African Re-awakening

JANUARY 2018

After a difficult period, we believe the outlook for African economies and stockmarkets has turned positive. In 2017 we highlighted a number of developments that would make African markets more attractive, and pleasingly many of these have come to pass. Commodity markets have gone up, Nigeria has opened up its exchange rate, Egypt has continued on its reform path, Kenyan elections passed without significant unrest, and, most recently the "right" candidate won the ANC leadership contest in South Africa. As global growth reaches its highest level for many years, we look at Africa in 2018 with optimism.

South Africa

South Africa is the dominant economy and stockmarket in Africa. It is home to the continent's leading businesses, many of which provide a gateway to the rest of Africa through their cross-border investments. The last two years have been turbulent as the extent of corruption at the heart of government was exposed. Economic growth stagnated, the currency collapsed, and business and consumer confidence evaporated. The December ANC conference was presented as a last chance for the party of Mandela to reclaim its moral authority, a straight choice between good and bad, hope and despair.

While this portrayal was always overly simplistic, one cannot underestimate the importance the markets placed on the outcome, and therefore it was a tremendous relief that Cyril Ramaphosa, the market-friendly candidate, emerged victorious. The rand, the bond and domestic stockmarkets have all enjoyed a relief rally, which we believe could lead to something much more sustainable. Some economists have already estimated the "Ramaphosa factor" could add 1% to annual GDP growth rates over the next five years. He has promised to clamp down on corruption, and a clear signal will be how the party deals with Jacob Zuma (still the President of the Republic, but under huge pressure). Speculation is rife that Zuma will be out of a job imminently, but irrespective of timing, if he is forced out before the end of his term in 2019, this would be taken as a major positive and evidence of Ramaphosa's ability to renew the party.

Business investment in South Africa has been low for several years; increased confidence would lead to investment, and much needed job creation. With inflation under control, there is every likelihood that interest rates will be reduced to encourage such investment and stimulate growth. A combination of a lower cost of equity and stronger growth, in a stockmarket that has been under-owned, should drive sustainable performance.

Egypt

For evidence of how quickly markets can react to increased business confidence and improved investor sentiment, one need only look at Egypt. In 2017 the EGX100 index returned 80% in US dollar terms. We believe this is just the beginning, and believe the reform path that the country is on will enable Egypt to finally start to deliver on its potential.

Since the Arab Spring of 2011, Egypt's growth has been below trend, and there has been a paucity of business investment. Everything changed with the devaluation of the Egyptian pound in November 2016, which, although long overdue, went far beyond market expectations. Together with high interest rates, this has provided an attractive carry trade for bond investors for the past year. Positive momentum continued with the very brave decision taken by President Sisi's regime to reduce the subsidy bill, leading to increased energy and fuel prices. Although this led to higher inflation for longer, it addressed a major distortion in fiscal policy, and is an encouraging signal that Sisi is prepared to use his political capital to take tough decisions for the benefit of the macroeconomy.

Business confidence has been high in Egypt for the past year, and while credit growth has been strong, this has been predominantly driven by working capital. Banks have been happy making money investing in T-bills. As interest rates come down over the course of 2018, we expect credit growth to be driven by longer-term investments, the sort that can boost GDP growth and jobs for years to come. Egypt's young, vibrant population needs this. We are optimistic that 2018 will see a strengthening of the EGP and high stockmarket returns, with a number of new offerings adding to excitement in the market.

Nigeria

Where Egypt has led, we are hopeful that Nigeria will follow. The creation of the NAFEX exchange rate regime allowed the naira to find a level for willing buyers and sellers, and with high interest rates bond investors again played the carry trade. FX Reserves are now back up to about USD40bn, providing ample cushion over imports, and with oil having made rapid recent gains, the Nigerian macro picture is looking the best it has for several years.

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Challenges undoubtedly remain – while the economy is growing again, consumer spending remains under pressure, and with President Buhari having spent much of the past year indisposed in UK hospitals, his ability to stand for re-election in 2019 will cause uncertainty. We expect the country to continue on its path to increasing self-sufficiency and diversification, reducing its dependence on oil, but at the same time the higher oil price will undoubtedly support the stockmarket. Banks are already talking of previously non-performing loans being serviced again, which if sustained will lead to higher earnings, increased dividends, and better capital ratios. In the run up to elections, there is a high probability of increased government related capex, closing some of the country's huge infrastructure deficit.

Kenya

The main event in Kenya in 2017 was the presidential election, and our hope was that it would pass peacefully, which it largely did. In fact we saw a new level of political maturity at this election, with the opposition candidate Raila Odinga challenging the election result, and the courts agreeing with him, demanding that the election be re-run. This is unprecedented in Africa, and although somewhat diminished by Odinga deciding not to stand in the re-run election, demonstrates the strength of democracy in that country. With election uncertainty out of the way we expect growth to rebound this year, with potential upside if the government revises its interest rate capping policy, implemented at some cost to the economy and the banking sector in 2016.

Zimbabwe and Angola

In recent months there have been positive developments from Zimbabwe and Angola, with long-standing Presidents removed or retiring from office. While we wait and see whether President Mnangagwa will capitalise on huge international goodwill for Zimbabwe by taking tough decisions, in Angola President Lourenco has already made quite an impact, devaluing the currency and firing his predecessor's children from their respective positions at the summit of the state oil company and the sovereign wealth fund. The message is clear – the new regime will do things differently and is not afraid to go after those who have corruptly benefitted in the past. While the fund does not have direct investments in these markets, South African holdings have operations there, and irrespective, these are further positive developments for the wider African continent.

To conclude, there are considerable grounds for optimism around African economies in the year ahead. With valuations undemanding in most markets, and the assets under-owned, we believe investors will make good returns.

Sharat Dua, CFA
Vice-President and Portfolio Manager,
Lead Portfolio Manager of the Magna Africa Fund

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Address: 39 St James's Street, London SW1A 1JD

Tel: + 44 (0)20 7518 2100
Fax: + 44 (0)20 7518 2199

Email: marketingeurope@fieracapital.com
Website: www.uk.fieracapital.com