Members of GTR Africa’s editorial board offer their views on how Africa is buffering the financial crises wreaking havoc across the globe.

ALL EYES ON AFRICA

Rupert Cutler
managing director,
financial and political risks,
Newman Martin and Buchan

Joe Mensah
CEO, Ghana
International Bank

Omen Muza
managing director,
TFC Capital (Zimbabwe)

Jean-Louis Ekra
president, Afreximbank

Chris Mitman
head of export and
agency finance,
Investec

Jorim Schraven
manager financial
institutions Africa,
FMO

Charles Morrison
partner,
DLA Piper UK
How is the unfolding eurozone crisis affecting the cost and availability of finance in Africa?

Ekra: It has been argued that the impact of the eurozone sovereign debt crisis on Africa is largely dependent on the degree of integration of individual African economies into the global financial system. The unfolding eurozone debt crisis is expected to have limited direct effect on the continent, given that Africa is less integrated into the global financial system. Nevertheless, the dependence of African counterparties on the international trade and payment system built around eurozone banks, many of which are emboldened and evidently weakened financially by the eurozone debt crisis, is expected to adversely impact the cost and availability of trade financing flows to Africa. This is on account of the fact that players in the eurozone, as a result of cultural and colonial affinities, have traditionally been guarantors (through confirmation) of letters of credit (LCs) issued by African counterparties or providers of direct funding in support of Africa’s trade with the rest of the world. Emerging data suggest wholesale suspension by European banks of LC confirmation lines of credit, which were until the outbreak of the crisis being used by African banks to support their traders. LCs issued by African banks are now being confirmed by European banks on the basis of full cash collateral or at a very high cost.

Furthermore, as a result of the knock-on effect of the eurozone debt crisis on the financial health of banks and regulatory pressures on OECD banks to reduce their exposure to emerging and developing countries following the global financial crisis of 2008/09, many banks in the affected eurozone countries are no longer providing finance to Africa. The cost to African counterparties also seems to be unusually high whenever financing is available. European sources of term funding for developing country counterparties, including Africans, have virtually dried up as many European banks and sovereigns queue up for such funding from European and traditional international development finance institutions.

Against this backdrop, the cost and availability of finance to African counterparties is expected to worsen if the nascent stability seen on international (equity and credit) markets should be ruffled by more austerity measures presently being deployed.

Schraven: Development finance institutions are failing part of this gap and growing south-south funding is also helping. That said, growth demand for finance appears to be outpacing supply in a number of fast-growing countries, such as Nigeria and Angola.

Morrison: We have seen evidence of retrenchment by some European banks previously active in the African trade finance market with uncertainty relating to exposure to eurozone sovereigns at least in part impacting their ability to lend. Conversely, we have seen the fall in activity in European markets result in a renewed focus by internationally active African banks on their comparatively buoyant home markets.

Mensah: Increasing economic and financial integration internationally means the global economy is much more integrated than at any time in the past. Consequently, the risks of crises spreading from one country to the next suddenly seem more pronounced. It also makes it a lot more difficult to predict the impact of disturbances in the global financial system.

In Africa, the global integration is no different. Thus, the effect of the eurozone crisis will have some winners as well as losers. While francophone economies with a single currency (CFA) pegged to the euro may experience higher costs than non-CFA economies, the emergence of China and other BRIC economies and their willingness to grant facilities means Africa now has other options when sourcing funds.

In terms of costs, perceived risks associated with the region have lowered in recent years, brought about by a much more attractive risk-reward profile as compared to Europe, where risks are similar but rewards a lot lower. Secondly, diversification of asset concentration has also contributed to lowered risk perceptions. In this regard, Africa has been much more confident in approaching and raising funds from the capital markets. The last few years has seen the likes of Namibia, Nigeria and Senegal raise maiden sovereign bonds, while other names like Cocobod, Sonangol, Afreximbank, GTB, PTA, etc, regularly seek funds from the capital markets at much thinner margins than other facilities of a similar structure.

Mitman: Things aren’t getting better. Bank euro funding costs remain historically high – particularly for longer tenors. The Pfandbriefe markets are proving useful providers of non-bank liquidity for some euro ECA programmes. Optimally, more eurozone ECAs would adopt fully securitisable programmes combined with either direct loan or specialist funding programmes in the interim.

“The eurozone debt crisis is expected to have limited direct effect on the continent.”

Jean-Louis Ekra, Afreximbank
Banks are well positioned to structure and arrange and bridge finance but are not currently natural providers of long-term debt finance. Recent US dollar pricing being achieved in the capital markets for US Exim paper underscores the need for this to be addressed.

GTR: How are African FIs exposed to government risk, and what is the impact of sovereign default on trade finance?

Schraven: Historically, government exposures of African financial institutions have been comparatively high. European counterparts have been closing that gap during the crisis. However, African banks still have relatively high direct exposures to central and local government and parastatals, as well as indirect exposures through the construction sector.

Cutler: Sovereign default slows or stops investment and trade loans. Nigeria’s current payment outstanding for product inputs is the current leading example for significant delay. Although this may not lead to an actual default, it has a detrimental effect may arise through loans availed to parastatals, or exposures to government bonds or securities.

A sovereign default undoubtedly drives up perceived risk in a country. Given the convention that institutions seldom receive higher ratings than the sovereign, default by a sovereign is likely to trigger a downgrade of the ratings, which invariably drives up the cost of sourcing funds. To traders or importers relying on trade finance, a downgrade would considerably raise the cost of doing business.

GTR: Will we see a drop in demand for African commodities from the eurozone countries that are tending to their own sovereign debt crises?

Ekra: The ongoing sovereign debt crisis facing some countries in the eurozone poses serious risks for Africa’s economic prospects. This is because, while only a few countries are affected, there is a higher probability that the crisis could spread rapidly to other countries in Europe and have spill-over effects on other OECD economies that are major buyers of Africa’s commodities; with dire consequences for Africa’s export and growth performances.

The indirect effect of the eurozone debt crisis is expected to be transmitted via falling demand for Africa’s commodity exports to Europe. However, the impact of the crisis on individual economies is expected to be determined by the degree of dependence on European markets. Given that the European Union remains Africa’s largest export market, a sustained weakening of economic activity across the eurozone precipitated by the sovereign debt crisis could adversely affect Africa’s export commodity prices and earnings.

North, Central and Francophone West Africa are likely to feel the effect more than other regions as a result of their close economic ties with the eurozone economies. Countries in these regions face significant risks arising from the expected fall in demand from the eurozone economies. This concern derives from the fact that Africa’s overall export volume shrunk over the four quarters from October 2010 to September 2011 partly as a result of weak demand from its traditional trading partners in Europe. The saving grace was the timely emergence of a number of major developing economies, such as China, India, and Brazil, among others, as major consumers, which somewhat propped up global demand for commodities during the period. Firm demand for commodities by these and other major developing countries is expected to make up for potential slack in demand by the eurozone economies.

Muza: With 37% of Africa’s non-oil exports destined for the European Union, it is inevitable that there will be a drop in demand. South Africa, with its strong trade links to Europe, will be one of the most affected African countries and it will transmit the effects to countries such as Zimbabwe through regional trade links. However, Asian, specifically Chinese, demand for African commodities will counter this drop somewhat and save the day for Africa.

Cutler: Price sensitivity combined with some demand inelasticity probably means less of a drop in demand for key commodities such as oil and cocoa.

Mensah: In recent times, tendering to these sovereign debt crises has resulted in several economies resorting to austere regimes. The overall impact has been reduced investment spending coupled with collapsing consumer as well as business confidence. Whether the current eurozone sovereign debt crisis impacts negatively on Africa’s trade with the region depends on several factors, such as the level and involvement of the private sector; the manufacturing capacity within the economy; and the level of consumer and/or business confidence. Another factor is the make-up of exports, which matters in the sense that exporters of tourism, base metals, construction materials, etc, may find exports to eurozone economies more challenging, whereas exporters of soft and food commodities, oil, gold and so forth, may find a contrasting environment.

“South Africa will be one of the most affected African countries.”

Omen Muza,
TFC Capital (Zimbabwe)
GTR: Is the interest from eurozone and other international banks still strong?

Mitman: For the most part, international banks’ interest remains strong, but balance sheet and terms are being reserved for core customers and markets. Helpfully we are also seeing strong interest from local banks, particularly in South Africa, to participate.

Ekra: As a result of growing doubts regarding the financial viability of many eurozone sovereigns and banks and other pockets of difficulties that exist in the global economy in general, many international financial institutions and investors have recently increased their investment in commodities as safe-haven assets. A potential worsening of the eurozone debt crisis could lead to a considerable asset switch as investors seek new ways to protect their wealth.

Cutler: Dependent upon the counterparty and track record, interest remains but decisions and ultimate financing is taking longer.

Morrison: Some banks have drastically cut back their interest in this market. However, for those that remain, there is still strong interest in African trade finance deals, provided it is a good deal and a good structure. However, it is noticeable that even the banks still active are becoming much more selective and as a result, the pace of transactions is noticeably slower.

We have, however, seen sustained PRC customers for offshore dollar financing of commodities which can in turn be used as collateral to procure Rmb domestic financing. Again, we monitor closely how the increase in availability of domestic Rmb financing in the PRC as a result of a loosening PRC monetary policy in response, at least in part, to the eurozone crisis, may impact the continuing requirement for offshore trade finance.

GTR: Where are the new markets?

Ekra: The big economies of Algeria, Angola, Egypt, Nigeria, South Africa and a few others, continue to be the main focus of international investors due to either their big market size or other favourable attributes such as transport and other trade-related infrastructure, or vast natural resource endowment.

However, new markets are beginning to emerge in the continent, namely Mozambique, Burkina Faso, Equatorial Guinea, Uganda, Tanzania, Ethiopia, Ghana and South Sudan. These markets have seen sustained economic expansion of over 5% a year: Equatorial Guinea (17.1%), Mozambique (7.9%), Ethiopia (8.4%), Uganda (7.4%), Tanzania (7%), South Sudan (6.3%), Ghana (5.8%) and Burkina Faso (5.7%) during 2000-10. Continued pursuit of structural reforms in the banking sector, investment regime and regulatory reforms, coupled with increasing capital investments in infrastructure development and education have revived the interest of investors in these markets.

Zambia, one of the rapidly emerging economies in the continent, has been described as one of the most attractive investment destinations by the World Bank and other international institutions. With 5.6% average annual growth, a booming copper industry, and major improvements in the agriculture sector, the Zambian economy has become attractive to many international investors. Evidently the last decade has seen tremendous flows of FDI into the economy, particularly from China. In Ghana, the recent discovery of oil, continued political stability, and ongoing improvements in trade-related infrastructure have spurred investor interest in the economy.

Although the growth performance of many of these economies continues to be constrained by limited market size, low private and household incomes, huge infrastructure gaps, and fluctuating exports and thus external finances, they nevertheless offer good opportunities to international investors.

Muza: South Sudan obviously has many opportunities for the intrepid lender/financier who can take calculated risk because the newest country on the continent is starting from a very low base. When you add oil wealth of roughly 500,000 barrels a day into the mix, you have a pretty exciting play. However, this excitement will be tempered by investor anxiety over border tensions with Sudan, which could escalate into a full scale war any time. If the European banks don’t have a go for South Sudan, the Chinese will have free reign.

Zimbabwe has lots of unserviced demand for affordable long-term credit. Attendant risk perceptions are overpriced but fortunately...
pan-African lenders such as Afreximbank and PTA Bank can distinguish between perception and reality and have been supporting Zimbabwe all the time, reducing both the perception and funding gaps. Ask them how many incidences of default they have come across and they will tell you not many, if at all.

Morrison: We have done a lot of work over recent years in Mozambique (primarily oil and infrastructure-based, but with some commodities-based work) and in Namibia, where we have acted on a number of acquisitions, and very much see these now as established markets.

Of the newer markets, there has been a lot of interest in, for example, South Sudan but this has not got a lot further than establishing what the legal structure is. We have acted on transactions involving the DRC and Sierra Leone but with this type of jurisdiction, it is the corporates and the traders that get involved first. The banks will not start to come in until they see more stability and more definition in the legal structures.

Morrison: Inventory financing has been very popular for a couple of years now and most of the transactions we see in commodity financing involve some form of borrowing base calculation. The advantage of these deals is that the banks’ lending is linked directly to the value of the physical assets. As such the banks are happy to lend more than they would otherwise, which is obviously popular with the borrowers. The legal and physical structures are robust enough in most jurisdictions to support the transactions and there are various organisations that can provide the collateral management services that are part of them.

It is a little early to say exactly how commodity exchanges are going to develop and work. They are potentially of great value as they should be able to provide more transparent pricing and thus create more confidence in local markets. From the legal perspective, the development of a warehouse receipt system would be very beneficial in terms of improving the robustness of the legal structures, particularly if such receipts could be negotiable.

We also expect renewed focus on financing by way of ownership structures (where the bank takes ownership of the financed goods) depending on the eventual impact of Basel III on pricing of traditional trade financing structures. This may help to boost the practical availability of trade finance which would otherwise be negatively impacted by increased pricing under Basel III.

Ekra: Commodity exchanges are a new phenomenon in the continent. As at the end of 2011, only eight commodity exchanges, namely Africa Mercantile Exchange (AFMX), Ethiopia Commodity Exchange (ECX), Agricultural Commodity Exchange for Africa (ACE), Malawi Agricultural Commodity Exchange (MACE), Mercantile Exchange of Madagascar (MEX), Kenyan Agricultural Commodity Exchange (KACE), Johannesburg Securities Exchange (SAFEX), Zimbabwe Agricultural Commodity Exchange (ZIMACE), were in operation.

The operations of these agricultural product-based exchanges have somewhat eased part of the financial challenges facing exporters of agricultural products. Many of the exchanges have, for instance, introduced warehouse receipts that smallholder producers could use as collateral to obtain appropriate financing from financial institutions. Physical and electronic warehouse receipts have widely been used in Eastern and Southern Africa to finance many commodities of trade to many economies in the region. In Tanzania, for instance, this product has been used in raising credit to support large scale processing.

Muza: Commodity exchanges in particular have significant potential to boost trade, especially in the agribusiness sector. But their setting up is largely caught up in a maze of bureaucratic bungling and petty political jealousies as typified by recent occurrences in Zimbabwe, and to some extent Ghana. Despite much hype in both countries, the commodity exchanges are not yet functional. The Commodity Exchange in Zimbabwe (COMEZ) was launched amidst pomp and fanfare in January 2010 but it is still to conduct the first trade. There are however places such as Ethiopia where commodity exchanges have been successfully implemented, benefiting trade significantly.

Mensah: Commodity exchanges are intended to give small-scale farmers leverage in negotiating for their crops by providing farmers with reliable market information, both pre and post-harvest, which improves competition and communications, and ensures higher prices for higher quality.

GTR: How are new and innovative solutions such as commodity exchanges and inventory financing boosting trade and agribusiness?

“Demand for finance is outpacing supply in a number of fast-growing countries.”

Jorim Schraven, FMO
In the region, such exchanges are in their infancy, whereas stock markets have had a longer run. In terms of raising finance, the jury is still out on either market.

GTR: Is resource nationalism affecting Africa’s risk profile in terms of both investment and trade?

Muza: Sadly it is, but I would hasten to add that if investors had proactively sought to uplift the communities in which they operate and ensured broad-based benefits to such communities, the situation would have turned out different. Recently Glencore, the world’s largest diversified commodities trader, warned that it would not hesitate to withdraw investments in places like Africa if governments change the terms of existing contracts in their favour. However, to put the matter into context, I would say that resource nationalism is no more a threat to Africa’s risk profile than it is to Australia’s.

Ekra: Resource nationalism is presently an unpopular concept in Africa. The period 1980-90 saw a wave of privatisation and the pursuit of market-oriented policies and programmes on the back of IMF/World Bank-sponsored structural adjustment programmes. The reforms removed state controls and enhanced private sector (African and non-African) participation in the economies of Africa, particularly the extractive industries. However, the enclave nature of the extractive industries reflected by their limited links with other sectors of the domestic economy as well as their high development gap necessitated promotion of local content as a way of raising the overall contribution of the extractive industries to national growth and development efforts. These local content programmes are similar to those that had supported development in other countries such as Norway and Australia, etc. Thus, the issue that is affecting our clients at the moment is the likely impact of the Petroleum Industry Bill (if passed) and the Nigerian Local Content Act. The terms of this legislation are wide-ranging and potentially draconian in their effect. However, the key issue is the final form of the PIB and how the legislation is interpreted and implemented and until we see this, it is a bit early to say how Nigeria’s risk profile is going to be affected. We recently ran a seminar on this subject with speakers from Nigeria and the early indications are that the Nigerian government will be pragmatic in its approach, so we are cautiously optimistic. The issue is going to be an increasingly important one as local content legislation is likely to spread to other African countries; for example, there are bills currently before legislatures in Ghana and Uganda.

Mensah: Resource nationalism is not necessarily bad for the region. However, the market may judge any form of resource nationalism as business unfriendliness. In this regard, funding sources available to borrowers can narrow, while associated costs become dearer. The flow of investment may also be curtailed if perceived risk is deemed excessive. Overall, the impact on trade could be negative.

Cutler: Lenders and investors treat the majority of African countries with more caution than other markets and therefore the risk weighting and reality of resource nationalism has raised the risk profile globally. In a year of elections with one coup to date in Mali, this means a heightened risk profile and delayed investment and sales. Local content, where modest, such as Nigeria, at 10% has not had the same effect as say Zimbabwe at 51%.

As always, resource nationalism is an easy vote winner in tough times as illustrated by the shadow of Argentina in its nationalisation of Repsol.

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