AFRICA FX OUTLOOK

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Egypt

The Egyptian pound is likely to perform well in 2021, as investors continue to be attracted by the relatively high real interest rates, the likelihood of a strong economic recovery, and by a story of fiscal discipline supported by the IMF.

Egypt has proven itself as the darling of EM countries again in 2020, with the IMF estimating GDP grew 3.5% in 2020, and that it will grow 3.2% in 2021. The Egyptian pound was also one of the top performers among emerging market currencies, appreciating by 2.6%, compared with an average depreciation of more than 20% for the Argentinian peso, the Turkish lira, the Brazilian real and the Russian ruble.

The Egyptian government continued to build on its success story with the IMF and acted swiftly to secure foreign currency financing exceeding US$15 billion, bringing total external debt payments in 2020-2021 to US$18.9 billion. We therefore expect Egypt to tap the Eurobond market in H121, and it could potentially engage in talks for a new IMF programme after the end of the current standby agreement by mid-2021.

The current account deficit is expected to widen further and hit 4.2% of GDP in 2021, after the collapse of key hard currency sources such as tourism and exports, which dropped by 55% and 15% respectively in H120 versus H119. Last year, foreign worker remittances only inched higher, by 8%.

The Ministry of Finance is seeking to expand its investor base further and attract more foreign investment flows to balance the current account. To do so, it is expected to have its local currency debt settled through Euroclear in H221, to issue its first floating-rate note by mid-2021, and to print its first Sukuk before June 2021. It also aims to get its local T-bonds included in JP Morgan's EM Government Bond Index.

Relatively high interest rates are likely to ensure plenty of demand for all these various instruments. The real interest rates of the country were at around 3.75% at the end of 2020, still one of the highest in the world, even after the central bank lowered its policy rates by 400 basis points recently.

The Central Bank of Egypt (CBE) was able to cut rates by this much because inflation fell persistently below the target of 9% (+/- 3%), with an expected average of 5.5% for 2020 and 6% in 2021.

The CBE is expected to continue its open market operations to manage liquidity and keep the country attractive to international investors. In 2021, the CBE is expected to be cautious about reducing rates too quickly, as there could be risks to the country's external financing. As such, the Egyptian pound rate is likely to settle within a 15.00-16.25 Egyptian pounds per US dollar range as a base case scenario, while local debt yields could fall by 50-100 basis points.

Ghana

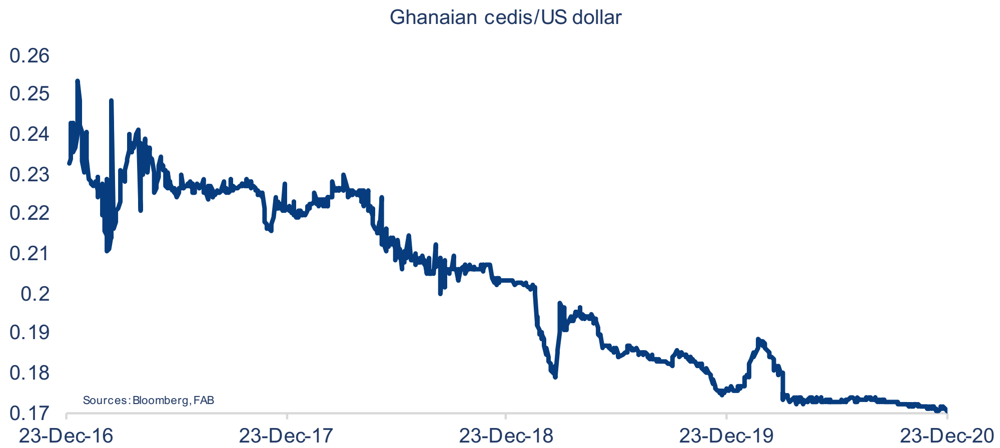
The Ghanaian cedi held its value well throughout 2020, supported by solid central bank currency reserves, a trade surplus, and strong current account funding from Eurobonds and an IMF loan. This outperformance of the local currency will most likely continue in 2021, driven by the domestic and global economic recovery, and by foreign investments attracted by relatively high real interest rates.

Offshore forwards were discounting the exchange rate at around 6.9-7.0 cedis per US dollar at the end of 2021, though we do not expect it to exceed 6.4-6.5. The degree of depreciation of the cedi will depend mainly on commodity prices and foreign investment flows, given that foreigners hold around 20% of the country's domestic bonds.

The Ghanaian economy has managed well through the pandemic, with an expected GDP contraction of only around 0.5% for 2020. There was a decline in mining activity, especially in the oil sector, which was a major growth generator in the last four years, but this has been compensated for by expansion in the service sector. The outperformance of telecom services in terms of GDP (74% rise, for the year-to-date to the Q220) surprised many observers, and demonstrated the maturity of the economy. In 2021, Ghana's GDP is expected to grow by 4%-5%.

Ghana is considered to be a stable and established democracy, with power transitions having gone smoothly for the past 30 plus years. In the presidential elections held on 7 December 2020 the incumbent Nana Akufo-Addo was declared the winner, securing a second four-year term. One of his key challenges will be to address the country's rapidly rising debt, which hit 71% of GDP in Q320.

Despite the debt problem, inflation is likely to continue on its multi-year downward trend after a temporary rise during the lockdown period in 2020, and should reach levels of around 7.5%-8.5% by year-end, from the current 10.5%. This will, in turn, allow the Bank of Ghana to cut interest rates by at least 100 basis points in the course of the year, from the current 14.5%.



Nigeria

In 2020, the APEX Bank, Nigeria's central bank, allowed the naira to weaken by about 10%. The country returned to its currency management regime of 2016, by which investors were rationed hard currency at a managed rate. This led to the resurgence of the parallel market, in which the naira was trading 20% weaker, at about 475 per US dollar, compared to 393 per US dollar in the interbank market.

Due to the West African nation's large import bill, the country depends on foreign investment flows to fund its current account deficit. The APEX Bank will have a difficult decision to make this year, as it may have to increase interest rates to offer a positive real return to attract inflows. This will most likely be achieved by a moderate depreciation of the official currency exchange rate towards 450 naira per US dollar, from the current 393, as well as by attractive money market returns.

Nigeria's central bank did not hike rates last year, even as the shifting black market rate helped to push inflation to 14.2% year-on-year in October, a three-year high, driven by rising food costs. That was far above the APEX Bank's 9% target. The central bank, however, claimed that prices are likely to decline from here, and that the uptrend in prices is driven by structural issues and supply shocks which should ease in 2021.

It may have to change its stance if inflation fails to taper off. The decision will be particularly painful, because in 2020 Nigeria entered its second recession in four years as the Covid-19 pandemic caused a sharp drop in crude oil prices, impairing both the government's fiscal and current account positions. Crude oil exports make up 75% of the government's revenue, and as much as 90% of foreign-exchange earnings.

The situation was mitigated by a US$3.4 billion IMF emergency financing package, while an additional US$1.5 billion budgetary support loan is expected to be approved by the World Bank in the first months of the year.

This has helped the FX intervention policy, while keeping foreign reserves steady (they were at US$35.5 billion on 2 December). On the positive side, some key reforms were implemented last year, such as the removal of fuel subsidies and the passing of the petroleum industry bill, which is set to unlock investments in the sluggish oil sector, and to make way for privatisation.

Uganda

The Ugandan shilling held its value against the US dollar during 2020. After losing as much as 6% at the onset of the pandemic, it reversed course and appreciated, as the government responded to the pandemic with a mix of fiscal and monetary stimulus. We expect the shilling to strengthen in Q1, to 3,650 per US dollar, and then depreciate towards 3,750 by Q3 as economic activity picks up.

The currency was already close to that Q1 target as of 22 December, at 3,654 per US dollar, a 0.28% gain compared to where it started 2020. The gains were supported by a US$491.5 million IMF loan, under its rapid credit facility, to address urgent balance of payments and fiscal needs.

This allowed the Bank of Uganda (BOU) to continue with its easing cycle, cutting interest rates by a cumulative 200 basis points in 2020, to 9%. Inflation edged to as high as 4.7% year-on-year in July, although it eased to 3.7% in October, remaining below the BOU's medium-term target of 5%.

We expect the BOU to keep rates on hold at 9% to stimulate the economy, which would keep bond yields stable in 2021. A world of low rates will most likely support moderate foreign investment flows into the local bond market, which remains very favourable when adjusted for currency volatility.

However, as economic activity improves, the government revenue shortfall could translate into a higher fiscal deficit. This could put moderate pressure on bond yields. Yet, the positive real rate as well as exchange rate flexibility will mean the government can provide further fiscal support to an economy which has suffered badly due to the pandemic. Uganda has been one of the fastest-growing economies in Africa, with GDP expanding 5.9% and 6.8% in 2018 and 2019 respectively, and extra fiscal support could help it recover even more.

First, however, the country faces an important test with the presidential elections, to be held in January 2021. Long-term President Yoweri Museveni, who has led the country since 1986, is running once again, but this time has a strong contender in musician, Bobi Wine, whose popularity among younger voters has been increasing. Wine was arrested last year for a short-period, and then released on bail for "contravening Covid-19 protocols" during his campaign. Although President Museveni is expected to win the elections, there is the risk of political instability and social unrest if there is a major upset to this prediction.