Current Issues

International topics

July 31, 2009

African frontier capital markets: More than a flash in the pan

What are Sub-Saharan African (SSA) frontier markets? Thanks to better economic fundamentals a group of low and middle-income countries from SSA has gained increasing attention of international investors over the last few years. While Nigeria, Ghana and Kenya are the most prominent in terms of size and capital-market development, Tanzania, Uganda and Zambia have strong potential as well.

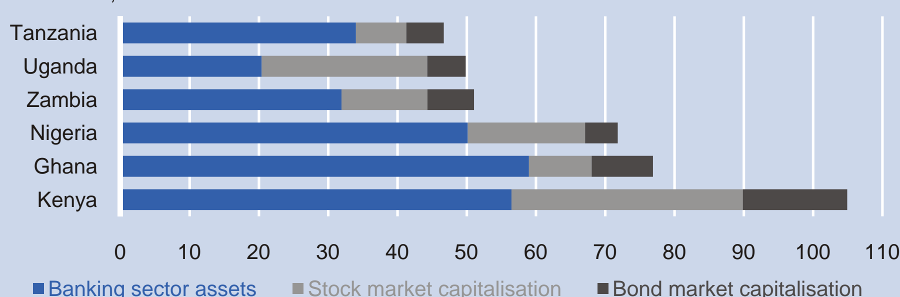
Capital-market development hinges on macroeconomic framework. A sound macroeconomic framework is a prerequisite for the development of capital markets. While most countries have manageable external and public debt levels, high fiscal and current-account deficits could undermine the macroeconomic improvements achieved over the last few years.

Equity markets are still not very liquid and relatively small. While banks still dominate the financial systems of all SSA frontier markets, capital markets are growing rapidly. On the equity markets, capitalisation, turnover and the number of listed companies are low compared to big emerging markets such as South Africa. The automatisation of trading systems, regional integration and increased primary market activity are expected to boost size and liquidity in the future.

Domestic and international bond markets growing from a low base. A bid for sovereign ratings and international bond debuts in 2007 have kick-started the international bond market. Driven by high public financing needs and the emergence of local pension funds, government bond markets are set to grow rapidly over the next few years. Corporate bond issuance is slow to take off.

Good chances for future development. In a conducive international environment interest in the African frontier markets is very likely to continue. A rising number of stock exchanges, external bond issuances and growing public financing needs will boost the SSA capital markets from the supply side. On the demand side, the growing importance of local institutional investors, the returning wealth of the African Diaspora and increased international investor interest will be supportive factors. Infrastructure upgrades, better regulatory standards and more regional integration could bring these markets to a higher level.

SSA: Mostly bank-dominated financial sectors
% of GDP, 2008*



*Nigerian bank and Tanzanian bond data from 2007.

Source: DB Research

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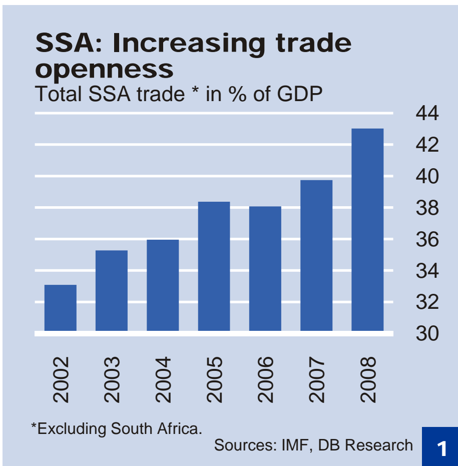
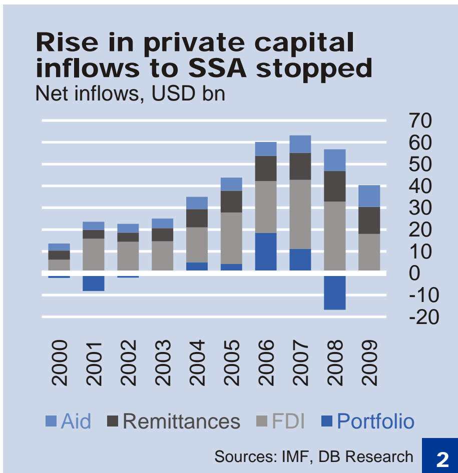
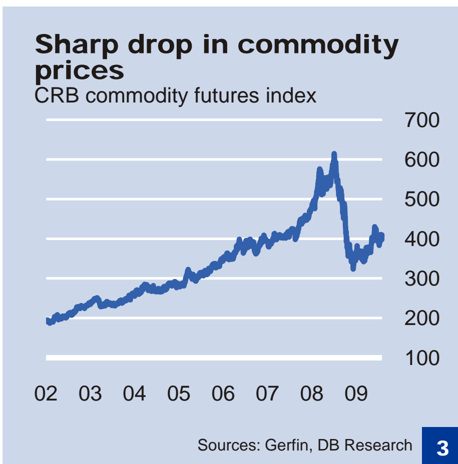
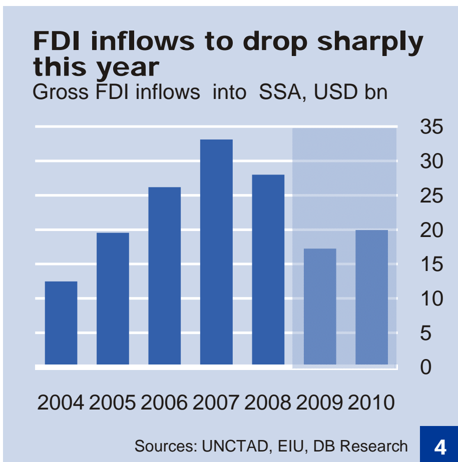








The emergence of the Sub-Saharan African frontier markets

A group of middle and low-income countries from Sub-Saharan Africa (SSA) has started to gain the attention of international investors in the last few years. These so-called African frontier markets have reached a certain level of economic and capital-market development, but are not considered emerging markets yet (such as South Africa, for example). According to the IMF's definition of frontier markets[1] this group of countries includes Cape Verde, Ghana and Nigeria in West Africa, Kenya, Mauritius, Tanzania and Uganda in East Africa and Botswana, Mozambique, Namibia and Zambia in Southern Africa. Angola, Côte d'Ivoire, Gabon and Malawi are also often considered frontier markets in the investment community. Over the last few months enthusiasm for these markets has waned as the global financial crisis has spread from western banks to the real economy, but it is unlikely that recent progress will stop completely or reverse. This is a good point in time to take stock of the current stage of development of these frontier markets and identify potential drivers of future development. We start with a short macro-economic outlook for Sub-Saharan Africa as a whole. We then provide an overview of the most important developments in the stock and bond markets and a more in-depth analysis of the Nigerian, Ghanaian and Kenyan markets. Finally, we present some factors that will influence the future development path of SSA's frontier markets and draw a country scorecard.

Lagged contagion from the financial crisis

Until mid-2008, rising commodity prices, favourable global economic conditions, external debt relief, sound macroeconomic policies and improved political stability had contributed to SSA's economic renaissance. With real GDP growth exceeding 5% for the fifth consecutive year in 2008, the continent enjoyed its most sustained period of growth in decades. Due to the limited direct exposure of SSA's financial institutions to complex financial products SSA was largely immune to the first-round effects of the financial crisis. But as a result of the increased integration in global trade (see chart 1) and capital flows (see chart 2) SSA is now being hit via several indirect contagion channels.

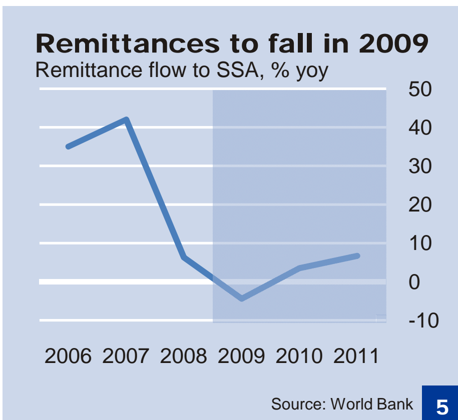
— First, the economic recession in SSA's key trading partners, the EU and the US, and the commodity-price slump (see chart 3) dampen exports. The contribution of net exports to GDP growth is likely to decrease significantly or even turn negative.

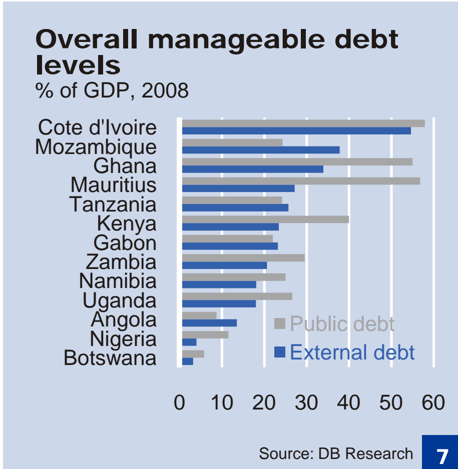
— Second, private capital flows into SSA have declined. According to our estimates, foreign direct investment, the biggest component of private capital flows into SSA, is set to reach only half the record figure of 2007 this year (see chart 4).

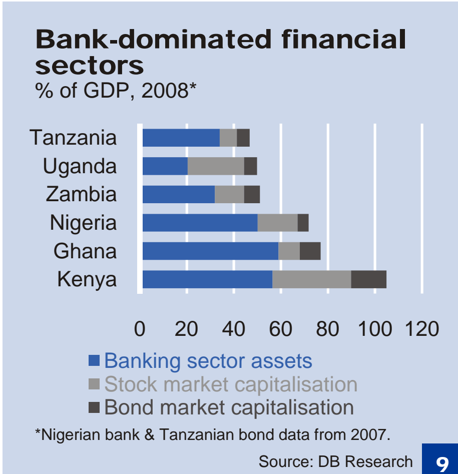
— Third, while the IMF and the World Bank have stepped up their lending to SSA, bilateral donor funds, which are still vital for growth and public finances in many countries, are expected to stagnate at best. This is driven by the fact that donor countries face economic difficulties at home.

— Fourth, the current synchronised global economic downturn will lead to a significant drop in remittances. According to the World Bank, remittances to SSA grew by 6% in 2008, but are expected to decline by 4.5% in a baseline and by 8% in a downside

[1] IMF, Regional Economic Outlook Sub-Saharan Africa, April 2009.

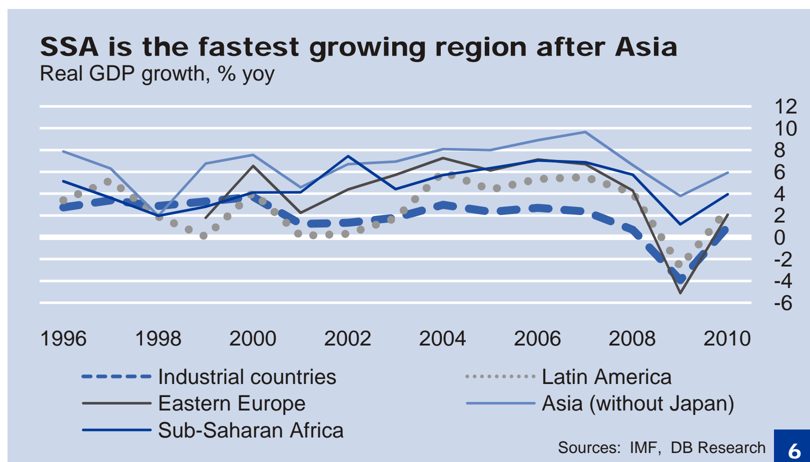






scenario this year (see chart 5).[2] In Kenya, for example, remittances have already fallen by 12% yoy in the first five months of this year.

Overall, we expect Sub-Saharan African real GDP growth to slow to around 1.0% yoy this year, from 5.7% yoy in 2008. SSA remains one of the few regions in the world expected to deliver positive growth rates this year (see chart 6). While this does not look too bad at first sight, regional GDP per capita will actually fall on the back of these meagre growth rates.



Quality of policies being tested

A sound and sustainable macroeconomic framework is a prerequisite for the adequate development of capital markets.[3] Prudent fiscal and monetary policies and strict control over inflation are essential to attract private long-term capital. Thus, the future development of the capital markets will strongly depend on the robustness of policy frameworks in SSA. While most countries have manageable external and public debt levels (see chart 7), high fiscal and current-account deficits (see chart 8) threaten to reverse the macroeconomic stabilisation achieved over the last few years. In the country-specific sections we will take a closer look at the macroeconomic policy challenges Ghana, Nigeria and Kenya are currently facing.

Bank-based financial systems

As in other emerging and developing countries, the financial systems of all SSA frontier markets are still very much bank-dominated (see chart 9). Capital markets do not play a significant role in financing the economy yet, but their importance has been increasing over the last few years. This is a positive development since, first, stock and bond markets are a source of long-term funding for productive investment and facilitate efficient resource allocation. Second, they offer diversification benefits for domestic private investors and thus help to mobilise savings. Third, government and corporate-bond markets enable the government and corporates, respectively, to manage their debt better.

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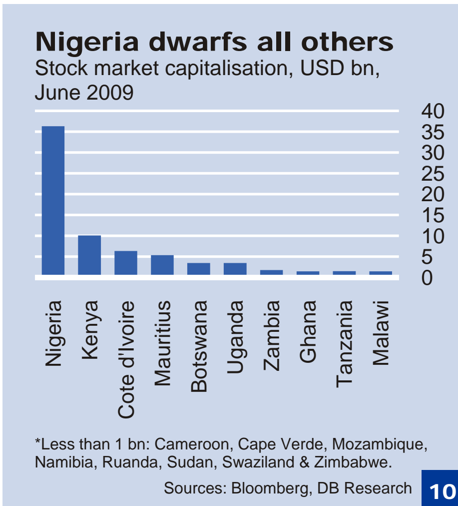
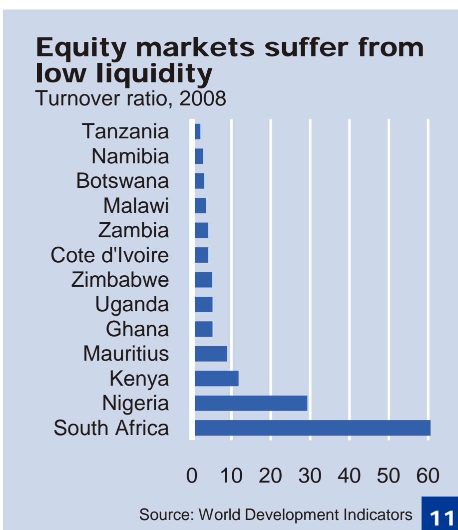
[2] World Bank, Migration and Development Brief Number 9, 2009.
[3] African Development Bank, African Fixed Income Guidebook, May 2007.



Nigeria dwarfs all others
Stock market capitalisation, USD bn, June 2009

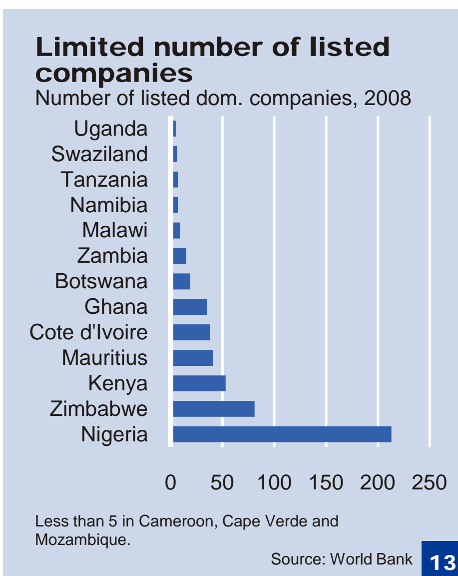
*Less than 1 bn: Cameroon, Cape Verde, Mozambique, Namibia, Ruanda, Sudan, Swaziland & Zimbabwe.

Sources: Bloomberg, DB Research 10



Equity markets suffer from low liquidity
Turnover ratio, 2008

Source: World Development Indicators 11



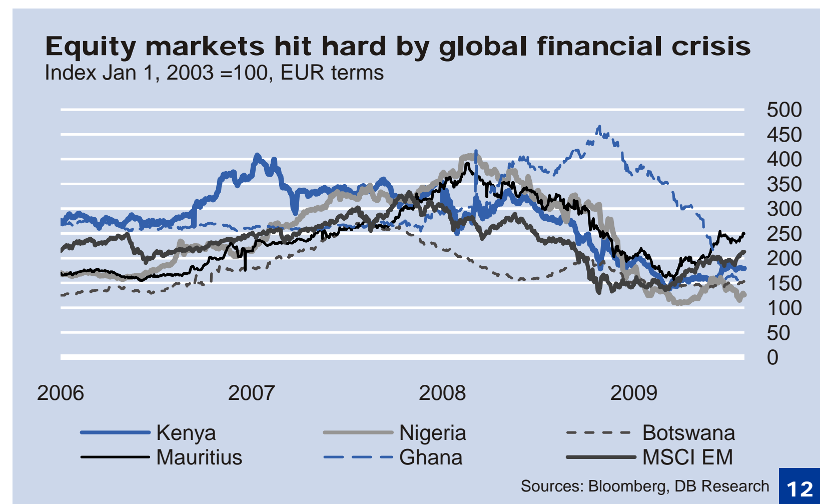
Limited number of listed companies
Number of listed dom. companies, 2008

Less than 5 in Cameroon, Cape Verde and Mozambique.

Source: World Bank 13

Equity markets: Size matters

Since 1989 the number of active SSA stock exchanges has increased from 5 (South Africa, Zimbabwe, Kenya, Nigeria and Uganda) to currently 19. This includes one of the few regional stock exchanges in the world, the BRVM, which is situated in Cote d'Ivoire and links eight French-speaking countries[4] in West Africa. The total number of stock exchanges might grow to 20 this year if Angola succeeds with its long-standing plans to open an exchange. While the overall number seems high, many of these markets are still in their infancy. So far, only Kenya, Mauritius, Nigeria, Cote d'Ivoire, Ghana and Botswana are part of the MSCI or S&P frontier market indices. Market capitalisation remains generally low. Looking only at domestic market capitalisation (i.e. excluding cross-listings), all stock exchanges remain way below the 100% of GDP capitalisation level reached in South Africa. This means that there is still considerable scope for a deepening of the stock markets over the next few years. In absolute terms, the capitalisation of all stock markets remains below USD 50 bn (see chart 10), which is considered a critical threshold to attract investments from global emerging markets funds.[5] Moreover, all markets suffer from low liquidity. Even though liquidity has improved in most markets over recent years, even the best-performing stock exchange (Nigeria) reached only half the turnover ratio of South Africa (see chart 11) in 2008. In absolute terms the annual value traded in Nigeria is estimated at USD 3 bn, compared with a USD 10 bn threshold for global emerging markets funds.[6] And finally, with the exception of Nigeria, all stock exchanges are characterised by a relatively low number of listed companies (see chart 13).



Equity markets hit hard by global financial crisis
Index Jan 1, 2003 =100, EUR terms

Sources: Bloomberg, DB Research 12

Most SSA stock markets have posted high returns. Between January 2003 and December 2008, most SSA stock-market indices outperformed the MSCI EM equity market index in EUR terms (see chart 12). Moreover, they offer diversification benefits. While correlation with the international markets has increased over the last few years, up to May 2009 it was in general lower than that of South Africa (see chart 14).

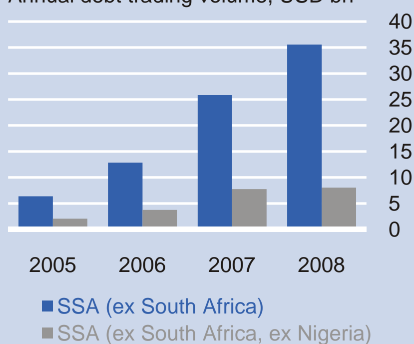
[4] Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, Togo.
[5] Opportunities in Sub-Saharan Africa's capital markets, IFR, November 2007.
[6] Ibid.

Relatively low correlation with international markets
Correlation coefficient, Jan 06 - May 09

	MSCI World	S&P 500	MSCI EM
Ghana	-0.67	-0.68	-0.44
Mauritius	0.07	-0.03	0.56
Nigeria	0.35	0.27	0.70
Kenya	0.89	0.86	0.79
Botswana	0.45	0.39	0.65
Namibia	0.96	0.92	0.90
South Africa	0.92	0.87	0.94

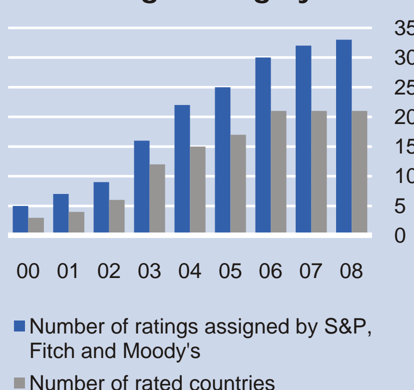
Sources: Bloomberg, DB Research 14

Strong rise in debt trading
Annual debt trading volume, USD bn



Sources: EMTA, DB Research 15

Half of the countries have a sovereign rating by now



Sources: Fitch, Moody's, S&P, DB Research 16

Int. sovereign bond debuts: most shelved for now

Ghana	750 m USD in Sept. 07
Gabon	1 bn USD in Dec 07
Kenya	300 m USD postponed
Tanzania	500 m USD postponed
Zambia	500 m USD postponed
Uganda	1 bn USD postponed
Nigeria	500 m USD* postponed

*Denominated in naira.

Source: DB Research 17

Bond markets: Strong take-off

Unlike equities, debt instruments have not emerged in Sub-Saharan African countries until the last few years. For a long time most SSA countries solely depended on external official financing. Access to the international bond markets was virtually closed as external debt burdens were very high and the countries lacked a sovereign rating. Moreover, very high real interest rates rendered the option of issuing domestic debt unattractive.By now, however, SSA debt capital markets have started to grow strongly both at the international and the domestic level. Debt trading volumes, dominated by Nigeria, soared from USD 6 bn in 2005 to USD 35 bn last year (see chart 15).

Bid for sovereign ratings

An important precondition for access to the international bond markets is a sovereign rating. As sovereign balance sheets improved following external debt relief and sound macroeconomic policies, the number of sovereign ratings in SSA almost quadrupled over the past six years (see chart 16). Currently, almost half of the countries in SSA have a sovereign rating, compared to only three countries, South Africa, Senegal and Mauritius, at the beginning of the century. Many countries aimed at sovereign issuance not only in order to fund their budgets, but also to create a benchmark for the issuance of corporate bonds. Further countries are expected to try and obtain a sovereign rating, but due to the financial crisis this is not likely to happen in the short run. For example, Tanzania and Zambia suspended their bid for a sovereign rating in March and are seeking alternative external funding (e.g. from multilateral financial institutions).

Further international bond issuances to come

The first SSA country, apart from South Africa, to tap the international bond markets was Ghana in September 2007. The 10-year USD 750 m bond was heavily oversubscribed and thus represented a successful test of investor appetite for African debt. The bond was listed on the London Stock Exchange and sold on both the US and European markets. Gabon followed suit in December 2007 by issuing a USD 1 bn bond with a maturity of ten years. Five other countries, Kenya, Tanzania, Uganda, Zambia and Nigeria, had voiced their intentions to issue an international bond (see table 17), but postponed their plans due to the financial crisis. Nevertheless, as soon as the capital markets reopen to lower-rated emerging-market issuers, they are expected to go ahead with their debut international bond issuances. Ghana's 2-year preparation period has shown that, in order to be successful, a sovereign bond market debut has be to carefully managed and well prepared in terms of data availability and institutional capacity.

Supranationals contribute to developing debt capital markets

Supranational institutions play an important role in fostering the development of domestic bond markets. By issuing bonds in the local currency of the country they help to establish and/or extend a benchmark yield curve. The African Development Bank, for example, issued a 2-year USD 45 m bond denominated in Ghanaian cedis in October 2006. In January 2007 it launched a USD 100 m Eurobond linked to the Nigerian naira. By doing so the bank enhanced the international visibility of the market and increased its attractivity by offering top-rated bonds in local currency. In addition, supranational institutions promote international best practices,

Selection of pure pan-Africa funds*

Company	Fund**
Imara	Imara East Africa Fund
Finch	Finch Africa Fund
Stanlib	Stanlib Africa Equity Fund
RMB	Africa ex-South Africa Funds
Coronation	Coronation Africa Fund
Nubuke	Nubuke Africa Focus Fund
Terra Global Capital Partners	African Land and Livelihoods Carbon Fund
Blakeney	Blakeney Africa Fund
EMM	EMM Frontier Africa Fund

*This list is not exhaustive & excludes South Africa funds.
**As of February 2009.

Source: Securities Africa 18

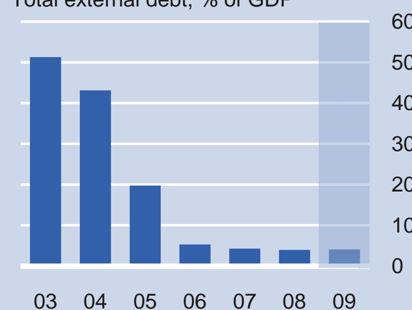
Nigeria: Low direct impact of oil sector on growth

Contribution to GDP growth, pp

Sources: Central Bank of Nigeria, DB Research 19

Nigeria: Debt slate wiped clean

Total external debt, % of GDP



Source: DB Research 20

transfer international financial know-how and assist in establishing a proper regulatory framework and infrastructure.

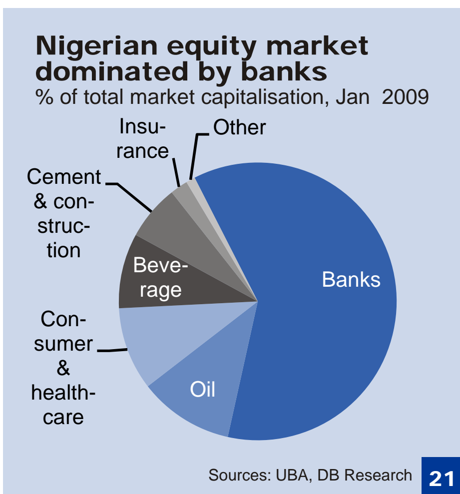
Local institutional investors are the main players in the African capital markets

Domestic institutional players (such as banks, insurance companies, pension funds) and local private investors account for the lion's share of investors in the SSA capital markets. Boosted by social-security reforms, pension funds are expected to gain importance over the next few years (for example in Nigeria and Botswana). Moreover, improved financial literacy and good return prospects bode well for an increased participation of domestic private investors and investors from the African Diaspora.

The importance of international investors for the SSA frontier markets has increased over the last few years. But still only a tiny share of emerging-market investments flows into African frontier markets as illiquidity and small market size deter many investors. Frontier Market indices, such as the MSCI Frontier Market Index or the S&P/IFCG Extended Frontier 150, cover only Nigeria, Kenya, Mauritius and Cote d'Ivoire and are considering including Ghana and Botswana. Some Europe, Middle East and Africa (EMEA) or Middle East and North Africa (MENA) funds invest a few percentage points of their assets in the bigger and more developed frontier markets such as Nigeria or Kenya. The number of pure pan-Africa funds has increased over recent years, but still remains small (see chart 18). In our view, such highly specialised niche funds will remain the main international players on the African capital markets in the near term. In the medium term, however, we expect more dedicated pan-Africa funds to emerge.

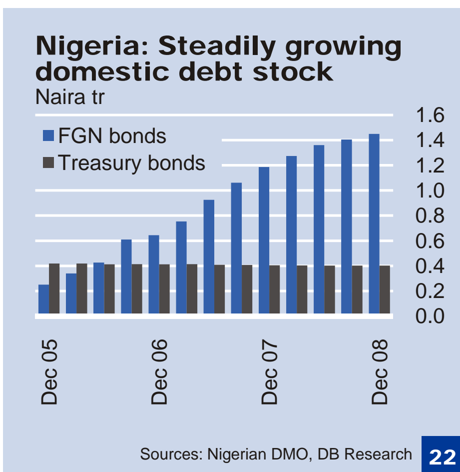
Nigeria: The curse of oil dependency

The decline in oil prices in the second half of last year and production shortfalls have hit the Nigerian economy hard. While the direct contribution of oil production to GDP growth has declined substantially in recent years (it even turned negative in 2006-07) (see chart 19), the indirect impact of oil prices on growth (via government spending and bank lending) is significant. Thus, GDP growth is expected to slow to around 3% this year. Moreover, with oil revenues accounting for 80% of fiscal revenues and 98% of export revenues, the fiscal and current accounts are expected to move into deficit for the first time in five years. In order to fund counter-cyclical spending Nigeria can dip into its oil savings, which it has accumulated in the so-called Excess Crude Account with a volume of around USD 15 bn. Moreover, Nigeria should not face any external financing problems as external debt is very low (see chart 20) and the country still has a substantial cushion of FX reserves. Foreign currency controls which were imposed in January to stem the depreciation of the naira, have been lifted in mid-July. With regard to the banking sector, a tight liquidity situation and worsening asset quality cloud the outlook. Although Nigerian banks remain among the best-capitalised in the world, they are suffering due to their exposure to the stock market, which fell by 66% between September 2008 and April 2009 and has only recovered slightly recently.



Equity market dominated by financials

The Nigerian stock market was established in 1961 with a total of 19 securities listed for trading. Today, Nigeria is the second-largest stock market in SSA after South Africa. 214 companies are listed on the stock exchange, with banks accounting for 61% of the total market capitalisation (see chart 21). The successful banking-sector reforms of 2004/2005, which led to a recapitalisation and consolidation of the banking system, substantially contributed to the development of the stock market via increased issuance, capital raising and trading activity. The market turned in March 2008 as investors locked in profits, international investors retreated and banks started to withdraw margin loans. Primary activity (new issues, M&A) remained relatively high up to the third quarter of 2008, but slowed sharply towards the end of the year. Greater market transparency is necessary in order to boost activity. The Nigerian Stock Exchange and the Securities and Exchange Commission seem committed to continuing their efforts in enhancing regulation and supervision and reducing bureaucracy (such as share registration and certification procedures).[7]



Growing domestic debt stock

The Nigerian Debt Management office (DMO), which was established in October 2000, is responsible for managing Nigeria's external and domestic debt and fostering the development of the bond markets. In order to increase the liquidity of the domestic bond market the DMO started to issue 3, 5, and 7-year benchmark FGN bonds in 2003. By issuing the first 10-year bond in mid-2007 the DMO further lengthened the yield curve. At the same time the issuance frequency was stepped up to twice a month, which also contributed to the increase in the debt stock (see chart 22). Secondary trading in debt instruments was boosted by the establishment of a primary dealer panel in June 2006. Local commercial banks, discount houses and non-bank financial institutions are the major investors in the domestic bond market. Foreigners, who are allowed to invest in securities with a tenor of at least 1 year, actively buy securities in the primary and secondary market as well. The total bond market capitalisation currently stands at around USD 13 bn. With the fiscal account moving into deficit this year and the issuance of an external naira-denominated bond postponed for now, we expect the domestic government bond stock to continue to grow.

Ghana: Macroeconomic challenges

Over the past two years ballooning deficits in the fiscal and current account (see chart 23) have increased macroeconomic vulnerability. Even though these large imbalances are likely to be reduced in 2009, they could rapidly erode the benefits Ghana gained from external debt relief. In order to restore sustainability the new government has promised to bring the budget deficit back under control. The government is keen to keep the goodwill of the international investor community, since official loans and grants remain key components of the financing mix. Ghana's economic prospects remain heavily dependent on commodity prices, with gold and cocoa each accounting for 30% of total exports. But as gold prices are expected to remain high and cocoa output is boosted by past reforms in the cocoa sector, we expect growth to remain

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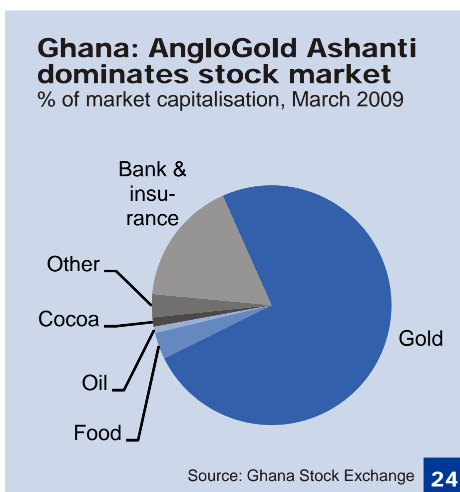
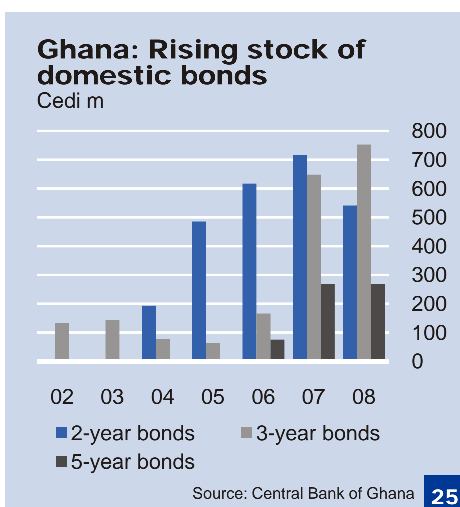
[7] Nigeria country report, IIF, March 2009.



Ghana: AngloGold Ashanti dominates stock market
% of market capitalisation, March 2009

Source: Ghana Stock Exchange 24



Ghana: Rising stock of domestic bonds
Cedi m

Source: Central Bank of Ghana 25

relatively robust at 3-4% of GDP in 2009. Moreover, successful drilling tests in the off-shore oil field discovered in 2007 increase the probability that oil production can actually start in 2011. Thus, in the medium term oil revenues should help to ease budget and balance-of-payments constraints.

Joining automated equity trading

Trading on the Ghana stock exchange commenced in November 1990. Currently, there are 34 companies listed on the stock exchange. AngloGoldAshanti, a gold producer listed on seven stock markets globally, dominates the Ghanaian stock market and accounts for 75% of total market capitalisation (see chart 24). The boom years 2007 and 2008 saw a total of four successful initial public offerings and were characterised by strong stock-market gains. At the beginning of 2009 the completion of the World Bank-assisted project to automate the Ghana Stock Exchange was a milestone. In addition to electronic trading the platform provides an electronic clearing and settlement system. The new platform is expected to improve transparency and increase trading volumes.

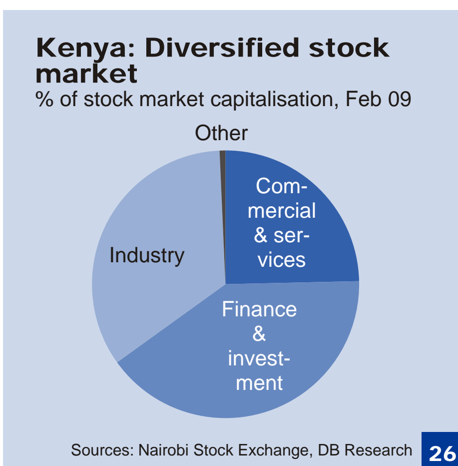
Government financing needs boost the bond market

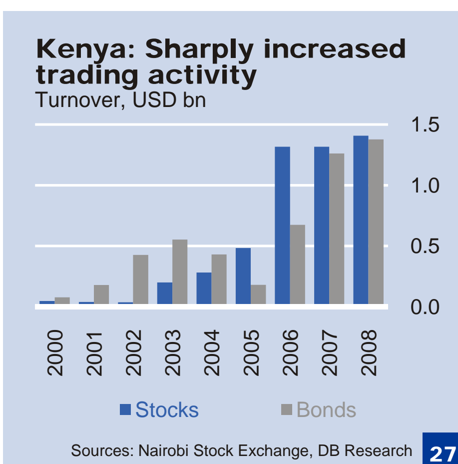
Ghana's local bond market is still nascent but has grown rapidly over the last few years (see chart 25). The 3-year index-linked government bonds introduced in 2001 have now been fully replaced by new 2 and 3-year fixed and floating-rate notes. In late 2006 the government issued the first 5-year bond in order to further extend the yield curve. As of December 2008, the volume of total outstanding government bonds amounted to USD 1.3 bn. As the Ghanaian government is expected to continue to run sizeable fiscal deficits we expect the domestic government-bond market to continue to grow over the next few years.

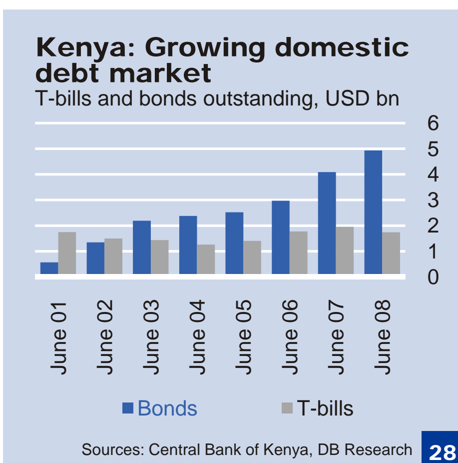
While the government remains the main issuer of debt securities, corporate bond issuance is also taking off slowly. So far, only financial-sector companies such as Barclays Bank of Ghana (10Y 9 m USD), Standard Chartered Bank Ghana (3.9 m USD) and Home Finance Company Ltd. (5Y 2.5 m USD) have issued corporate bonds. Since 2006 all bonds (corporate and government) have been traded on the Ghana Stock Exchange, which helps foster the secondary trading of the securities and increase liquidity.

Kenya: Political stability is key

The formation of a grand coalition government in April 2008 improved Kenya's internal stability after the outbreak of post-election violence at the beginning of 2008. As Kenya is a trade hub and financial centre for East Africa, this is a welcome development for the whole region. Hit by the combination of political risk and a severe drought, the Kenyan economy expanded by a meagre 2.2% yoy last year. Economic growth is not expected to accelerate much this year. First, due to the downturn in key European markets a recovery in the vital tourism sector is unlikely. Second, demand for Kenya's main exports products, horticulture and tea (each of which accounts for 15% of total exports), is set to remain subdued. Third, lower FDI inflows and lower remittances will slow down domestic investment and consumption. We therefore expect continued sluggish economic growth of around 2.5% this year. However, given the fact that Kenya's economy is relatively well diversified and thus more resilient against external shocks than that of its regional peers, growth is set to return to 3-4% in 2010. Moreover, falling public and external debt levels have not been driven by debt relief, but reflect







sound macroeconomic policies. However, in the short run the global slowdown will continue to affect Kenya and result in larger current account and fiscal deficits and declining foreign exchange reserves. Due to these vulnerabilities Kenya had to turn to the IMF, which extended a USD 209 m loan in May and thus helped Kenya to withstand funding pressures. Inflation is an additional challenge for Kenya's policymakers. While the calculation of a new index is likely to lead to lower inflation numbers than the 18% recorded in June, inflation is still estimated to be in the double digits.

Regional integration of the stock market on the cards

The Nairobi Stock Exchange (NSE) was established in 1954. Today, it is the largest stock exchange in east and central Africa with 54 listed companies. While Safaricom (the leading Kenyan telecommunications company) is by far the largest company in terms of market capitalisation (17% of the total), the stock market is not heavily dominated by any one sector (see chart 26). The implementation of an automated trading system in 2006 has actively contributed to the deepening of the market. Trading volumes in stocks and bonds have risen to around USD 1.5 bn per year (see chart 27). The Safaricom IPO in June 2008 (USD 3 bn), the biggest IPO ever in east Africa, was seen as an important test of the capacity of the stock exchange and proved its ability to transact large volumes. The Nairobi stock exchange plans to shorten the settlement period from t+5 to t+3 and to increase foreign participation, which now accounts for around 20% of total market activity. Another ambitious goal is the integration of the trading platform with those of Rwanda, Uganda and Tanzania. In our view, fostering regional integration is a good way to increase economies of scale and attract foreign investors.

Lengthening the yield curve

In 2001 the Kenyan government started to actively manage its domestic debt in order to lengthen maturities. The ultimate goal was to minimise refinancing risks and promote growth of the domestic bond market. Kenya's domestic bond market did indeed grow rapidly over the past 8 years (see chart 28). In June the Treasury unveiled plans to double domestic borrowing in fiscal year 2009/2010, so the bond market is expected to continue to grow strongly. The share of T-bills in the total debt stock fell from 75% in June 2001 to 26% in June 2008. The government first issued 2-year and 3-year bonds instead of treasury bills, then moved on to 5 and 6-year bonds. In 2003 the yield curve was extended to 10 years. Finally, a 20-year bond was issued in June 2008, reflecting increased appetite by domestic institutional investors (pension funds and insurance companies). Overall, commercial banks hold around 50% of total government bonds outstanding. The Kenyan corporate-bond market is still small, but has been boosted by an increased number of corporate-bond listings since 2005, with Celtel Kenya, PTA Bank and Barclays Bank being the largest on offer. In order to spearhead an efficient functioning of the market the Central Bank of Kenya and the NSE are working to connect the Central Bank's Central Depository System with NSE's automatic trading system, which will facilitate online secondary market bond trading.

Medium-term outlook for the SSA frontier markets

Notwithstanding the uncertainties over the short-term economic outlook, structural improvements in the macroeconomic and capital-markets framework have set the stage for a further development of the African capital markets over the medium to long term. Several factors are likely to help the African frontier markets to gain increasing importance in the financial map of the world.

Most commodity prices expected to recover

	2008	2009	2010	2011	2012
WTI (USD/bbl)	99.7	63	55	80	85
Natural gas (mmBtu)	9.0	4.3	6.0	8.0	8.5
Copper (USD/t)	6936	4197	4420	5291	6173
Gold (USD/oz)	873	933	869	825	800
Cobalt (USD/lb)	37.4	14.7	17.0	20.0	23.0

Source: Deutsche Bank as of July 17 29

Commodities and link to Asia will boost growth

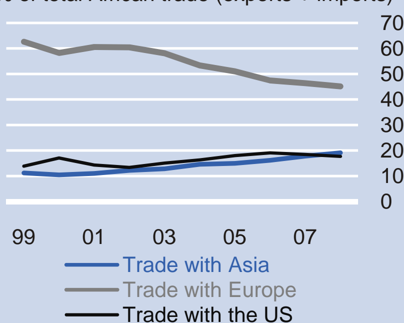
SSA is endowed with a large share of the world's natural resources. 5% of the world's proven oil reserves (Nigeria, Angola, Sudan, Gabon, Equatorial Guinea), 4% of the world's proven gas reserves (Nigeria), 60% of the world's diamond reserves (Democratic Republic of Congo, Botswana, South Africa), 20% of the world's gold reserves (South Africa, Ghana), 49% of the world's cobalt reserves (Congo and Zambia) and 3.4% of the world's copper reserves (Zambia) are located in SSA. Demand for energy and other commodities is expected to continue to rise faster than GDP[8], which bodes well for commodity prices (see chart 29) and the outlook for resource-rich economies.

New trade patterns are also an encouraging trend. Over the past decade, Europe's share in trade with Africa has declined from 63% to 44%, while Asia's share has nearly doubled from 11% to 19.3% (see chart 30). Increasing trade with Asia bodes well for Africa in view of the strong growth rates expected for Asia (especially China and India) over the next few years. Moreover, this has opened new distribution channels for non-commodity exports as well.[9]

Finally, structural advances over the last few years such as debt relief, improvements in the business environment and the use of new information and communication technologies are supportive of medium-term economic growth and thus set the stage for further capital-market development.

Africa diversifies its trading markets

% of total African trade (exports + imports)



Sources: IMF DOTS, DB Research 30

Supply and demand-side factors will foster capital markets

An increasing number of stock exchanges (for example Angola), new external bond issuances (for example Kenya, Tanzania, Zambia, Uganda and Nigeria), growing government financing needs and increased primary-market activity are supply-side factors that will boost the SSA capital markets. On the demand side, the increasing importance of local institutional investors with a long-term investment horizon (in particular pension funds in Nigeria and Botswana) will lead to the issuance of longer-dated securities. Another important demand-side driver of the capital-markets development will be the wealth of the African Diaspora, which has started to flow into SSA over the last few years.

Challenges to be tackled

Notwithstanding the relatively positive growth prospects for the SSA frontier capital markets, several issues still need to be tackled to accelerate their development. First of all, SSA governments have to build a longer track record of macroeconomic stability and maintain political stability. Second, timely availability of macroeconomic data has to be improved. Third, it is important to strengthen regulation, increase regulatory transparency and ensure gradual convergence

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[8] Global Economic Prospects, Commodities at the Crossroads, World Bank December 2008.
[9] Sub-Saharan Africa: Forging New Trade Links with Asia, IMF, October 2007.

Cross-listing of stocks as first step to regional integration

Country of primary listing	Country of Secondary Listing	Number of companies
Cote d'Ivoire	WAEMU*	all
	Nigeria & Ghana	1
Kenya	Uganda	3
	Tanzania	3
Nigeria	South Africa	1
S. Africa	Botswana	2
	Ghana	1
	Namibia	25
	Zambia	1

*West African Economic & Monetary Union.

Source: IMF 31

to international regulatory standards (e.g. IFRS reporting standards). Fourth, the capital-markets infrastructure has be to improved further (e.g. automatisation of trading, clearing and settlement, extension of the daily trading session, migration from floor-based centralised trading to wide area network trading etc.). Fifth, fostering the regional integration of exchanges by, for example, regional cross-listing (see chart 31) and pooling of issuances would increase scale and thus render these markets more attractive.[10] Sixth, easier access for foreign investors would help to increase trading on and the liquidity of markets. Seventh, a further lengthening of local yield curves and the creation of a sovereign benchmark for corporate external bonds would foster the development of bond markets. Eighth, a reduction of transaction costs and fees would likely increase secondary-market trading.

Country ranking: Nigeria and Kenya first, Angola has good potential

Our country scoreboard (see chart 32 overleaf) provides an overview of the SSA frontier markets and of financially developing countries (i.e. countries which may become frontier markets over the next few years). We rank the countries according to the growth potential of their capital markets (as measured by the IMF's capital market development index), the size of the economy, the level of equity-market capitalisation, the existence or non-existence of an automated trading system and the country's sovereign creditworthiness.

Nigeria tops the list due to its relatively advanced capital-market development (including an automated trading and central depository system), the big size of its economy and equity market and its relatively strong external rating of BB-.

Kenya comes second in terms of the size of its economy and capital markets. Moreover, being a trade and financial markets hub in eastern Africa gives Kenya an edge. Kenya is followed by Tanzania, Ghana, Uganda, Zambia and Botswana.

Among the financially developing countries, Angola stands out. Given the size of its economy and its oil wealth the country has the potential to become an even more interesting market in the medium run.

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[10] Adelegan, Olatundun, Can Regional Cross-Listings Accelerate Stock Market Development?, IMF December 2008.

Sub-Saharan Africa's capital markets at a glance

	Country classification[1]	Capital market development[2]	Nominal GDP, USD bn, 2008	Equity market capitalisation[3], Jun '09, USD bn	Automated trading system	Sovereign rating S&P/Fitch/Moody's
Emerging market countries						
South Africa	Middle-income	4	277	315	yes	BBB+/BBB+/Baa1
Frontier market countries						
Nigeria	Low-income	4	214	36.3	yes	BB-/BB-
Kenya	Low-income	4	30	10.1	yes	B/B+
Tanzania	Low-income	4	21	1.5		n.a.
Ghana	Low-income	4	16	1.5	yes	B+/B+
Uganda	Low-income	4	15	3.5		B+/B
Zambia	Low-income	4	14	1.4	yes	n.a.
Botswana	Middle-income	4	13	3.5		A/n.a./A2
Mozambique	Low-income	3	10	n.a.		B+/B
Mauritius	Middle-income	3	9	5.4	yes	n.a./n.a./Baa2
Namibia	Middle-income	4	8	0.3	yes	BBB-
Cape Verde	Middle-income	3	2	0.1		B+/B+
Seychelles	Middle-income	2	1	No market		SD
Financially developing countries[5]						
Angola	Low-income	2	83	Stock market planned		n.a.
Cote d'Ivoire	Low-income	2 [4]	24	6.3	yes	n.a.
Senegal	Low-income	2	13	No market		B+
Zimbabwe	Low-income	3	12	n.a.		n.a.
Burkina Faso	Low-income	3	8	BRVM[6]		B
Benin	Low-income	3	7	BRVM		B/B
Rwanda	Low-income	3	4	n.a.		B-
Swaziland	Middle-income	4	3	0.15		n.a.
Gambia	Low-income	2	1	No market		n.a.

[1] Low income (less than USD 935 gross national income per capita), middle-income (USD 936-11455), high-income (more than USD 11455).

[2] Following IMF REO SSA April 2008: "4" - all four markets, "3" - treasury bill & bond markets & corporate bond or equity market, "2" treasury bill & treasury bond markets.

[3] Only domestic companies.

[4] No treasury bill market, but equity market.

[5] Only countries with capital market development indicator >2 shown.

[6] Regional stock exchange for West African countries.

Sources: IMF, National stock exchanges, DB Research

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