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AFRICA SOVEREIGN CREDIT RATING REVIEW

2023 Mid-Year Outlook

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**Africa Peer Review Mechanism
Continental Secretariat**
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in Collaboration with the
**United Nations Economic
Commission for Africa (UNECA)**

ABOUT THIS REPORT

This report analyses the long-term foreign currency sovereign credit rating actions in Africa by the three dominant international credit rating agencies (CRAs) – Moody's Investors Service, Fitch Ratings and S&P Global (S&P) – during the first half of 2023 (2023H1) and makes recommendations to both CRAs and African governments on how credit ratings can be improved..

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1 INTRODUCTION

The trend of sovereign credit ratings in Africa continues on the downward spiral, with five African economies being downgraded in the 2023H1. This trend, however, does not reflect the optimism of economic recovery projected by the African Development Bank (AfDB)¹ in its 2023 Macroeconomic Performance and Outlook report. The 2023H1 period has also witnessed a few contested rating actions. Nigeria and Kenya rejected their ratings citing lack of understanding of the domestic environment by the rating agencies, a premise that has been repeatedly cited by African countries as a serious deficit.

In addition, African policymakers increasingly register their dissatisfaction with the lack of response on the call to reform the approaches and methodologies of the 'Big Three' global rating agencies in assessing risk on the continent – which, in their view, is a key component in reforming the Global Financial Architecture. Addressing the 30th Africa Export-Import Bank (Afreximbank) annual general meetings, President Nana Akufo-Addo of Ghana – who is also the Champion of African Financial Institutions – criticised rating

¹ <https://qz.com/africa-will-outperform-the-world-in-economic-growth-af-1850039139>

agencies for exacerbating fiscal challenges in developing countries with unwarranted rating downgrades that shut government out of the capital markets, *'turning liquidity crises into solvency crises'*.

These concerns have led to calls by the African Union to examine the feasibility of establishing an African Credit Rating Agency (ACRA) as an independent entity of the Union to provide alternative credit ratings to the 'big three'. It is envisaged that the ACRA would provide balanced and comprehensive opinions on African credit instruments to support affordable access to capital and the development of domestic financial markets. Other entities globally such as the United States (US) Securities and Exchange Commission are also readjusting their positions in response to the continuing failures of the 'big three' rating agencies. The US Securities and Exchange Commission adopted rules² amending

² <https://www.federalregister.gov/documents/2023/06/20/2023-12591/removal-of-references-to-credit-ratings-from-regulation-m>

Regulation M on credit rating agencies to remove any references to credit ratings and replacing them with alternative measures of creditworthiness. This amendment is aimed at reducing reliance and references to credit ratings in regulations.

Moody's, Fitch and S&P continue to make significant errors in their ratings, yet they continue to influence global financing decisions and flow of capital. Similar to events during the subprime mortgage crisis fifteen years ago, the 'big three' failed³ yet again to correctly assess the intrinsic value of the US Silicon Valley Bank and its ability to meet obligations. Rather than flagging the financial risks associated with the bank, the rating agencies maintained the bank's A-rating until its collapse on 10 March 2023, despite signals showing a sharp increase in credit risk.

³ <https://www.wsj.com/articles/silicon-valley-banks-distress-wasnt-reflected-in-credit-ratings-93cd9dff>



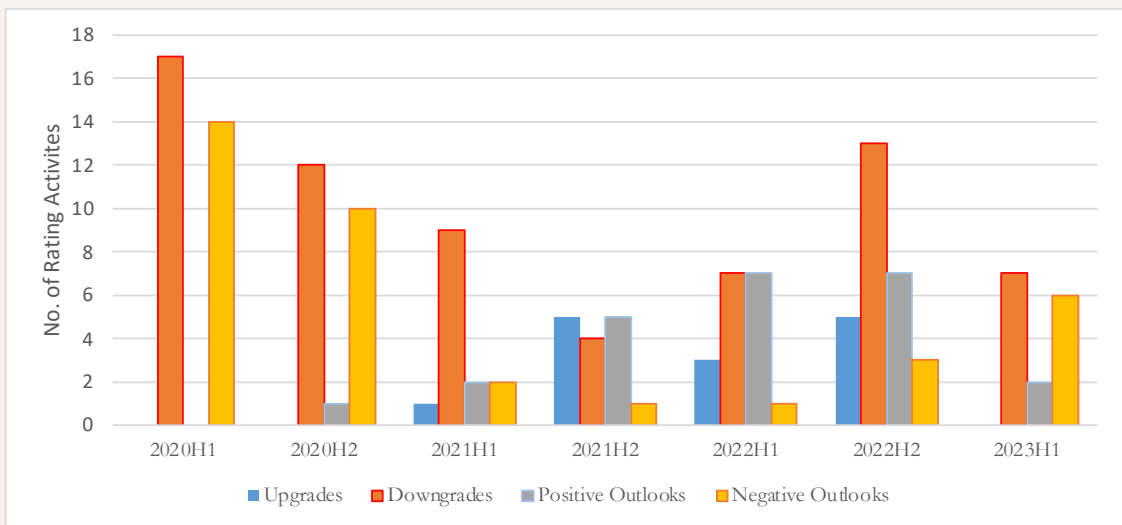
2 GENERAL RATING OUTLOOK

Unlike in the first half of 2022 (2022H2), rating actions in 2023H1 were predominantly negative, with no single African country being upgraded during the period. A total of thirteen negative rating actions – seven downgrades and six negative changes in outlooks – were assigned to eleven countries. This trend has raised questions about why Africa’s credit ratings are not reflective of the current global ‘economic recovery phase’. These developments have reversed the optimism amongst investors on the international financial markets that African countries are recovering

from the devastating Covid-19 economic shocks.

The Federal Government of Nigeria disagreed with the Moody’s Investors Service over its downgrade of the country’s credit rating on the basis that the government was already addressing the ratings agency’s concerns. In the view of the Federal Government of Nigeria, by proceeding to downgrade the government’s rating after rigorous engagements on all the efforts the government has undertaken to stabilise the economy, confirms that

Figure 1: Sovereign credit rating actions 2020-2023



Source: APRM Primary Data Monitoring, 2023

the rating agency lacks the full appreciation of the country's domestic environment in the context of the international political economy. This view could have been affirmed by the other rating agencies that maintained Nigeria's rating unchanged on the basis that the downside factors are likely to be partially counterbalanced by the new and more business-friendly political administration. Also, by end of 2023H1, the rating agency's projection that interest payments to general government revenue and general government debt-to-GDP over the short-term will rise by 50% and 45%, respectively, were incorrect. Instead, tax revenue to GDP has almost doubled to its highest level in seven years.

The Government of Kenya also disputed Moody's rating downgrade on the basis of increase in government liquidity risks and deteriorating domestic funding conditions, arguing that its liquidity market is gaining stability. These conclusions were supported by the International Monetary Fund (IMF)⁴ which expressed confidence that Kenya's debt is sustainable and the chances of defaulting on its debt were near zero. The IMF added that the Government of Kenya is moving swiftly to improve its fiscal position. The government's view could have also been affirmed by yields on all Kenyan Eurobonds⁵ that defied Moody's downgrade, taking a steady downward trajectory, with rates easing between 1.1% and 5.5% points in just two weeks following the rating downgrade.

4 <https://www.bloomberg.com/news/articles/2023-05-05/imf-chief-calls-kenya-innocent-bystander-in-world-s-debt-shock#x-j4y7vzkg>

5 <http://www.worldgovernmentbonds.com/country/kenya/>



Table 1: Summary of sovereign credit rating actions (Jan – Jun 2023)

Country	Moody's		S&P		Fitch	
	Previous	Current	Previous	Current	Previous	Current
Credit Rating downgrades						
Kenya	B2 (Neg)	B3 (UR)				
Egypt	B2 (Neg)	B3 (Stable)			B+ (Neg)	B (Neg)
Nigeria	B3 (Stable)	Caa1 (Stable)				
Tunisia	Caa1 (Neg)	Caa2 (Neg)			CCC+	CCC-
Ghana					C	RD
Total		4		0		3
Positive changes in Credit Rating Outlooks						
Rwanda			B+ (Neg)	B+ (Stable)		
Cape Verde					B- (Stable)	B- (Pos)
Total		-		1		1
Negative changes in Credit Rating Outlooks						
Uganda					B+ (Stable)	B+ (Neg)
Kenya			B (Stable)	B (Neg)		
Egypt			B (Stable)	B (Neg)		
Togo	B3 (Stable)	B3 (Neg)				
Nigeria			B- (Stable)	B- (Neg)		
South Africa			BB- (Pos)	BB- (Stable)		
Total		1		4		1

Source: APRM Primary Data Monitoring, 2023

3 CONTINENTAL KEY RATING DRIVERS

According to the 'big three' CRAs, the rating downgrades and negative changes in outlook witnessed in the 2023H1 were mainly driven by the following key risk factors. First, the increasing government financing needs, which is expected to remain high in the near term. Second, the increasing financing pressures from the upcoming '2024 wall of Eurobond maturities' combined with poorly structured terms of international bonds, especially those issued during the Covid-19 pandemic period, with very short tenors and high coupons. Third, weakening external liquidity position due to an unfavourable foreign exchange trajectory

and reduced external liquidity buffers, risking countries' ability to finance their external requirements. Fourth, debt service cost remains the fastest growing budget expenditure item, taking up to more than half of governments' fiscal revenue. Fifth, yields on the Eurobond financial markets, which had become an important financing option for African governments, have gone beyond the 9% mark, making them unsustainable and closing governments out of international financial markets. Lastly, failing to make coupon payments due on outstanding Eurobonds.

4 PROJECTED OUTLOOK IN 2023H2

There have been some significant improvements in the macroeconomic environment in a number of countries in the 2023H1, hence we project some positive rating developments in the following countries during the second half of 2023 (2023H2). First, we expect Zambia to come out of default driven by stronger economic recovery and growth following the country's breakthrough agreement on debt treatment with official creditors. Zambia reached an agreement with its creditors to restructure US\$6.3 billion of its debt on the margins of the Paris Pact Summit to reschedule its debt to over more than 20 years with a three-year grace period during which only interest will be paid.

Second, Ethiopia is projected to receive a positive change in outlook because the country has consolidated its peace deal after the Tigrayan People's Liberation Front (TPLF)

fighters handed over heavy weapons to the Federal Government, ending the country's civil war. The People's Republic of China also agreed to cancel some of its bilateral debt, extending a boost to Ethiopian recovering economy. Lastly, Cote d'Ivoire will likely be upgraded based on significant improvement in the fiscal and debt metrics more than projected by the rating agencies in 2022. This also reflects improvements in the country's economic shock absorption capacity, institutional strength and governance. Cote d'Ivoire is also amongst the five African countries back in the league of the world's 10 fastest-growing economies in 2023/24, with an estimated growth rate of 6.2%, together with Senegal (8.3%), Democratic Republic of Congo (6.3%), Rwanda (6.2%) and Ethiopia (6.1%), which we also expect to receive positive rating actions in 2023H2.

5 AFRICAN SOVEREIGN DEBT MARKET

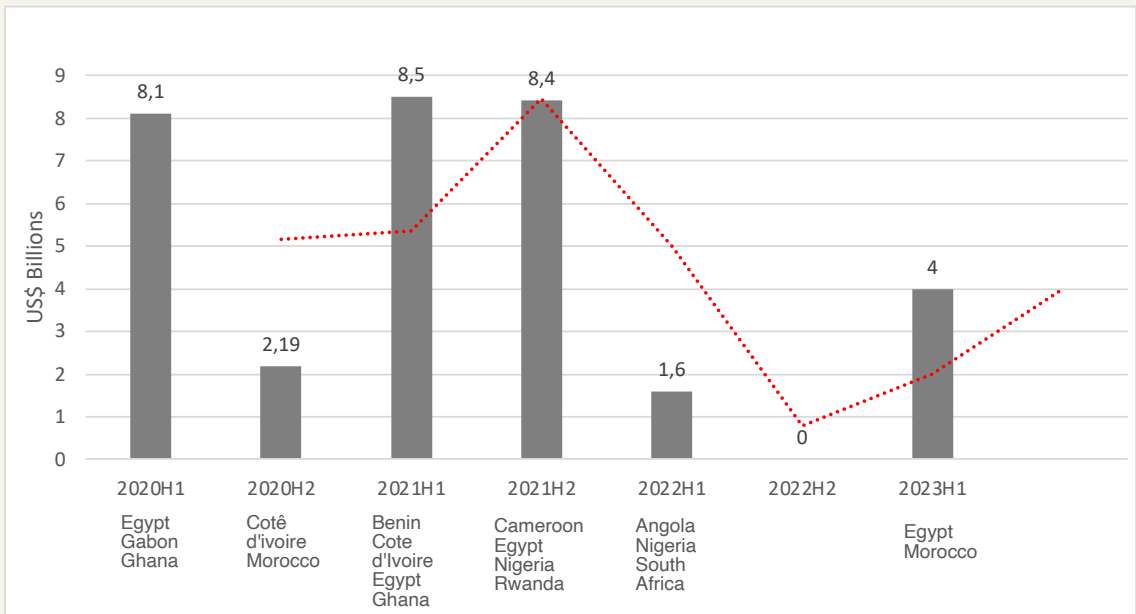
Unlike in the 2022H2, when there was no single issuance of sovereign bonds, the 2023H1 witnessed two bond issuances from Egypt and Morocco, who issued a combined US\$4 billion. Egypt, which now has the highest sovereign bond value outstanding in Africa at US\$37.5 billion, was downgraded by Moody's and Fitch, pushing its borrowing cost high, to issue the Sukuk bond at over 10%. Due to the significantly elevated government debt stock, this was Egypt's most expensive issuance in history and its yields on outstanding coupons remains elevated, averaging 14.5%.

Amongst the few countries that have gone back to the financial markets to issue bonds more than once since 2020H1 when the Covid-19 pandemic emerged in Africa, Egypt is the only country that has done so 4 times, raising a total of US\$14.8 billion in three and a half years. Cote d'Ivoire, Ghana and Nigeria have each ventured into Eurobond issuances twice since 2020H1.

Table 2: Eurobond issuance Jan – Jun 2023

Country	Issue date	Amount (US\$B)	Purpose	Tenor	Coupon	Subscription
Egypt	28/02/2023	1.5	Refinance and repay existing debt	3-year	10.875%	4x
Morocco	08/03/2023	1.25 1.25	Finance capital projects	5-year 10-year	5.95% 6.5%	4.4x

Source: APRM Primary Data Monitoring, 2023

Figure 1: Trend of Eurobond issuances

Government bond yields remained elevated in the 2023H1, prohibiting governments that could have considered raising funds through financial markets. For example, yields on 10-year Eurobonds for –Ghana, Kenya, Nigeria, Mozambique, Angola, Cameroon, Gabon and Rwanda – were all trading at an average of 10.5% in the 2023H1. A few of the bonds, like

the Ghana and Kenya's 2024 Eurobond spiked to above 17%⁶ due to rising concerns about public debt burden from investors. Although it is already costly for governments to raise funds through financial markets due to the exchange rate volatility, no government will be able to sustain borrowing cost of above 9%.

⁶ <https://cbonds.com/bonds/79271/>

6 CHALLENGES IN RATING SERVICES

A few challenges were noted during this period, most of which may easily be addressed if international CRAs are willing to cooperate:

i. Errors in publishing ratings and commentaries: despite the commitment by 'big three' CRAs to enhance internal controls, analysts continue to make mistakes that filter through their systems without notice. For example, Fitch made an error⁷ in the application of the long-term foreign- and local-currency Issuer Default Ratings (IDRs) to the relevant issue ratings during its review of Tunisia in December 2022⁸, which was only corrected after three months. Fitch only issued corrections to comply with the European Securities Markets Authority (ESMA)'s regulatory requirements. Without European regulatory requirements, where the analysts responsible are based, it was unlikely that such corrections would have been publicly announced. Many such errors⁹ in rating issuances¹⁰ and commentaries¹¹ show fundamental defects that still exist in organisational internal

7 <https://www.fitchratings.com/research/sovereigns/fitch-upgrades-tunisia-to-ccc-removes-from-uco-01-12-2022>

8 <https://www.fitchratings.com/research/sovereigns/fitch-upgrades-tunisia-to-ccc-removes-from-uco-01-12-2022>

9 <https://www.fitchratings.com/regulatory/rating-corrections>

10 <https://www.esma.europa.eu/document/esma-fines-sp-eu111-million-failures-related-premature-release-credit-ratings-public-press>

11 <https://www.fitchratings.com/research/sovereigns/correction-fitch-downgrades-ghana-long-term-foreign-currency-idr-to-rd-21-02-2023>

control mechanisms¹² and structures. This needs an urgently response from African regulators.

ii. Locating analysts outside the continent to avoid regulatory obligations: it has been observed that the lead analysts for the 'big three' international CRAs are based outside Africa – in Europe, Asia and the US. This situation has been interpreted by Africa's policymakers and regulators as a strategy to circumvent regulatory obligations as the analysts would not need to comply with the regulatory requirements of African Regulators as they are technically viewed as operating from outside the continent. Reports¹³ have argued that the lead analysts, who are usually based in London, Dubai or Hong Kong, barely spend adequate time in the countries they rate to adequately understand and evaluate the perceived risk factors. Lack of adequate consultations and short-timed visits have also led to analysts basing their assessments on pessimistic assumptions, desktop reviews, virtual discussions and publicly available information, omitting critical data that is often best obtained in-country in during credit reviews.

12 https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-596_esma_censures_standard_u_poors_for_internal_control_failings.pdf

13 <https://afripoli.org/how-are-the-big-three-rating-agencies-impacting-african-countries-54>

Box 1: Afreximbank would be A-rated if it was not lending more to African projects

One of Africa's leading Multilateral development banks, the African Export-Import Bank (Afreximbank) which is in process of being granted the status of a Specialised Agency of the African Union is rated by the big three. It has been cited by policymakers as a good example of both, the failure to understand Africa's business environment and associated risk by the international CRAs. Reports of the rating agencies have indicated that they would have rated the bank an A-class if the business environment in which the bank operates was not high-risk, illiquid and insolvent. Despite acknowledging that the bank has a strong profile, capitalisation and increasing importance due to the expanding key mandates given to the bank by the African Union, the rating agencies have been sceptical to upgrade the bank's rating above BBB-class. Because of the presumed 'high-risk business environment', the rating agencies¹⁴ adjust the Afreximbank rating downwards by two-notch. This is also contrary to the ratings by the Japan Credit Rating Agency and the African-based Global Credit Rating (GCR), which rates the Afreximbank long-term issuer rating at A- and A, with a stable outlook, respectively.

14 <https://media.afreximbank.com/afrexim/Fitch-rating-report-2023.pdf>

iii. Impromptu rating actions and announcements:

unlike in the European Union, there are no regulations in African countries requiring rating agencies to publish a rating calendar for the following year before December of the current year. The calendar announces two dates per year, on Fridays after close of business – to avoid market disruptions from knee-jerk investor responses – for the potential release of sovereign credit rating actions and must stick to it, unless there are extraordinary macroeconomic events. As such, rating agencies release a sovereign credit rating action for African countries on any random date as their calendars exclude the majority of countries on the continent^{15,16,17}. The rationale of regulatory rating announcements is to minimise unnecessary market disruptions. The lack of such regulation has left African countries prone to analysts abuse, who issue impromptu commentaries that are neither linked to any rating action nor in-depth research report.

iv. Herding behaviour amongst the rating agencies:

studies¹⁸ present evidence showing that none amongst the 'big three' prefers to be the last mover in issuing credit ratings. Hence, they are usually under pressure to follow other rating agencies' actions and are likely to review countries, especially if it is a rating downgrade involved. Empirical findings suggest that the 'big three' CRAs account

15 <https://ratings.moody.com/api/rmc-documents/54017>

16 <https://www.fitchratings.com/research/sovereigns/sovereign-rating-review-calendar-2023-19-12-2022>

17 <https://www.spglobal.com/ratings/en/research/articles/190702-calendar-of-2019-emea-sovereign-regional-and-local-government-rating-publication-dates-midyear-update-10798236>

18 <https://onlinelibrary.wiley.com/doi/full/10.1111/fmii.12155>

for their competitors' views in their opinions and any agency that makes a misjudged decision in contrast with the 'first mover' will be punished by the investors. This becomes a strong incentive to herd to protect their reputational capital.

v. Threat of withdrawing rating services:

there are a few examples of entities¹⁹ that have collapsed following the withdrawal of rating services, which has created a presumed impression in the credit rating industry that 'African governments need rating agencies more and not vice-versa', which are key in accessing international financial markets. On this basis, some African regulators are sceptical to implement and enforce regulatory measures as the rating agencies threaten to withdraw from rating the government, entities and instruments in their jurisdiction. This is tantamount to a threat of informal sanction.

¹⁹ <https://allafrica.com/stories/202103310622.html>

²⁰ <https://www.sec.gov/files/2023-ocr-staff-report.pdf>

vi. Increased rating analysts' workload:

regulators of rating agencies²⁰ have identified a potential risk arising from instances of increased analyst workloads, which could result in failures to adhere to applicable surveillance policies and procedures. In accounting for enforcement actions and examination findings, regulators noted that rating agencies sometimes have deficiencies in recordkeeping, integrity of credit rating formula, accidentally sending information to the incorrect recipients, publishing incorrect information for public access and communication between rating services sales representative and rating analysts. These defects are compounded in Africa where one analyst is responsible for tracking information and making rating decisions on more than 10 countries, whilst based outside the continent.

7 DOMESTIC CREDIT FINANCIAL MARKET

The Mauritius based CARE Ratings Africa is on an expansion strategy into East and Southern Africa, now licensed by the Capital Markets Authority to operating Kenya. The Agency is also expanding into offering sovereign ratings, a space which has been largely dominated by the 'big three'. Sovereign Africa Ratings (SAR) also

announced its second sovereign credit rating on South Africa in the 2023H1, affirming the country's long-term and short-term credit ratings at BBB and B+, respectively, with a Stable outlook.



RECOMMENDATIONS

The solution to these challenges lies in implementing effective regulation and reducing reliance on credit rating opinions. Also, effective regulation should ensure that rating agencies remain independent, keeping up the integrity and quality of the rating process. To address failures of CRAs and improving the effectiveness of rating agencies' operations in Africa, the following recommendations are made;

To African regulators of CRAs:

- i. Develop regulatory mechanisms for accountability:* African regulators need to develop regulatory mechanisms to supervise the work of both international and regional CRAs operating within their respective jurisdictions to ensure proper conduct of business and enforcement. It is imperative for regulators to ensure accountability for inaccurate rating opinions issued in Africa.
- ii. Regulating publication of ratings and a rating calendar:* as part of their regulatory response, African regulators need to regulate the timing of rating issuance, make it mandatory for rating agencies to publish a rating after close of business on Fridays and publishing a rating calendar for the following year before December of the current year and comply with the same, unless there are extraordinary macroeconomic events. This will address impromptu rating announcements that disrupt financial markets to the detriment of African economies.

To the CRAs:

- i. Acknowledge the weaknesses and reform:* despite conspicuous shortcomings being pointed out, rating agencies have continued to resist implementing warranted reforms, arguing that they already have competent internal processes in place to manage these weaknesses. It is imperative to accept the fundamental defects and weaknesses that still exist in their institutional structures and work to improve internal control mechanisms for effective control to safeguard information processing systems and decision-making procedures.
- ii. Locate more analysts on the continent and widen the scope and time of consultations:* for the 'big three' international CRAs, having more analysts on the continent will address a number of challenges stemming from foreign-based desktop assessments. It will be easier for locally based analysts to extend their scope of stakeholder consultations, to spend more time in the countries they rate, and their interpretation of events and perception of risk will be different. This will partly address the contestations around the lack of adequate consultations.
- iii. Rating calendar should include all rated African countries:* it is in line with global standards on transparency and disclosure for CRAs to include all African countries in their rating calendars and stick to it on issuing both rating actions and related announcements. This will minimise unnecessary market disruptions.

To African governments:

Work on improving integrity of data used in the rating process: the credit rating process relies on the availability of reliability of data. Increased transparency through data dissemination should be able to reduce uncertainty around macroeconomic developments and provide a basis for a fair assessment of events. This would likely lead to a reduction in the 'Africa risk premium' when countries access financial markets



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