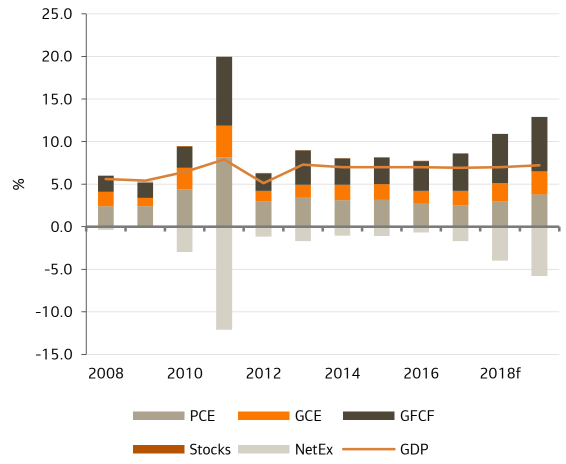
There is renewed hope for the upcoming fiscal year budget containing more pro-business reforms, especially after President Magufuli's candid discussions with private sector lobbies and various Tanzanian entrepreneurs.

However, the new mining laws, passed by parliament earlier this year, in addition to the already cumbersome business environment the mining sector faces with the export ban on raw concentrates, could slow down the economy. Even though the mining sector's share as a percentage of GDP is less than those of the other sectors, the indirect impact on the services sector will likely be detrimental to growth.

Importantly, the IMF is, as are we, concerned about the disconnect between official GDP estimates and economic indicators such as electricity consumption, private sector credit (PSC) growth, and tax collection – all of which are subdued.

Furthermore, the government's slow validation of VAT refunds means that domestic arrears stock has been accumulating, which is also slowing down private sector activity.

Composition of GDP growth by demand



Source: National Bureau of Statistics; Standard Bank Research

Contribution to GDP by sector (%)

	2005	2010	2014	2016
Agriculture	29.0	26.3	23.0	21.0
Mining & quarrying	4.2	3.4	3.4	3.6
Manufacturing	6.6	7.5	7.3	7.4
Electricity & gas	2.0	1.8	0.9	0.9
Construction	6.7	7.8	9.9	11.4
Wholesale & retail trade	9.1	10.0	10.2	10.3
Transport & storage	6.0	6.0	6.3	6.7
Hotels & restaurants	1.9	1.7	1.5	1.4
Information & communication	2.1	3.4	4.3	4.7
Financial & insurance activities	2.2	3.8	4.1	4.5
Real Estate	6.6	5.3	4.4	4.1
Public administration	8.5	6.1	6.6	6.5

Source: National Bureau of Statistics

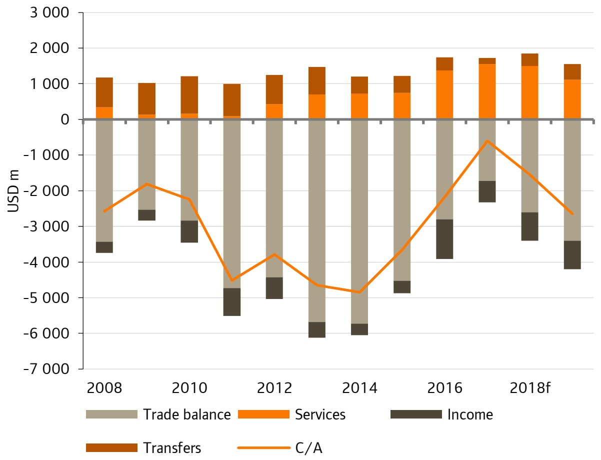
Balance of payments: imports could rise

We expect the C/A deficit to widen to 3.0% of GDP in 2018 and 4.6% of GDP in 2019, from 1.1% in 2017. The BOT has not published trade account data for the BOP since Jun 17 due to the statistical challenges associated with the implementation of the single customs territory under the East African Community (EAC).

Curiously, the BOT was concerned about the accuracy of the trade data (which has been indicating a declining trend in net exports). The BOT believes that this shouldn't have been the case because FX reserves have grown. Policymakers believe that, since exports to EAC countries were not subject to the previous restrictive regulations and internal border controls, the figure may have been underestimated by the National Bureau of Statistics (the custodian of trade data). Yet, despite our concerns on mining export revenue mainly from the potential of lower gold receipts, tourism and transport earnings should boost service inflows over the coming year, and somewhat counterbalance this. However, the waning mining sector could impinge on the FDI needed to fund the C/A deficit, specifically as the imports of goods look set to rise over the next 2-y.

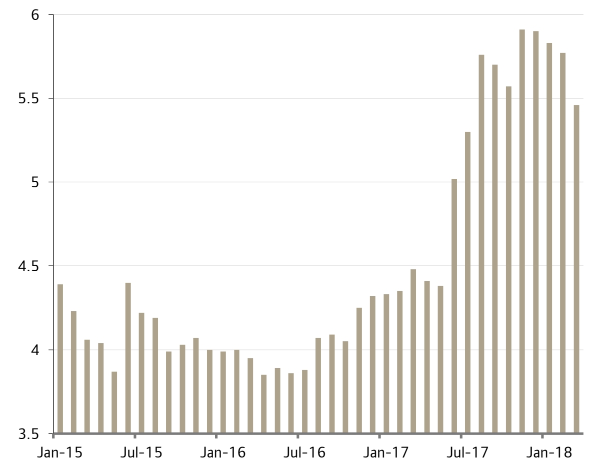
Higher international oil prices, and the likelihood of a moderate recovery in economic activity, will likely increase net imports over the medium, more so if the government's execution on public infrastructure projects improved. However, Tanzania's reliance on oil imports for power generation could subside, due to the availability of natural gas. FX reserves have risen sharply, to USD5.77bn (5.9 months of import cover) as at Feb 18, in large part due to the issuance of external commercial loans. We see FX reserves at USD5.3bn by end 2018, thereafter increasing to USD5.8bn by end 2019.

Current account developments



Source: Bank of Tanzania; Standard Bank Research

FX reserves (USD bn)

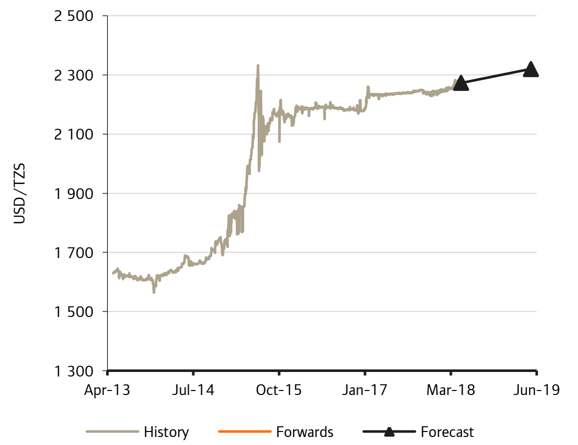


Source: Bank of Tanzania

FX outlook: still stable, but bias for weakness

We expect the USD/TZS to trade around 2300 - 2320 by end 2018, from 2280 - 2300 previously. Admittedly, the pair rose quite abruptly in Q1:18, as indeed can be the cyclical trend, on seasonal dividend payments coinciding with poor mining sector inflows. The BOT is now, understandably, a net seller of USD to the market, after being a net purchaser for the better part of the last 2-y. Indeed, with such a strong external account position, it's hard to fathom the BOT's inability to slow down TZS depreciation. Moreover, between May and Sep, increased inflows, associated with the agriculture sector, tend to provide some stability for the TZS. However, since FX reserves have been boosted by, largely, foreign commercial loans, there is clearly upside risk to USD/TZS as the government increases expenditure for public projects such as the Standard Gauge Railway (SGR), driving down FX reserves.

USD/TZS: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: arrears weigh down revenue

Government expenditure on development projects remains subdued, while revenue collections have diminished perhaps due to the recent slowdown in private sector activity. Only 92.5% of the revenue target was achieved in H2:17, although development expenditure achieved an absorption rate of 70.7% during the period.

Notably, the government has ambitious plans for development expenditure over the medium term. Key flagship projects such as the construction of the SGR and Stiegler's Gorge hydropower dam are likely to keep expenditure elevated over the next 2-y. Moreover, President Magufuli has acknowledged businesses concerns regarding harassment by the Tanzania Revenue Authority (TRA) must be addressed; also, he has demanded the Ministry of Finance clear domestic arrears owed to contractors.

Domestic arrears excluding VAT refunds and money owed to pension funds are estimated at TZS3.7tr. The government had previously argued that, as claims could be fraudulent, as has been the case historically, claims were now being validated more carefully.

Unfortunately, despite having one of the steepest yield curves in our African coverage, the closed capital account remains an impediment to foreign portfolio investors wanting to explore this opportunity.

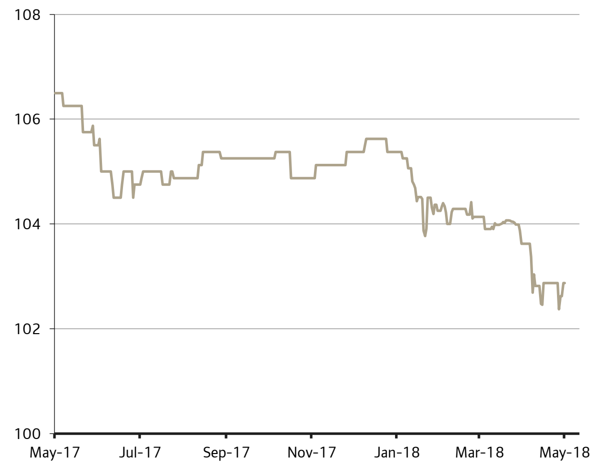
T-bill yields have plummeted to historical lows due to the ultra-loose monetary policy stance by the BOT. This decline has been intensified by the lack of PSC growth. Indeed, as lending to the private sector moderately picks up over the coming year, the short-end of the yield curve could rise again, specifically if the government cannot attract sufficient external funding for general budget support (GBS).

Central government budget

% of GDP	FY2016/17	FY2017/18
Total revenue	14.1	15.3
Total expenditure	20.8	23.0
Wages	8.9	6.5
Interest	1.4	1.5
Development expenditure	8.2	10.8
Overall balance (- grants)	-6.7	-7.7
Overall balance (+ grants)	-4.5	-3.8
Net domestic borrowing	1.6	1.1
Net external borrowing	2.9	2.7
Donor support (grants)	2.2	3.9

Source: Ministry of Finance

Tanzania '20 prices – mid



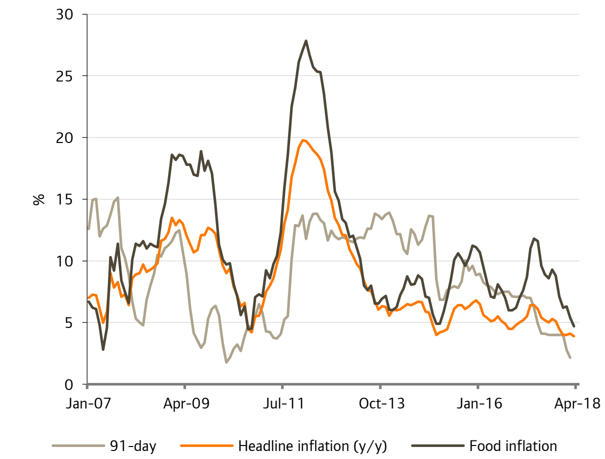
Source: Bloomberg

Monetary policy: still accommodative

The MPC will maintain an accommodative stance over the coming year as they strive to revive PSC. Headline inflation is likely to bottom out between May and Jun, and then rise above 6.0% y/y by Q4:18 as base effects unwind. Core inflation has also remained anchored below 2.0% y/y in the 4-m to Apr. However, as economic activity improves and the second-round effects of higher oil prices filter through, underlying inflationary pressures could increase over the coming year.

Furthermore, the MPC aims to move to an interest-rate-based monetary policy by the end of FY2017/18, using the interbank cash market rate as an operational target. Nonetheless, an obvious risk for the MPC in its pursuit of stimulating PSC could be USD/TZS movements. Previously, the BOT provided TZS liquidity by purchasing USD from the market. Of course, the opposite would be required if TZS pressures intensified.

Inflation and interest rates



Source: Bank of Tanzania; National Bureau of Statistics

Annual indicators

	2013	2014f	2015f	2016	2017	2018f	2019f
Output							
Population (million)	45.8	46.7	47.6	48.6	49.6	50.5	51.4
Nominal GDP (TZS bn)	70 953	79 718	90 864	103 745	111 600	123 440	136 700
Nominal GDP (USD bn)	43.7	48.0	44.6	47.4	49.9	54.0	58.5
GDP / capita (USD)	954	1 028	937	975	1 006	1 068	1 139
Real GDP growth (%)	7.3	7.0	7.0	7.0	6.9	7.0	7.2
Gold production ('000 Kg)	47.0	47.8	41.7	44.5	39.5	37.0	41.5
Tobacco production ('000 MT)	101.5	102.9	103.7	104.5	104.9	106.4	108.2
Coffee production ('000 MT)	60.8	62.2	62.1	63.5	63.1	63.9	64.8
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-7.6	-7.3	-6.7	-7.5	-6.7	-7.7	-7.9
Budget balance (incl. Grants) / GDP (%)	-4.1	-3.9	-3.2	-3.8	-4.5	-3.8	-4.4
Domestic debt / GDP (%)	8.6	9.4	9.5	9.9	10.1	9.7	9.9
External debt / GDP (%)	25.4	25.2	29.7	29.5	30.2	31.6	32.0
Balance Of Payments							
Exports of goods and services (USD bn)	8.5	8.6	8.7	9.3	8.5	8.4	8.9
Imports of goods and services (USD bn)	13.5	13.6	12.5	10.7	8.9	9.9	11.2
Trade balance (USD bn)	-5.0	-5.0	-3.8	-1.4	-0.4	-1.7	-2.3
Current account (USD bn)	-4.7	-4.8	-3.7	-2.2	-0.6	-1.6	-2.7
- % of GDP	-10.6	-10.0	-8.3	-4.5	-1.1	-3.0	-4.6
Financial account (USD bn)	5.4	3.2	2.9	2.3	3.2	3.8	4.4
- FDI (USD bn)	1.9	1.4	1.6	1.4	1.1	1.2	1.6
Basic balance / GDP (%)	-6.4	-7.1	-4.7	-1.7	1.1	-0.7	-1.9
FX reserves (USD bn) pe	4.7	3.9	4.0	4.3	5.9	5.3	5.8
- Import cover (months) pe	4.2	3.4	3.8	4.2	5.4	4.9	4.7
Sovereign Credit Rating							
S&P	nr	nr	nr	nr	nr	nr	nr
Moody's	nr	nr	nr	nr	nr	nr	nr
Fitch	nr	nr	nr	nr	nr	nr	nr
Monetary & Financial Indicators							
Consumer inflation (%) pa	7.9	6.1	5.8	5.1	5.3	4.7	5.6
Consumer inflation (%) pe	5.6	4.8	6.8	5.0	4.0	6.3	5.7
M3 money supply (% y/y) pa	13.1	14.5	15.3	9.3	5.5	9.4	13.3
M3 money supply (% y/y) pe	9.8	15.6	18.8	2.9	8.0	11.0	15.5
BOT discount rate (%) pa	12.7	16.0	16.0	16.0	11.5	9.0	9.0
BOT discount rate (%) pe	16.0	16.0	16.0	16.0	9.0	9.0	9.0
3-m rate (%) pe	13.8	13.6	9.2	7.1	4.0	3.5	6.2
1-y rate (%) pe	15.6	15.0	18.7	15.8	8.4	6.5	9.2
2-y rate (%) pe	15.0	15.3	16.9	17.7	11.1	9.0	10.7
5-y rate (%) pe	15.4	16.4	17.5	18.0	13.6	11.8	13.2
USD/TZS pa	1 625	1 660	2 038	2189	2237	2288	2335
USD/TZS pe	1 610	1 728	2 155	2188	2240	2320	2370

Source: Bank of Tanzania; National Bureau of Statistics; Ministry of Finance; Bloomberg; Standard Bank Research

Notes: pe – period end; pa – period average; nr – not rated

Tunisia: a revival in tourism would raise growth

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	0.7	1.2	1.3	1.2	1.9	1.8	2.1	2.0	2.7	2.7	2.7	2.7
CPI (% y/y) pa	3.4	3.6	3.9	4.0	4.6	4.9	5.6	6.2	7.2	7.6	6.8	5.9
M3 (% y/y) pa	4.6	6.1	7.2	8.4	7.3	9.2	9.1	9.5	8.9	8.6	8.4	8.1
CA/GDP (%) pe	-7.7	-11.9	-5.9	-9.8	-13.2	-10.4	-6.4	-12.0	-10.1	-8.7	-4.3	-10.3
FX reserves (USD bn) pe	6.2	5.5	5.8	5.7	5.6	5.2	5.3	5.3	5.0	5.4	5.5	5.6
Import cover (mths) pe	3.5	3.1	3.3	3.2	3.0	2.8	2.8	2.8	2.4	2.6	2.7	2.7
BCT policy rate (%) pe	4.25	4.25	4.25	4.25	4.25	5.00	5.00	5.00	5.75	5.75	5.75	5.50
USD/TND pe	2.02	2.22	2.20	2.30	2.28	2.46	0.00	2.47	2.43	2.54	2.63	2.63

Source: Banque Centrale de Tunisie; Institut National de la Statistique; Bloomberg; Standard Bank Research
Note: pa – period average; pe – period end

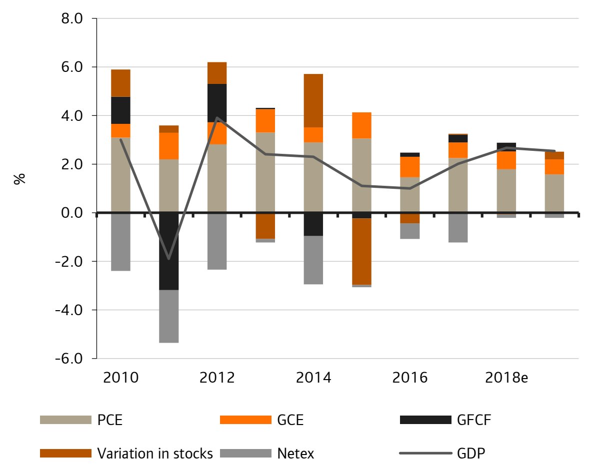
GDP growth: still struggling, but hopeful

GDP grew by 2% y/y in 2017, from 1.1% y/y in 2016, due to a sound harvest and a recovery in the services sector (which was running at c.4% y/y last year). We expect this momentum to continue this year, given the 23% y/y increase in foreign tourist bookings for Q1:18. Since the services sector comprises 40% of the economy, this should raise GDP growth.

However, the industrial sector continues to struggle, as in 2017. Mineral extraction decreased 10.5% y/y during Jan/Feb 18 mainly due to a steep decline in phosphates production, which had a knock-off effect for the chemical industry. Manufacturing was down 2.7% y/y, not least because oil refining production has been shut since Nov 17. In fact, the only two manufacturing sectors that grew in Jan/Feb 18 were electrical products (7.1% y/y) and agribusiness (21.1% y/y), the latter due to bumper oil production that had tripled on the year before. Industrial production, which accounts for a quarter of GDP, was down 3.9% y/y in the first 2-m of 2018, much more than the year before.

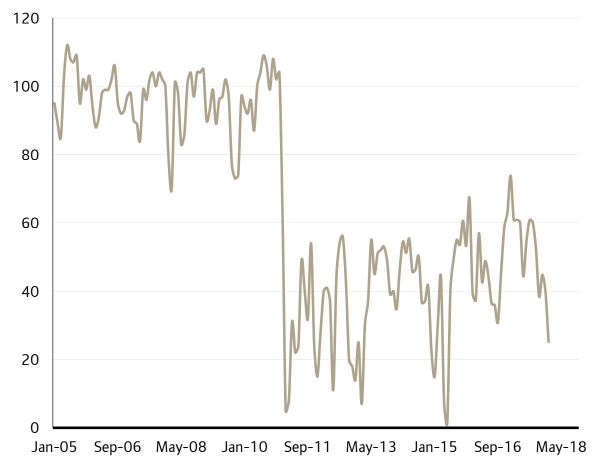
We therefore decrease our 2018 GDP forecast from 2.9% y/y to 2.7% y/y. Our previous estimates were based on expectations of increased consumption, not least due to increases in salaries and wages. However, the sharp increase in inflation this year will diminish those. Also, we do not expect the recent rate hike to have much of a negative effect on economic growth in 2018. More likely, its consequences will be felt in 2019. This, and a deceleration of economic growth in the EU, will likely dampen economic growth in 2019 but we retain our forecast for 2019 GDP at 2.5% y/y; however, the risk lies to the downside.

Composition of GDP growth by demand



Source: Banque Centrale de Tunisie; l'Institut National de la Statistique; Standard Bank Research

Extraction of Minerals for the Chemical Industry and Natural Fertilizers, Index, 2010 = 100



Source: l'Institut National de la Statistique

Balance of payments: to improve

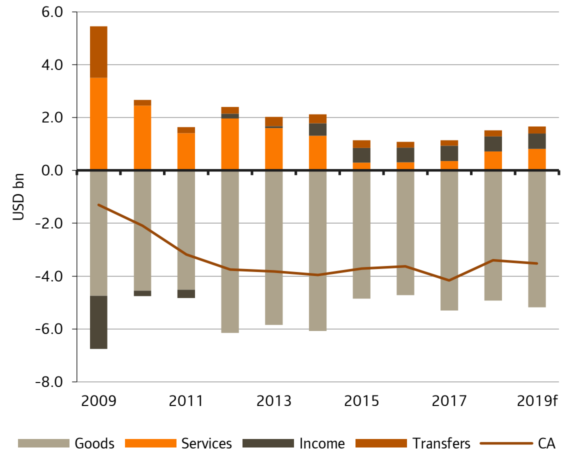
External trade kicked off well, as goods exports surged by 35.2% y/y in Q1:18 (from 7.4% y/y last year). Many export sectors registered stellar growth, with a gross profit for oil sales increasing nearly three-fold, products of agriculture 90% y/y, and the manufacturing industries 27% y/y. In fact, the only sector that contracted in Q1:18 was mining and phosphates. Preliminary data shows that the services sector is likely to continue expanding, as European tourist arrivals increased by 52% y/y in Q1:18. While it is unlikely that exports will maintain these rates of expansion this year, some conditions should remain favourable for longer. In particular, a low base effect for oil prices should still run a while. Also, a resumption of dinar depreciation should support exports.

However, the rate of import growth is still high (21.3% y/y in Q1:18, unchanged from the year before), with raw materials and capital goods increasing by 28.4% y/y and 17% y/y respectively.

We increase our forecast for the C/A deficit in 2018 to USD3.4bn from USD3.9bn previously. But this will still be a reduction from 2017, likely a one-off as decelerating economic growth both in the EU and in Tunisia in 2019 will have a dampening effect on exports, especially if agricultural output returns to normal this year. We leave our forecast for C/A deficit in 2019 unchanged at USD3.6bn.

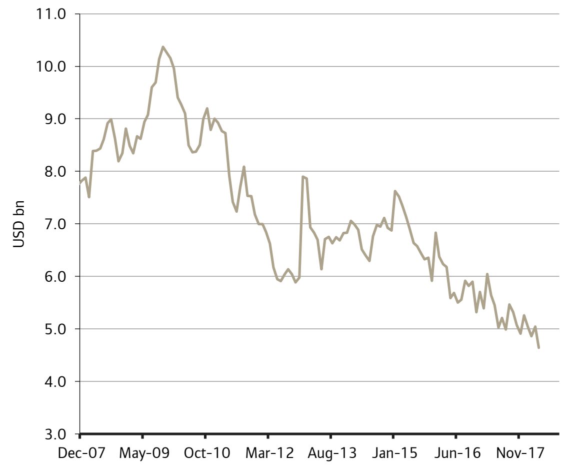
After nearly two years of plummeting, FX reserves are now likely to stabilise. In March, the IMF's released a USD257m of a third tranche of the 4-y loan agreement, which should ease access to external funding, including a planned USD1bn Eurobond issuance. Separately, the Islamic Development Bank had agreed to lend USD1.8bn over 3-y period to support Tunisian SOE. That said, the import cover will remain precarious, at 2.6-m.

Current account



Source: l'Institut National de la Statistique; Banque Centrale de Tunisie; Standard Bank Research

FX reserves

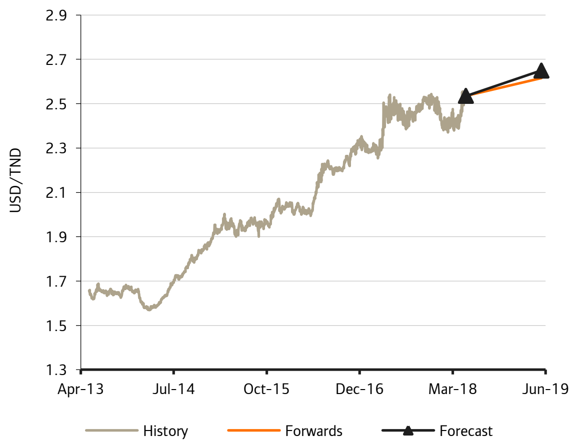


Source: Banque Centrale de Tunisie

FX outlook: dinar depreciation

The BCT has brought depreciation of the managed currency basket (which we estimate as EUR60% and USD40%) to a standstill this year, from c.11% annualised in H2:17, partly to rein in inflation. We doubt that the monetary authorities will be able to keep the currency basket stable for much longer, given the demands from the IMF for a more flexible exchange rate and as the FX reserves dwindle. Most likely, once inflation shows signs of abating, the BCT will likely revert to c.10% basket depreciation. For this reason, and given our forecast for EUR/USD of 1.30 and 1.40 by YE:18 and YE:19 respectively, we expect USD/TND to rise to 2.63 and to 2.67 over the same timeframe. Importantly, under these assumptions, dinar depreciation against the euro would be over 10% this and next year, which should help to narrow the C/A deficit, given that the EU is Tunisia's largest trading partner.

USD/TND: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: a tighter deficit

Given the preliminary budget execution figures for 2017 and our GDP estimates, the country's budget deficit widened to 5.9% of GDP in 2017, exceeding both the 2017 Act's initial target and the revised estimates. The Achilles' heel remains poor tax receipts due to a sluggish economy, the inability to rein in the state's wage bill, and a ballooning subsidies account.

The 2018 Act envisages a sharp reduction in budget deficit to 4.5% of GDP (excl. grants and privatisation receipts). This may not be realistic. Granted, an expected recovery in economic growth should support tax collection but is unlikely to lead to the c.11% y/y increase pencilled in the Act. Not surprisingly, during Jan/Feb 18, tax collections were below target, and even much improved VAT receipts and corporate taxes didn't offset the lack of income taxes. On the expenditure side, the wage bill is unlikely to be reduced as envisaged, as the planned compulsory redundancies are not materialising. It is therefore not surprising that in the first 2-m of 2018, wages exceeded the pro-rata target. During Jan/Feb 18, we estimate the budget deficit at 5.7% of GDP. We increase our forecast for a deficit in 2019 to 5.4% of GDP, from 5% previously.

A persistently wide deficit takes a toll on the debt burden which is expected to reach 74% of GDP in 2018. Before the BCT raised the policy rate in Mar, the Treasury managed to borrow almost 2/3 of the yearly target in the local market. Now, with much higher domestic rates, the attention will switch to external borrowing. The largest part should come from the IMF and the World Bank (to make up for Qatar's loans which are not expected this year). Tunisia will have to tap the financial markets to raise at least USD1bn. This should put further pressure on Tunisia's dollar-denominated Eurobonds (which we expect to underperform our Eurobond African index, SBAFSO).

Central government budget

% of GDP	2013	2014	2015	2016	2017 (prel)	2018 (Act)
Total revenue	26.3	24.7	23.5	23.6	24.6	24.9
- Tax revenue	21.7	23.1	21.9	20.9	22.0	22.5
- Non-tax revenue	4.6	1.6	1.6	2.7	2.6	2.5
Total expenditure and net lending	31.2	29.7	28.2	29.1	30.7	29.4
- Current expenditure	23.2	21.4	20.4	20.6	22.2	21.2
- Wages and salaries	12.8	13.0	13.7	14.7	14.9	14.1
- Subsidies	7.3	5.1	3.4	2.5	3.6	3.4
- Capital expenditure	5.8	5.9	5.7	6.1	5.9	5.5
- Net lending	0.2	0.5	0.3	0.3	0.1	0.1
- Interest payment	1.9	1.9	1.9	2.2	2.3	2.7
Overall balance	-4.9	-4.9	-4.7	-5.6	-6.1	-4.5
Grants	0.3	0.5	0.3	0.1	0.2	0.3
Overall balance (+grants)	-4.6	-4.5	-4.4	-5.4	-5.9	-4.2
Net domestic borrowing	0.7	1.2	0.7	2.3	0.8	0.3
Net external borrowing	2.3	3.2	4.5	3.2	4.9	3.9

Source: Ministère de l'Economie et des Finances

Eurobond: spread over UST

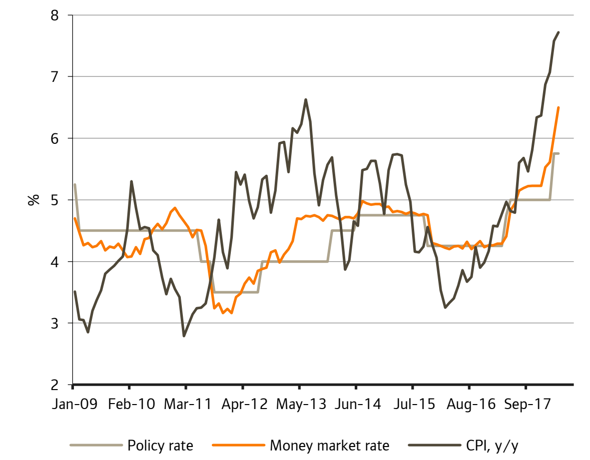
Source: Bloomberg; Standard Bank Research

Monetary policy outlook: stable, after the hike

As we foresaw in our Jan publication, faced with inflation running out of control the BCT had to lift interest rates, opting for a 75 bps increase in Mar 18. This brings the bank rate to 5.75%, or 1.5% higher since the tightening cycle started 2-y ago. Quite a remarkable increase, considering that during that period, economic growth was an average of just 1.4% y/y.

As inflation surged due to non-monetary factors, such as hikes in various taxes, salary increases and rising commodity prices, the higher policy rate will take time to calm inflation. Hence, we expect CPI to start decelerating meaningfully only by year-end. The BCT, wary of higher oil prices, the possibility of a looser fiscal policy in the 2019 election year, and a weaker currency, is likely not to reverse the hikes any time soon, even if inflation started abating.

Inflation and interest rates



Source: Banque Centrale de Tunisie

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	10.9	11.0	11.1	11.3	11.4	11.5	11.6
Nominal GDP (TND bn)	75.1	80.8	84.7	89.6	96.4	104.5	112.1
Nominal GDP (USD bn)	45.9	46.8	42.8	41.1	39.8	41.1	42.1
GDP / capita (USD)	4,211	4,251	3,854	3,634	3,490	3,578	3,630
Real GDP growth (%)	2.4	2.3	1.1	1.0	2.0	2.7	2.5
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-4.9	-4.9	-4.7	-5.6	-6.1	-5.7	-5.4
Budget balance (incl. Grants) / GDP (%)	-4.6	-4.5	-4.4	-5.4	-5.9	-5.6	-5.3
General gov. debt / GDP, domestic (%)	20.0	20.1	20.1	21.8	22.1	21.4	20.9
General gov. debt / GDP, foreign (%)	26.6	30.7	35.3	40.6	48.5	51.5	50.4
Balance of Payments							
Exports of goods and services (USD bn)	21.9	21.3	17.4	16.7	17.6	20.6	22.1
Imports of goods and services (USD bn)	-26.2	-26.5	-22.1	-21.1	-22.5	-24.8	-26.6
Trade balance (USD bn)	-4.3	-5.2	-4.7	-4.4	-5.0	-4.2	-4.5
Current account (USD bn)	-3.9	-4.3	-3.8	-3.7	-4.2	-3.4	-3.6
- % of GDP	-8.4	-9.3	-9.0	-9.0	-10.5	-8.3	-8.6
Capital & Financial account (USD bn)	3.0	5.0	4.1	2.9	4.1	3.7	3.9
- FDI (USD bn)	1.0	1.0	1.0	0.7	0.8	0.8	0.8
Basic balance / GDP (%)	-6.2	-7.1	-6.8	-7.4	-8.5	-6.4	-6.6
FX reserves (USD bn) pe	6.8	6.9	6.8	5.7	5.3	5.6	6.0
- Import cover (months) pe	3.1	3.1	3.7	3.2	2.8	2.7	2.7
Sovereign Credit Rating							
S&P	NR	NR	NR	NR	NR	NR	NR
Moody's	Ba3	Ba3	Ba3	Ba3	B1	B1	B1
Fitch	BB-	BB-	BB-	BB-	B+	B+	B+
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.8	4.9	4.9	3.7	5.3	6.9	4.9
Consumer inflation (%) pe	5.7	4.8	4.1	4.2	6.4	5.6	4.7
M3 money supply (% y/y) pa	8.2	7.7	5.0	6.6	8.5	8.5	8.0
M3 money supply (% y/y) pe	6.6	7.8	5.3	8.1	9.0	8.0	8.0
Policy rate (%) pa	4.0	4.6	4.6	4.3	4.8	5.55	5.30
Policy rate (%) pe	4.5	4.75	4.25	4.25	5	5.5	5.25
USD/TND pa	1.63	1.70	1.96	2.15	2.42	2.54	2.66
USD/TND pe	1.65	1.86	2.03	2.30	2.47	2.63	2.72

Source: Banque Centrale de Tunisie; Institut National de la Statistique; Ministère de l'Economie et des Finances; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average; na – not available; nr – not rated

Uganda: joining the 6.0% club

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	4.0	3.2	2.1	2.8	4.1	5.2	7.5	6.4	6.2	5.8	6.1	5.7
CPI (% y/y) pe	6.2	5.9	4.2	5.7	6.4	6.4	5.3	3.3	2.0	2.0	3.2	4.5
M3 (% y/y) pe	10.9	7.1	3.3	11.1	12.6	13.6	12.7	12.8	11.1	11.7	13.9	14.5
FX reserves (USD bn) pe	2.9	3.0	3.0	3.0	3.2	3.4	3.6	3.7	3.6	3.6	3.4	3.5
Import cover (months) pe	5.5	5.6	5.3	5.1	5.2	5.3	5.3	5.1	5.1	5.0	4.9	4.9
3-m rate (%) pe	16.6	15.2	14.2	14.0	10.7	10.4	9.8	8.4	8.7	8.8	9.1	9.4
5-y rate (%) pe	16.9	16.5	16.3	16.9	15.7	15.0	13.7	12.7	12.5	12.7	12.9	13.1
USD/UGX pe	3351	3360	3425	3596	3615	3602	3602	3643	3688	3720	3790	3820

Source: Bank of Uganda; Uganda Bureau of Statistics; Bloomberg; Standard Bank Research
Notes: pe – period end; pa – period average

GDP growth: an impressive recovery

We raise our GDP estimates for 2018 and 2019 to 6.0% y/y and 6.3% y/y respectively due to the impressive quarterly GDP growth published by the Uganda Bureau of Statistics (UBOS) for 2017 even though quarterly GDP numbers tend not to add up to calendar-year data.

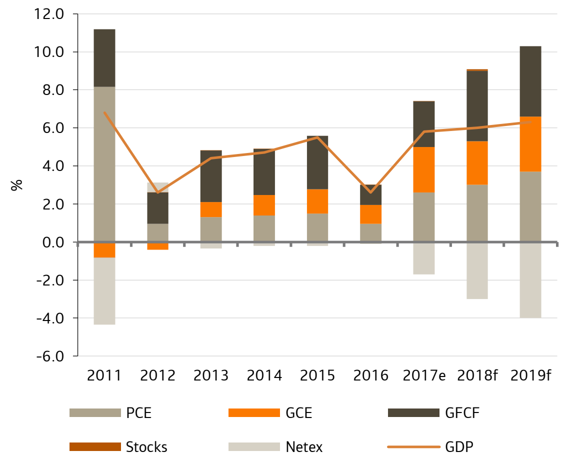
The quarterly GDP data showed that the economy expanded by an average of 7.0% y/y in H2:17, from 5.6% y/y in H1:17 and 2.4% y/y in H2:16. Interestingly, the broad-based recovery was spearheaded by the industrial sector which grew 6.4% y/y in H2:17, from 2.5% y/y in the previous 6-m.

Most of the rebound was likely attributable to increased domestic demand, supported by an accommodative monetary policy stance and better weather conditions for agricultural production. The mining sector too expanded, by a solid average of 18.6% y/y in H2:17, after the 3.0% y/y contraction in the 6-m to Jun 17.

However, the Final Investment Decision (FID) related to the oil and gas sector will probably be made in H1:19, rather than in H2:18, mainly due to delays in finalising production-sharing agreements with the government. Our growth projections are unlikely to be affected materially though, as the infrastructure investments required for commercial oil production are likely commence prior to the FID by the oil and gas firms, which should help spur economic activity.

The agricultural sector in H2:18 poses the usual risks to growth, as this sector could face headwinds due to the excessive rains earlier this year, which could have damaged crops.

Composition of GDP growth by demand



Source: Uganda Bureau of Statistics; Standard Bank Research

GDP contribution (%)

	2008	2010	2014	2016	2017
Agriculture, forestry & fishing	27.1	25.2	22.5	21.1	21.5
Mining & quarrying	1.2	1.2	1.4	1.5	1.5
Manufacturing	8.7	5.6	7.8	7.9	7.6
Construction	5.5	5.6	6.5	6.6	6.5
Trade & repairs	13.3	12.9	11.6	11.0	11.1
Transport & storage	2.6	2.6	2.8	2.8	2.8
Accommodation & food service	2.1	2.2	2.4	2.4	2.5
Information & communication	4.2	6.3	8.3	9.2	10.1
Financial & insurance	2.4	2.4	2.8	2.8	2.8
Real estate activities	5.5	5.2	5.3	5.5	5.4
Public administration	2.8	3.1	3	3.3	3.2
Education	5.3	5.0	5.4	5.7	5.9

Source: Uganda Bureau of Statistics

Balance of payments: C/A deficit to widen

We still expect the C/A deficit to widen, to 6.0% of GDP in 2018, from 4.4% in 2017, and thereafter to 8.1% in 2019.

The government's public investment in infrastructure projects will likely prompt this widening, as import demand is likely to increase. Expenditure on the roads and Kabaale airport around Hoima Bay will probably take centre stage in 2018. However, 2019 may see imports rise further as, in addition to the aforementioned projects, the government plans to kick off the construction of its oil refinery, while developments with the crude oil pipeline to Tanga could also be in an advance stage by then.

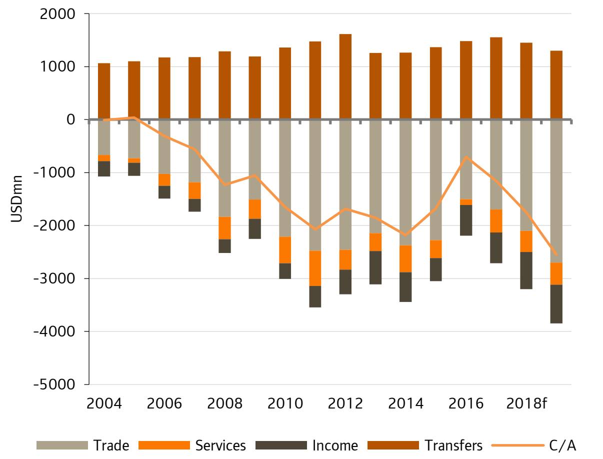
Moreover, due to improving global growth as well the potential for strong demand emanating from the COMESA region, exports are also likely to rise over the medium term. However, import demand will still probably outpace growth in exports, and widen the C/A deficit.

In fact, the sharp rebound in domestic demand conditions over the past 6-m, in addition to a higher oil import bill, will likely continue over the next 2-y, which should result in higher imports.

The increased FDI associated with these oil and gas projects should provide sufficient financing for the C/A deficit in the form of both greenfield investments and other external commercial funding.

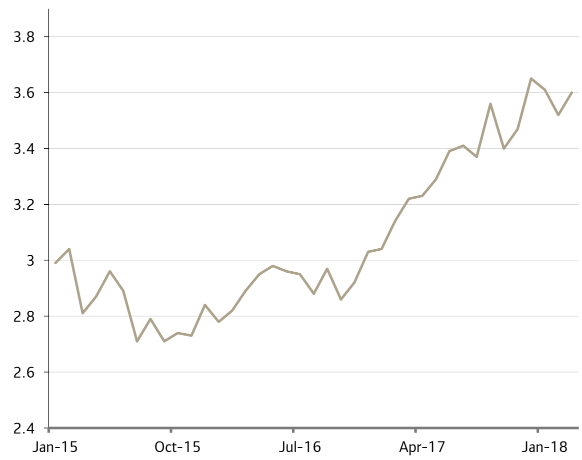
We still see FX reserves at USD3.5bn (equivalent to 4.9 months of import cover) at end-2018, thereafter rising to USD3.8bn (4.7 months) at end-2019.

Current account



Source: Bank of Uganda; Standard Bank Research

FX reserves (USD bn)



Source: Bank of Uganda

FX outlook: UGX weakness as growth recovers

In the Jan edition of this report we expected the USD/UGX to trade at 3750 - 3800 by end-2018. We now expect the pair to trade closer to the top of that range, at 3800-3830, by end 2018, as economic activity and import demand are gaining momentum, as consistently reflected by both the official GDP estimates as well as the Stanbic Bank Purchasing Managers Index (PMI) as regards improving domestic demand conditions. Crucially, while the BOU has not been selling USD to the market, it has sporadically opted to put on hold its USD purchases amidst the recent move higher in USD/UGX. More importantly, the BOU is content with moderate UGX weakness, as long as it's driven by the fundamentals, in this case improving real output. We expect economic output to grow further, and therefore see USD/UGX at 3970 - 4010 by end-2019.

USD/UGX: forwards versus forecasts

Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: expenditure requirements could widen budget deficit

In the supplementary budget submitted to parliament, the fiscal deficit for FY2017/18, excluding grants, was increased to 7.9% of GDP, from 7.2%, mainly due to the total-revenue under-collection.

Total revenue and grants was revised lower to UGX15,979bn, from UGX16,698bn, while total expenditure was slightly higher, at UGX22,351bn, from UGX22,304bn.

Furthermore, this larger deficit will now be financed by higher net domestic borrowing, which was increased to UGX1,690bn, from UGX984.0bn, whereas external financing was broadly unchanged, at UGX4,562bn.

Importantly, the government's planned fiscal deficit excluding grants for FY2018/19 is now lower, at 6.6% of GDP, which seems optimistic, given the government's the infrastructure endeavours, specifically in the oil and gas sector. We wouldn't be surprised if this number was a little higher at the next budget reading in Jun 18.

The increase in the FY2017/18 domestic borrowing target is notable, and to this effect, auction sizes have been increased by UGX35.0 across both government bonds and T-bills. Not surprisingly, T-bill yields have started edging higher, although we doubt that the yield curve will rise aggressively, in comparison to both 2011 or 2015, given the substantial UGX liquidity overhang in the interbank market. We estimate that around UGX2.2tr in repos and term auction deposits is still outstanding.

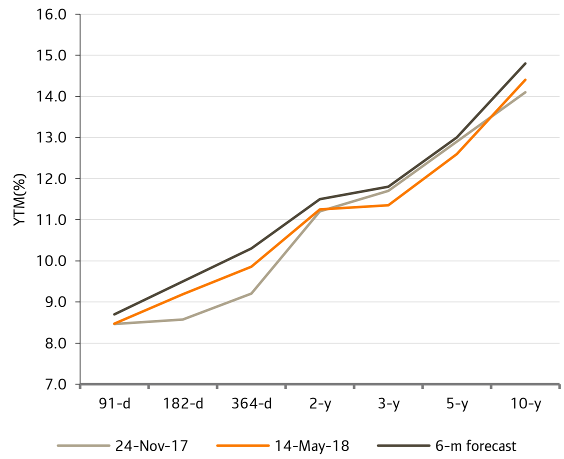
Although UGX duration exposure is tempting, given the steep spread between the mid- and long-end of the curve, we will wait for better re-entry levels.

Central government budget

% of GDP	FY2017/18	FY2018/19
Total revenue (- grants)	14.1	15.0
Total expenditure	22.0	21.6
Wages	3.6	3.8
Interest	2.8	3.5
Development expenditure	11.3	11.4
Overall balance (- grants)	-7.9	-6.6
Overall balance (+ grants)	-6.2	-5.4
Net domestic borrowing	1.4	1.1
Net external borrowing	4.8	4.3
Donor support (grants)	1.7	1.2

Source: Ministry of Finance

Changes in the yield curve



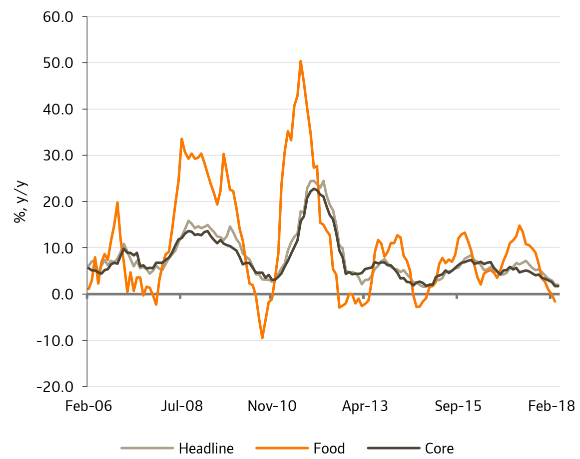
Source: Bank of Uganda; Standard Bank Research

Monetary policy outlook: steady

We expect the MPC to leave its policy rate unchanged at 9.0% this year. The MPC cut the key benchmark rate by 50 bps in Feb due to the slow pick-up in private sector credit (PSC) growth. We see this as the last cut in the easing cycle that begun in Apr 16, as the MPC will probably acknowledge that monetary policy may have run its course, and stimulus from fiscal policy, specifically clearing domestic arrears, could underpin a durable recovery in economic activity.

This is the lowest the CBR has been since the inception of the "inflation-targeting-light" framework in 2011. Core inflation pressures have remained muted, consistent with the trend of monetary aggregates despite the strong recovery in GDP. We see headline inflation bottoming out around May 18 but, by year-end, 5.0% y/y is unlikely to have been breached.

Inflation and interest rates



Source: Uganda Bureau of Statistics

Annual indicators

	2013	2014f	2015f	2016	2017	2018f	2019f
Output							
Population (million)	33.51	34.47	35.49	36.56	37.67	38.82	40.00
Nominal GDP (UGXbn)	66 517	72 351	81 229	86 756	98 770	109 110	120 340
Nominal GDP (USDbn)	25.8	27.6	24.4	25.3	27.3	29.1	31.3
GDP / capita (USD)	769	801	686	691	725	749	782
Real GDP growth (%)	4.7	4.5	5.6	3.0	5.8	6.0	6.3
Coffee production ('000 Tonnes)	209.8	216.5	221.8	226.5	229.7	235.9	242.4
Tea production ('000 Tonnes)	61.5	60.5	50.7	56.6	75.6	78.0	72.1
Central Government Operations							
Budget balance (excl. Grants) / GDP (%)	-4.9	-5.0	-5.4	-8.0	-4.6	-7.9	-6.6
Budget balance (incl. Grants) / GDP (%)	-3.5	-4.0	-4.2	-6.6	-3.5	-6.2	-5.4
Domestic debt / GDP (%)	12.0	13.0	13.1	13.0	13.5	13.9	14.1
External debt / GDP (%)	15.7	18.8	21.4	19.2	19.7	23.5	25.0
Balance Of Payments							
Exports of goods and services (USDbn)	4.93	4.91	4.73	4.79	4.95	4.90	5.00
Imports of goods and services (USDbn)	7.40	7.77	7.33	6.40	7.10	7.35	7.60
Trade balance (USDbn)	-2.47	-2.86	-2.60	-1.61	-2.15	-2.45	-2.60
Current account (USDbn)	-1.85	-2.18	-1.68	-0.70	-1.20	-1.75	-2.55
- % of GDP	-7.2	-7.9	-6.9	-2.8	-4.4	-6.0	-8.1
Financial account (USDbn)	1.36	1.82	0.88	0.99	1.29	1.12	1.20
- FDI (USDbn)	1.14	1.03	0.74	0.63	0.70	1.15	1.30
Basic balance / GDP (%)	-2.8	-4.2	-3.9	-0.3	-1.8	-2.1	-4.0
FX reserves (USDbn) pe	3.1	3.2	2.8	3.0	3.7	3.5	3.8
- Import cover (months) pe	5.1	5.5	5.5	5.2	5.1	4.9	4.7
Sovereign Credit Rating							
S&P	nr	B	B	B	B	B	B
Moody's	B1	B1	B2	B2	B2	B2	B3
Fitch	B	B	B	B	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	5.5	4.3	5.8	5.5	5.4	2.9	5.6
Consumer inflation (%) pe	6.7	1.8	8.7	5.7	3.3	4.5	5.2
M3 money supply (% y/y) pa	11.0	16.9	13.9	8.2	12.9	12.8	16.3
M3 money supply (% y/y) pe	6.0	17.1	11.7	11.1	12.8	14.5	18.5
BOU policy rate (%) pa	11.7	11.2	14.0	14.9	10.5	9.1	9.0
BOU policy rate (%) pe	11.5	11.0	17.0	12.0	9.5	9.0	9.0
3-m rate (%) pe	9.79	11.82	19.50	14.0	8.4	9.4	9.7
1-y rate (%) pe	12.75	13.92	22.30	15.9	9.0	10.5	11.1
2-y rate (%) pe	13.35	14.32	20.10	16.7	11.2	11.8	12.2
5-y rate (%) pe	14.75	14.39	22.30	16.9	12.7	13.1	13.8
USD/UGX pa	2 582	2 636	3 334	3433	3615	3754	3845
USD/UGX pe	2 523	2 766	3 381	3596	3643	3820	3970

Source: Bank of Uganda; Uganda Bureau of Statistics; Ministry of Finance; Bloomberg; Standard Bank Research

Notes: pe – period end ; pa – period average

Zambia: external financing constraints are evident

Quarterly indicators

	Q1:16	Q2:16	Q3:16	Q4:16	Q1:17	Q2:17	Q3:17	Q4:17	Q1:18e	Q2:18f	Q3:18f	Q4:18f
GDP (% y/y) pa	3.3	4.6	3.4	3.8	3.1	3.6	4.5	5.0	3.9	3.7	3.5	3.6
CPI (% y/y) pe	22.2	21.0	18.9	7.5	6.7	6.8	6.6	6.1	7.1	7.8	9.5	9.9
M3 (% y/y) pa	19.9	19.7	-5.0	-5.7	4.2	8.3	13.3	21.4	9.9	7.7	9.5	14.1
CA/GDP (%) pe	-4.0	-3.4	-3.5	-4.6	-4.9	-2.2	-3.7	-2.9	-2.7	-2.1	-1.4	-2.8
FX reserves (USD bn) pe	2.6	2.4	2.3	2.4	2.4	2.4	2.2	2.1	1.8	1.7	1.6	1.7
Import cover (months) pe	4.8	4.4	4.2	4.3	3.6	3.6	3.4	3.2	2.3	2.2	2.1	2.2
3-m rate (%) pe	22.0	21.0	20.5	20.5	14.0	12.4	9.1	9.5	10.4	10.5	11.3	12.0
5-y rate (%) pe	28.5	27.9	25.9	25.0	19.5	19.2	17.7	17.5	17.5	17.2	17.0	16.8
USD/ZMW pe	11.3	10.7	10.0	9.8	9.6	9.3	9.4	10.0	9.7	10.3	10.7	11.4

Source: Bank of Zambia; Central Statistics Office; Bloomberg; Standard Bank Research
Notes: pa – period average; pe – period end

GDP growth: still subdued

We expect GDP growth to remain subdued over the next 2-y, remaining below 4.0% y/y in both years. We expect final consumption expenditure to be restrained.

As it became apparent last year, the government's financing options appear to be constrained by the failure to agree to an IMF program. Attempts to fill that gap with domestic funding risks crowding out the private sector, keeping interest rates elevated. Additionally, it risks exerting significant pressure on net exports.

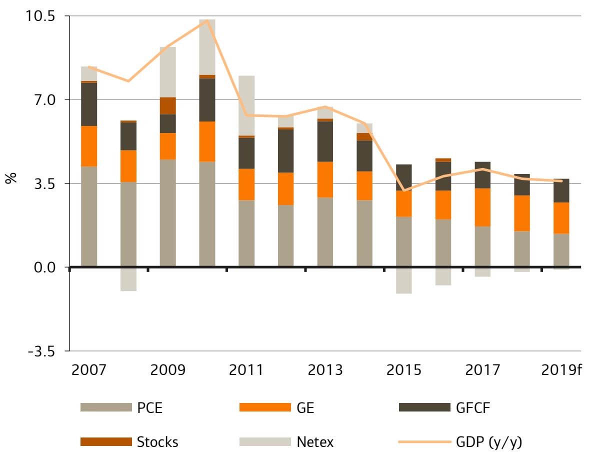
Investment spending will likely remain robust, with the global growth backdrop helping to spur investment in the mining sector. Financing for this will likely be unaffected by the government's borrowing strategy. After all, much of the investment spending in the mining sector will likely continue to be financed by FDI inflows.

After being stuck below 4.0% y/y since 2015, GDP growth accelerated to 4.5% y/y and 5.0% y/y in Q3:17 and Q4:17 respectively. But this seems to be mostly attributable to unwinding base effects associated with a large decline in the output of the information and communication sector.

It looks highly probable that the agricultural sector will continue to grow strongly. The impact of fall armyworms doesn't seem to have been particularly harmful thus far. With rainfall more normal, there is not much downside risk.

Wholesale and retail trade is unlikely to add much to overall GDP growth. The sector has barely managed to grow over the past 2-y. This corroborates the view that private consumption spending is depressed.

Composition of GDP growth by demand



Source: Bank of Zambia; Standard Bank Research

Contribution to GDP by sector

% of GDP	2015	2017
Agriculture, forestry and fishing	7.3	8.2
Mining and quarrying	10.3	10.4
Manufacturing	8.1	8.0
Construction	10.3	11.0
Wholesale and retail trade	22.8	21.3
Transportation and storage	3.4	3.4
Information and communication	3.5	3.3
Financial and insurance activities	3.9	3.5
Real estate activities	3.4	3.4
Public administration and defense	5.0	5.2
Education	7.4	7.7

Source: Central Statistics Office

Balance of payments: deteriorating

Policy action is required to arrest the deterioration of the BOP. Despite the assistance of a ramp-up in copper production and higher copper prices, FX reserves have continued to decline over the past 2-y. In the absence of fiscal policy tightening, it seems highly probable that FX reserves will decline further.

Our forecast that FX reserves will end this year around USD1.7bn might turn out to be optimistic. FX reserves amounted to USD1.8bn in Mar. In part our forecast is predicated on the expectation that economic growth will subside this year, thus dampening import growth.

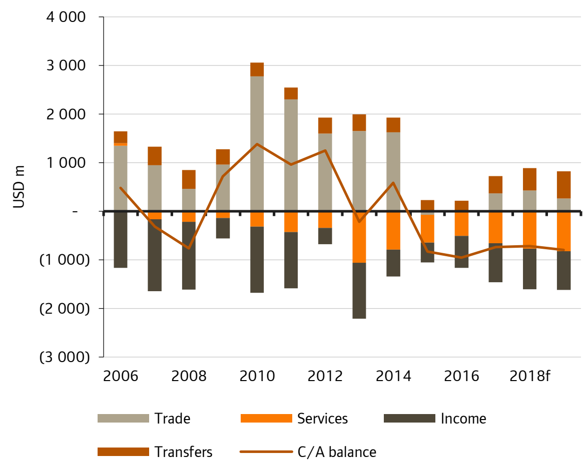
However, we admit that the risk of there being a sharp fall in FX reserves is elevated. After all, the holdings of local currency bonds by foreigners amounted to ZMW8.7bn (roughly USD870m) in Mar. Accounting for over 45% of FX reserves, if something were to trigger investors to sell down their holdings, there could be a run on FX reserves.

Net income outflows are likely to remain elevated, as will the services deficit likely persist over the course of the next 2-y.

The recovery in copper exports was not enough to turn the C/A deficit into surplus in 2017. We expect that the deficit will persist over the next 2-y. Goods imports are likely to remain elevated, with the trade surplus too small to overwhelm the services deficit and net income outflows.

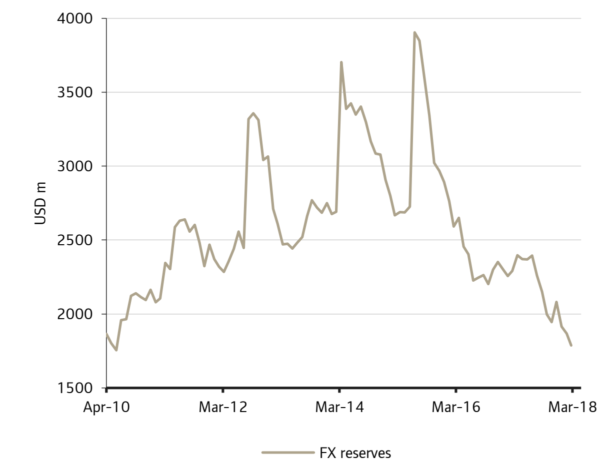
It seems reasonable to believe that the factors bolstering import demand have to do with strong government expenditure rather than private sector spending. Granted, FDI inflows have been strong, with capital goods imports partly accounted by private investment spending. But credit to the private sector is still constrained, with a dramatic increase in government borrowing.

Current account developments



Source: Bank of Zambia; Standard Bank Research

FX reserves

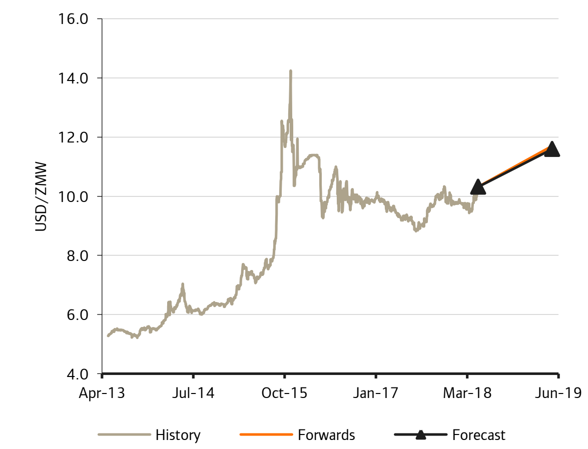


Source: Bank of Zambia; International Monetary Fund

FX outlook: USD/ZMW biased to the upside

USD/ZMW will probably head higher over the course of the year. We expect the pair to climb over 11.0 in the next 12-m. There are probably some portfolio investors that bought ZMW bonds in anticipation of the government coming to an agreement with the IMF on addressing fiscal concerns. There is more than the equivalent of USD870m in holdings of ZMW bonds by foreigners, meaning that they account for more than 45% of FX reserves. Irrespective, the BOZ occasionally withdraws liquidity from the market. Hence, whenever mining companies sell USD to satisfy their ZMW cash flow needs, it tends to reverse the upward pressure on USD/ZMW. But if there were to be a surge in USD demand, which could be occasioned by portfolio outflows or a resurgence of import demand, then there is a strong likelihood that USD/ZMW would rise pretty fast. That is the risk to our view, with the pair rising faster than we anticipate.

USD/ZMW: forwards versus forecasts



Source: Bloomberg; Standard Bank Research

Fiscal policy and bond outlook: binding external financing constraints

Despite eloquently making the case for a funded IMF program, it increasingly looks like there will not be any agreement for such a program. Certainly the IMF was adamant last year, upon being approached by the government, that it was concerned about the government's medium-term financing needs. In effect, it advised the government to reduce the fiscal deficit and the pace of debt accumulation.

Together with the World Bank, the IMF conducted a Debt Sustainability Analysis last year. The results of this analysis show that the government's debt is at high risk of distress.

All indications are that the government is not prepared to cut spending. The government has been similarly steadfast in its communication that it seeks the IMF's acquiescence to a financing of the government's Economic Stabilisation and Growth Programme.

Has this stand-off affected budget execution? It is worth noting some differences between the budgeted figures for 2017 and the preliminary outcome. Noteworthy is that the overall fiscal deficit was nearly 2 percentage points lower than budgeted. Much of the reduction in spending seems to have been necessitated by the government's inability to obtain external sources of financing, with programme loans 84% lower than budgeted and project loans 51.6% lower than budgeted. This difficulty in obtaining this financing may be a direct consequence of the failure of the government to secure a funded program with the IMF.

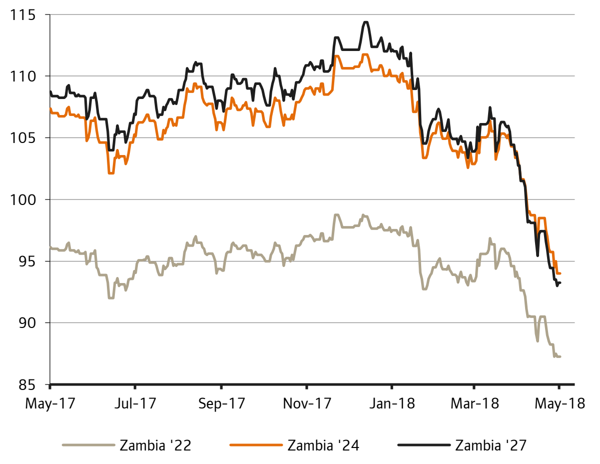
Even though the government boosted domestic borrowing, in what appears to have been an attempt to make up for the disappointing external financing, there were still some cuts in spending. Capital expenditure, for example, was 26.1% lower than budgeted.

Central government budget

% of GDP	2017	2018
Total revenue and grants	18.3	18.8
Total expenditure	26.2	26.2
- Interest	4.7	5.2
Overall balance (+ grants)	-7.8	-7.3
Net domestic borrowing	1.6	4.1
Net external borrowing	6.3	3.3
Donor support (grants)	0.9	0.9

Source: Ministry of Finance and National Planning

Eurobond prices - mid

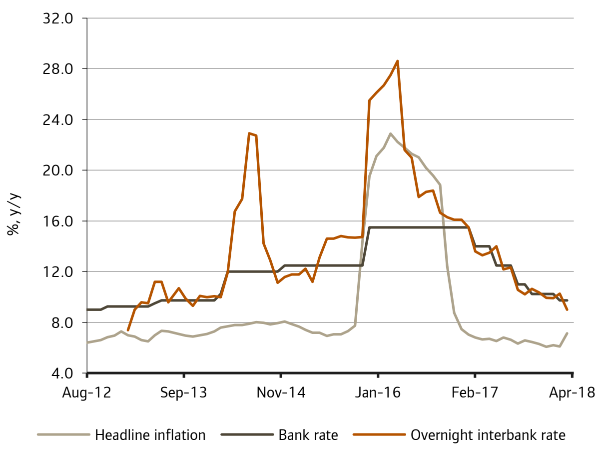


Source: Bloomberg

Monetary policy outlook: neutral stance

The BOZ's MPC will likely keep the policy rate unchanged for much of this year. Inflation will likely keep heading higher, but remain in single digits for most of the next 2-y. We expect it to end the year at 9.9% y/y before reversing course in 2019 to 6.7% y/y at the end of that year. There has been a noticeable acceleration in inflation recently, taking it to 7.4% y/y in Apr, from an average of 6.5% y/y in the 12-m to Feb. The headline CPI accelerated to an average pace of growth of 1.0% m/m in the last 6-m, compared with 0.2% m/m in the previous 6-m. The food and non-alcoholic beverages sub-index, accelerating to a 1.1% m/m pace of growth in the last 6-m, after being essentially stable in the prior 6-m, was the primary cause for this spurt. We are still not convinced that the spurt in the headline CPI will be sustained. Nonetheless, the acceleration of the food sub-index bears watching, since it poses upside risks to headline inflation.

Inflation and interest rates



Source: Bank of Zambia; Central Statistics Office

Annual indicators

	2013	2014	2015	2016	2017	2018f	2019f
Output							
Population (million)	14.6	15.0	15.6	16.0	16.4	16.9	17.5
Nominal GDP (ZMW m)	144 722	166 533	183 381	223 703	247 415	275 126	303 188
Nominal GDP (USD bn)	26.8	26.9	19.2	21.5	25.6	26.1	26.7
GDP / capita (USD)	1 838	1 789	1 235	1 341	1 575	1 550	1 533
Real GDP growth (%)	6.7	6.0	3.2	3.3	4.1	3.7	3.6
Copper production ('000 tons)	830	708	711	775	755	830	850
Central Government Operations							
Budget balance / GDP (%)	-5.6	-5.7	-9.3	-8.8	-7.8	-7.3	-5.8
Domestic debt / GDP (%)	13.6	14.1	13.6	16.1	14.4	16.7	16.5
External debt / GDP (%)	13.1	17.8	33.3	34.3	31.7	33.2	33.9
Balance Of Payments							
Exports (USD bn)	10.8	10.2	7.4	6.5	8.2	9.7	11.1
Imports (USD bn)	9.2	8.6	7.4	6.5	7.9	9.2	10.8
Trade balance (USD bn)	1.6	1.6	-0.1	0.0	0.4	0.4	0.3
Current account (USD bn)	-0.2	0.6	-0.8	-1.0	-0.7	-0.7	-0.8
- % of GDP	-0.8	2.2	-4.3	-4.5	-2.9	-2.8	-3.0
Capital and Financial account (USD bn)	-0.3	-0.5	0.4	0.8	0.8	0.2	0.6
- FDI (USD bn)	1.7	3.2	1.2	0.5	0.9	0.8	0.7
Basic balance / GDP (%)	5.5	14.1	1.8	-2.2	0.6	0.1	-0.3
FX reserves (USD bn) pe	2.7	3.1	3.0	2.4	2.1	1.7	1.5
- Import cover (months) pe	3.5	4.3	4.8	4.3	3.2	2.2	1.7
Sovereign Credit Rating							
S&P	B+	B+	B	B	B	B	B
Moody's	B1	B1	B2	B3	B3	B3	B3
Fitch	B	B	B	B	B	B	B
Monetary & Financial Indicators							
Consumer inflation (%) pa	7.0	7.8	10.0	18.2	6.5	7.5	6.6
Consumer inflation (%) pe	7.1	7.9	21.1	7.5	6.1	7.2	6.1
M3 money supply (% y/y) pa	17.0	19.6	22.0	7.2	7.8	12.0	13.6
M3 money supply (% y/y) pe	12.7	12.6	35.2	-5.7	21.4	14.1	13.2
Policy interest rate (%) pa	9.50	11.13	13.00	15.50	12.31	9.79	9.80
Policy interest rate (%) pe	9.75	12.50	15.50	15.50	10.25	9.75	9.75
3-m rate (%) pe	8.0	13.0	15.0	16.8	9.5	12.0	12.0
1-y rate (%) pe	15.8	20.4	21.5	18.4	14.2	18.0	18.5
3-y rate (%) pe	15.5	16.2	23.5	21.2	18.0	18.3	18.8
5-y rate (%) pe	16.5	22.4	28.0	25.7	18.0	18.8	19.3
USD/ZMW pa	5.4	6.2	9.6	10.5	9.6	10.5	11.3
USD/ZMW pe	5.6	6.4	11.0	9.8	10.0	11.4	12.5

Source: Bank of Zambia; Central Statistics Office; Bloomberg; Standard Bank Research; Ministry of Finance and National Planning
Notes: pa – period average; pe – period end

Glossary

For brevity, we frequently use acronyms that refer to specific institutions or economic concepts. For reference, below we spell out these and provide de

14-d	14-day, as in 14-d deposit, which denotes 14 day deposit
10-y	10-year
16 Jan 13	16 January 2013
3-m	3 months
3m	3 million, as in USD3m, which denotes 3 million US dollars
3bn	3 billion, as in UGX3bn, which denotes 3 billion Ugandan shillings
3tr	3 trillion, as in TZS3.0tr, which denotes 3 trillion Tanzanian shillings
AOA	Angola Kwanza
BAM	Bank Al Maghrib
BCC	Banque Central du Congo (Central Bank of Congo)
BCEAO	Banque Central des États de L'Afrique de l'Ouest (Central Bank of West African States)
BCT	Banque Central de Tunisie
BM	Banco de Moçambique
BNA	Banco Nacional de Angola
BOB	Bank of Botswana
BOG	Bank of Ghana
BOM	Bank of Mauritius
BON	Bank of Namibia
BOP	Balance of payments – a summary position of a country's financial transactions with the rest of the world. It encompasses all international transactions in goods, services, income, transfers, financial claims and liabilities.
BOT	Bank of Tanzania
BOU	Bank of Uganda
BOZ	Bank of Zambia
BR	Bank Rate (Reserve Bank of Malawi)
BRVM	Bourse Régionale des Valeurs Mobilières (Regional Securities Exchange)
BWP	Botswana Pula

C/A	Current account balance. This is the sum of the visible trade balance and the net invisible balance of a country. The latter includes net service, income and transfer payments.
Capital account	Captures the net change in investment and asset ownership for a nation by netting out a country's inflow and outflow of public and private international investment.
CBE	Central Bank of Egypt
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CDF	Congolese Franc
CPI	Consumer Price Index – An index that captures the average price of a basket of goods and services representative of the consumption expenditure of households within an economy.
Discount rate	Policy rate for Bank of Uganda
Disinflation	A decline in the rate of inflation. Here prices are still rising but with a slower momentum.
Disposable income	After tax income
DM	Developed markets
ECB	European Central Bank
EGP	Egyptian pound
EM	Emerging markets
ETB	Ethiopian Birr
Eurobond	A bond denominated in a currency other than the home currency of the issuer.
Exports	The monetary value of all goods and services produced in a country but consumed broad.
FMDQ	FMDQ OTC Securities Exchange, Nigeria
FX	Foreign Exchange
FY2016/17	2016/17 fiscal year
GCE	Government Consumption Expenditure - Government outlays on goods and services that are used for the direct satisfaction of the needs of individuals or groups within the community. This would normally include all non-capital government spending.
GDE	Gross domestic expenditure, the market value of all goods and services consumed in a country – both private and public – including imports but excluding exports. This is measured over a period of time – usually a quarter/year.
GFCF	Gross Fixed Capital Formation – this is investment spending, the addition to capital stock such as equipment, transportation assets, electricity infrastructure, etc to replace the existing stock of productive capital that is used in the production of goods and services in a given period of time, usually a year/quarter. Normally, the higher the rate of capital, the faster an economy can grow.
GDP	Gross Domestic Product – the monetary value of all finished goods and services produced in a country in a

	specific period, usually a year/quarter.
GHS	Ghanaian Cedi
H1:16	First half of 2016
Imports	The monetary value of goods and services produced abroad and consumed locally.
Inflation	The rate at which the general level of prices of goods and services are rising. It is usually measured as the percentage change in the consumer price index over a specific period, usually a month/year.
Invisible trade balance	The value of exports of services, income and transfers, less imports of same.
Jan 16	January 2016
KBRR	Kenya Bankers' Reference Rate
KES	Kenya Shilling
KR	Key Rate (Bank Al Maghrib)
KRR	Key Repo Rate
m/m	Month on month, in reference to a rate of change
MAD	Moroccan Dirham
MLF	Marginal Lending Facility
MOF	Ministry of Finance
MPC	Monetary Policy Committee, the committee that makes the decision on policy rates
MPR	Monetary Policy Rate
MUR	Mauritian Rupee
MWK	Malawian Kwacha
MZN	Mozambican Metical
NAD	Namibian Dollar
NBE	National Bank of Ethiopia
NBR	National Bank of Rwanda
NEER	Nominal Effective Exchange Rate. This is the weighted average rate at which a country's currency exchanges for a basket of currencies, usually trading partner currencies. It is measured in index format.
NGN	Nigerian Naira
Nominal GDP	The monetary value of all finished goods and services produced in a country in a specific period, usually a year/quarter, measured in current prices.
NPL	Non-Performing Loans
Parity	Refers to the par or nominal value of a debt instrument. This is usually the price at which the said instrument

	is redeemed on maturity.
PCE or HCE	Personal or Household Consumption Expenditure: The monetary value of household purchases of durable goods, non-durable goods, semi durables and services within a given period of time, usually a year/quarter.
PR	Policy Rate
Prime rate	key lending rate
q/q	quarter on quarter, in reference to a rate of change
Q1:16	First quarter of 2016
RBM	Reserve Bank of Malawi
Real GDP	The monetary value of all finished goods and services produced in a country in a specific period, usually a year/quarter, measured in constant prices.
REER	Real Effective Exchange Rate. This is the weighted average rate at which a country's currency exchanges for a basket of currencies - usually trading partner currencies – while taking into account any changes in relative prices between the host country and its trading partners. It is often measured in index format.
RWF	Rwandan Frank
SARB	South African Reserve Bank
SDF	Standing Deposit Facility (Mozambique)
SLF	Standing Lending Facility (Mozambique)
T-bill	Treasury bill – A short-dated, government backed security that yields no interest but is issued at a discount over a period of less than one year.
TND	Tunisian Dinar
Treasury bond	A marketable government debt security with a maturity of a year or longer
TZS	Tanzanian Shilling
UGX	Uganda Shilling
USD	US Dollar
VAT	Value Added Tax
Visible trade balance	The value of exports of visible goods less imports.
WAEMU	West African Economic and Monetary Union, also known as Union Economique et Monetaire Ouest Africaine (UEMOA)
XAF	Central African Franc
XOF	West African Franc
y/y	Year on year, in reference to a rate of change
Yield	The return on an investment, usually expressed as a percentage over a period of time, usually a year.

YTD	Year to date
ZAR	South African Rand
ZMW	Zambian Kwacha

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