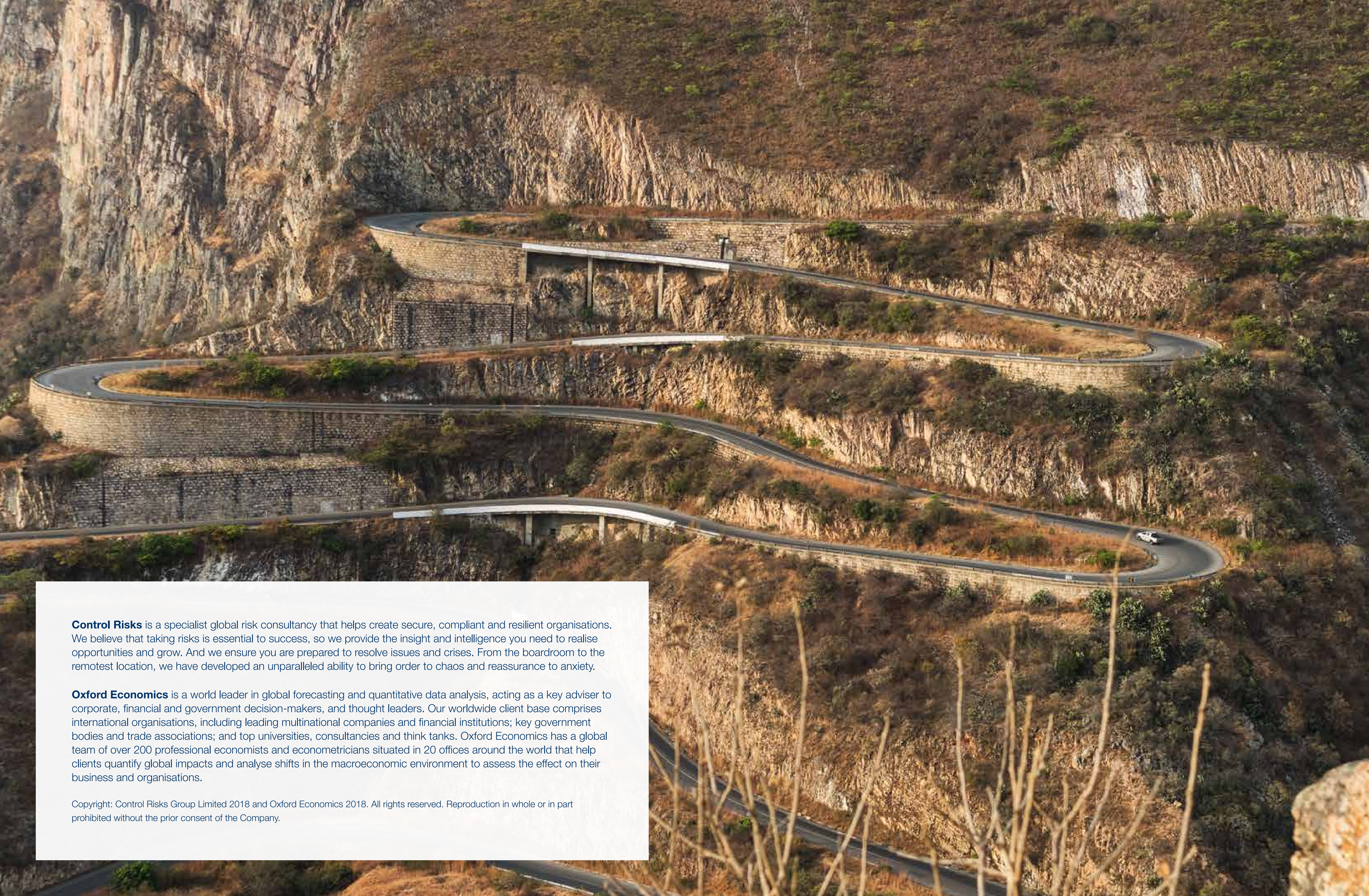
Africa Risk-Reward **Index**

June 2018



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Foreword

A wave of change swept Southern Africa in the second half of 2017 and early 2018. Not all of it was unexpected – Control Risks predicted the power transitions in Zimbabwe and South Africa. Still, change extended more widely and unexpectedly to other countries in the region such as Angola.

And change was desperately needed. The first half of 2017 saw a sharp fall-off in M&A deals, with a 25% decrease in volume and 26% drop in value relative to the second half of 2016, driven by political uncertainty in South Africa, the continent's largest M&A market*.

In our first edition of the Africa Risk-Reward Index, we analysed the impact of political uncertainty on economic performance in Africa's three powerhouses: South Africa, Nigeria and Egypt. But these three countries were not alone:

Kenya in 2017 was dominated by a seemingly endless presidential election cycle, though estimated real GDP growth still showed a resilient 5%.

Nigeria in 2017 recovered to 0.8% real GDP growth, after a painful recession triggered by a dip in oil prices. Protectionist policies and uncertainty over President Muhammadu Buhari's health also discouraged foreign investors. Nigeria's recently initiated Economic Recovery and Growth Plan has begun to tackle some of the economy's challenges, including corruption and an infrastructure deficit. The plan has also sought to remove bottlenecks to improve the ease of doing business. Economic activity in 2018 will be overshadowed by politicking ahead of the 2019 presidential election. However, Nigeria's economy will weather the political uncertainty.

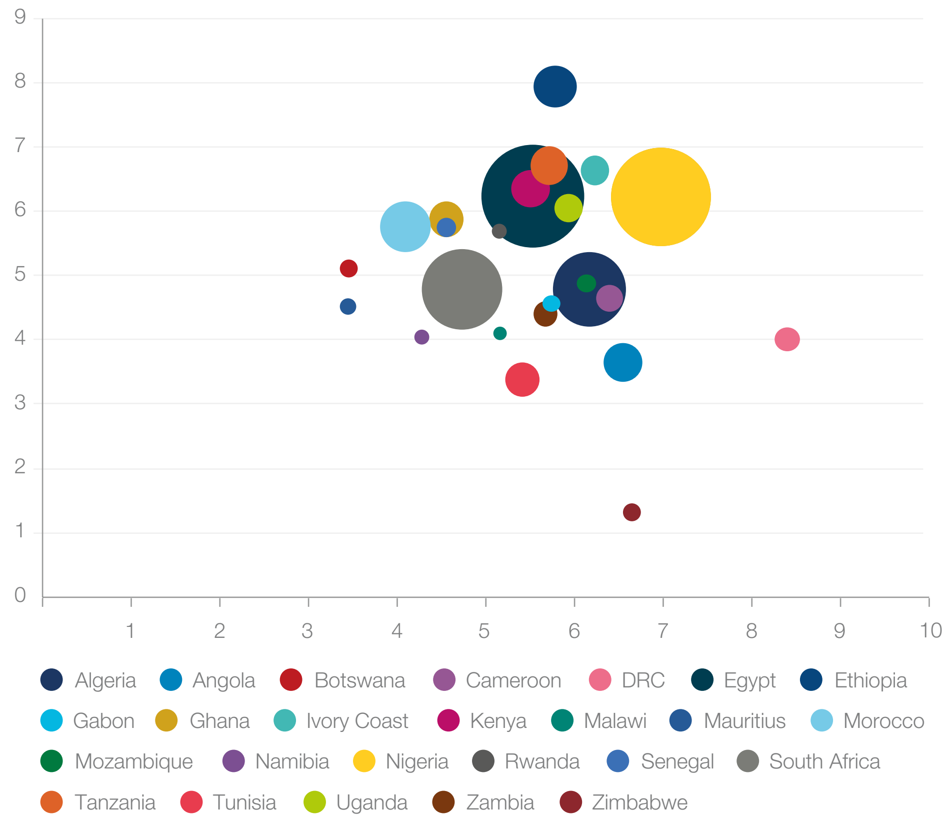
In this second edition of the Africa Risk-Reward Index we review changes observed in the second half of 2017 and early 2018, and look more closely at Angola and South Africa. We also examine what the end of Kenya's painful election cycle has meant for that country. In the spirit of the Index, we also shine a light on countries stirring the interest of investors for some time now: Senegal and Côte d'Ivoire.

The Africa Risk-Reward Index plots each country's performance relative to African peers, and highlights how some of Africa's largest economies are outshone by smaller rivals. The position of each country is defined by its risk and reward score; the size of its bubble represents the size of the country's GDP. Further details on the methodology for calculating each country's scores are provided in detail in the annex.

The Africa Risk-Reward Index should not replace an in-depth analysis tailored to your sector and company. Please contact us to discuss at: **enquiries@controlrisks.com** or **africa@oxfordeconomics.com**

Source: Control Risks and Oxford Economics 2018

Fig.1 ▸ Africa Risk-Reward Index



*Source: Resourceful dealmaking – Outlook for M&A in Africa; Mergermarket and Control Risks, 2017

Late 2017 and early 2018 saw dramatic political developments. In Angola and Zimbabwe, two of the continent's longest-serving leaders left office. In South Africa, President Jacob Zuma resigned amid allegations of corruption and economic mismanagement. Further north, the protracted spectacle of the Kenyan presidential election may not have resulted in a change of leadership but undoubtedly impacted on investor confidence. Uncertainty persists in Ethiopia following the shock resignation of prime minister Hailemariam Desalegn in February 2018. In Congo (DRC), President Joseph Kabila clings to power in the absence of elections.

These political developments have inevitably had an impact on the position of these countries on the Africa Risk-Reward Index.

In Southern Africa, the changes have been broadly positive. New leaders promising economic reforms are lowering risks, though the effects will take time to translate into an improved reward score. Elsewhere, uncertainty around unresolved political issues has raised risks or tempered our outlook on potential rewards. Three countries illustrate these trends:

Politics versus economics – Angola, South Africa and Kenya

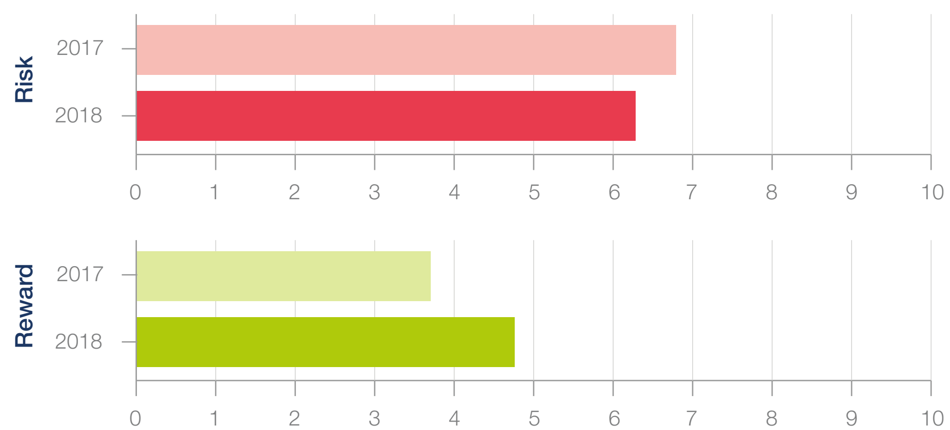
Angola inaugurated President João Lourenço on 26 September 2017. Since then, he has acted with remarkable speed and decisiveness to consolidate his authority. More than 100 allies of his predecessor, José Eduardo dos Santos (1979-2017), have been removed from public posts. These include the former president's daughter Isabel dos Santos as chairperson of state oil company Sonangol and his son José Filomeno dos Santos as chairperson of Angola's sovereign wealth fund. State contracts and agreements held by companies linked to the dos Santos family have also been cancelled.

These efforts to dismantle dos Santos's networks may be in part politically motivated, but they have also provided new opportunities for foreign investment in sectors previously dominated by companies linked to the former president and his family. Lourenço has been strengthened by his popular mandate to tackle corruption and deliver economic growth, and the president has followed his attacks on dos Santos's interests with reforms intended to facilitate investment. This combination of weakening vested interests and improving the regulatory environment is most prominent in the oil and gas, diamond, and telecommunications sectors.

Lourenço will struggle to implement all of his proposed reforms. As necessary fiscal consolidation and currency devaluation start to impact on living costs, the popular mandate underpinning his actions will start to weaken. Senior figures within the ruling Popular Movement for the Liberation of Angola (MPLA) will offer resistance once the focus shifts from the dos Santos family to other political players with business interests. But for the moment Angola is looking increasingly attractive as an investment destination.

Source: Control Risks and Oxford Economics

Fig.2 ▶ Risk-Reward Index in Angola – 2017 & 2018



The economic perspective

Higher oil prices will benefit Angola's external balances in 2018. We forecast that exports will rise by 28.8% to USD 41.6bn, driven by increased oil output and higher global prices for the commodity, which will improve the overall outlook for the Angolan economy. There have been some positive developments on the policy front, too: the central bank surprised markets early in the year with the announcement that it would adopt a flexible exchange rate within horizontal bands. The weaker kwanza will contribute to mounting price pressures, especially during H1, but inflation is nonetheless seen declining from 32.2% in 2017 to 27.6% in 2018. The new system will also tend to facilitate investment and trade. Real GDP growth is forecast to rise from 0.9% in 2017 to 2.1% in 2018, and to average 2.8% a year in 2019-20.

Source: Control Risks

Fig.3 ▶ Key personnel changes under Lourenço

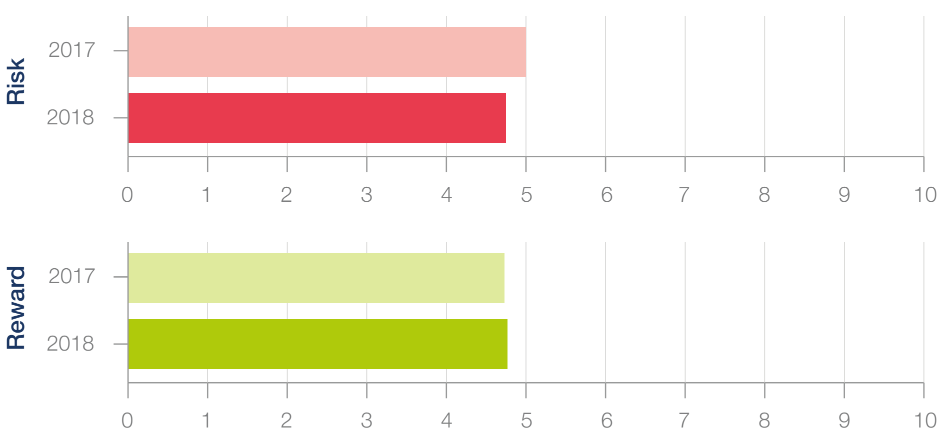
Sonangol	Sovereign Wealth Fund	State Intelligence and Security Service	External Intelligence Service	Angolan Armed Forces
↑ Carlos Saturnino	↑ António Egído de Sousa Santos	↑ Fernando Garcia Miala	↑ Ângelo Eduardo Paca	↑ António Egídio de Sousa Santos
↓ Isabel dos Santos	↓ José Filomeno dos Santos	↓ Eduardo Octávio	↓ André de Oliveira João Sango	↓ Geraldo Sachipengo Nunda

In **South Africa**, the December 2017 election of Cyril Ramaphosa as African National Congress (ANC) president and his subsequent ascent to the national presidency in February 2018 provided an immediate boost to investor confidence. Ramaphosa's administration is expected to deliver greater policy certainty in strategic economic sectors, including mining, energy and financial services. Moreover, Ramaphosa is likely to oversee the implementation of policies intended to consolidate fiscal expenditure and tackle corruption in public institutions and state-owned enterprises, increasing opportunities for doing business in South Africa.

Nonetheless, Ramaphosa faces a divided African National Congress (ANC), and may at times struggle to impose his authority and vision. This will be most evident in the ANC's rhetoric on accelerating a policy of land expropriation without compensation. Electoral pressures ahead of the 2019 general elections will aggravate these risks. Meanwhile, deeply entrenched patronage networks spread across state entities and institutions will remain difficult to uproot. This is likely to contribute to the relatively slow recovery in the governance of state-owned entities, which remain a key source of vulnerability for South Africa's sovereign rating.

Source: Control Risks and Oxford Economics

Fig.4 ▸ Risk-Reward Index in South Africa – 2017 & 2018



The economic perspective

The election of Ramaphosa as head of state in February has triggered a notable recovery in business and consumer confidence. Nonetheless, it will take time for the GDP growth rate to lift more meaningfully, as numerous economic challenges persist. Chief among these challenges are those identified by Ramaphosa in his first State of the Nation Address in February 2018: restoring the health of state-owned enterprises, addressing the policy impasse in the mining industry, improving job creation (especially addressing youth unemployment), reviving the manufacturing sector, promoting small business development, growing the tourism sector and exploring digital industrial revolution opportunities. There are many political obstacles to implementing meaningful changes in these areas, not least South Africa's combative trade unions. Disappointing performances in the mining and manufacturing sectors meant that the economy hardly expanded in Q1. Furthermore, headwinds are gathering for consumers, with the recent surge in international oil prices pushing fuel costs to all-time highs. We have revised our GDP growth forecast for 2018 marginally lower from 2.0% to 1.9%, and are keeping next year's GDP growth forecast unchanged at 2.0%.

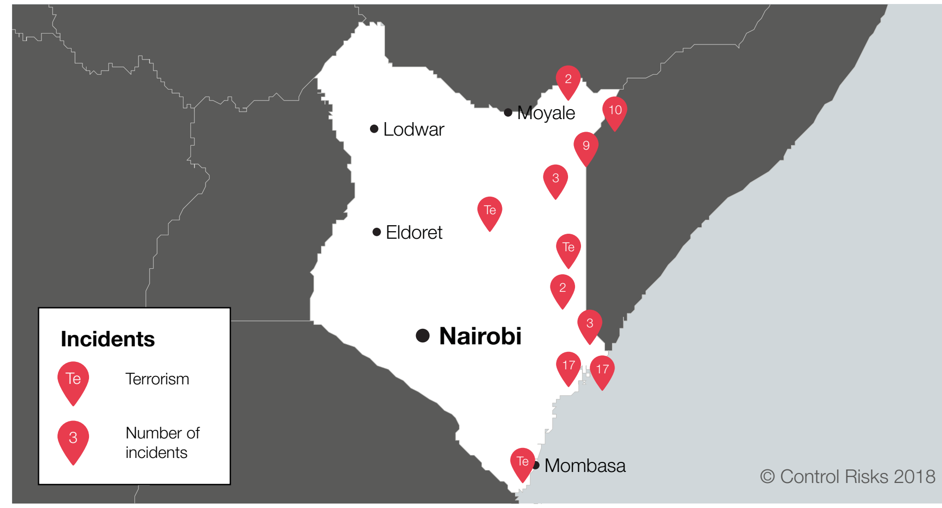
Kenya's tumultuous election period in 2017 exposed the persistent ethnic and regional divides that still characterise politics in the country. 2017 was slow for investors – domestic and foreign – as many chose to wait out this extended period of political uncertainty. The suspension of some broadcasters for covering defeated opposition leader Raila Odinga's mock swearing in and ignoring of court orders for the restitution of broadcast services by the Jubilee Party of Kenya (JPK) government in February 2018 further unnerved investors.

Meanwhile, there are increasing concerns over the government's external debt burden, with a new USD 2bn Eurobond issued in February even as the proceeds of a previous issue have yet to be fully accounted for*. Moreover, security remains a challenge amid high levels of criminality across the country and the continued threat posed by Somali Islamist group al-Shabab.

Despite this, Kenya's reward score is among the highest in sub-Saharan Africa. A pro-business approach underpins the JPK's plans to further diversify the economy, which is expected to grow at 4.9% in 2018. Continued investments in infrastructure will help boost manufacturing and trade with Kenya's neighbours. Combined with its well-educated workforce, improvements in the regulatory environment and strong innovative service sector, Kenya presents an attractive investment destination. Improving relations between the government and opposition will be instrumental in ensuring that political tensions do not undermine economic growth, and more prudent fiscal and macroeconomic policies would also help maintain positive economic prospects.

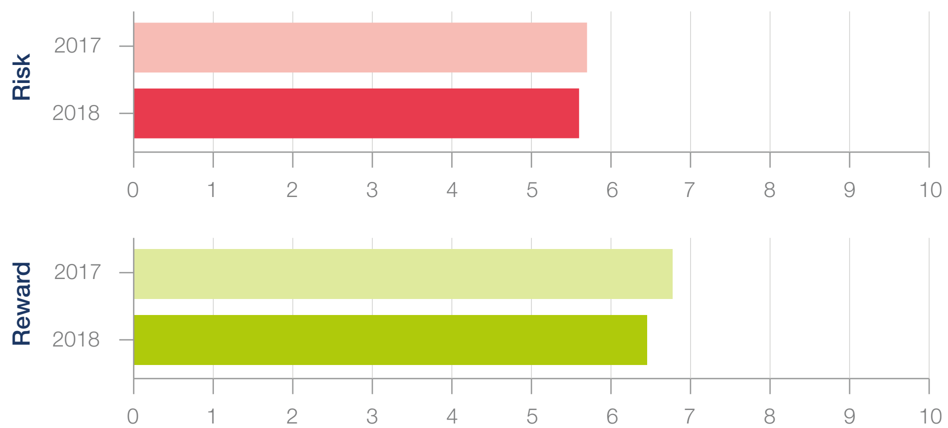
Source: Control Risks 2018

Fig.6 ▸ Attacks by Islamist extremists in Kenya 30 April 2017 - 30 April 2018



Source: Control Risks and Oxford Economics

Fig.5 ▸ Risk-Reward Index in Kenya – 2017 & 2018



The economic perspective

The Kenyan economy grew by 4.7% year-on-year during the first three quarters of 2017. A weak agricultural performance during 2017 H1 and a slump in economic activity during the extended election period in 2017 H2 are estimated to have pushed real GDP growth down to 4.6% last year – the slowest economic expansion since 2012. Economic growth is expected to pick up this year, supported by more favourable weather conditions (relative to 2016 and H1 2017), strong public investment (stimulating industry), and an improvement in business sentiment as political tensions resulting from electoral dramas in 2017 subside. Real GDP growth is projected to average just under 6% p.a. over the next four years, with the development of the domestic hydrocarbons sector gaining some momentum towards the end of the decade.

*Read more on Africa's debt problem here: https://www.controlrisks.com/riskmap-2018/articles/at-debts-door

Investors often focus on Africa's giants of Egypt, Nigeria and South Africa. But in the second tier of African economies a number of countries are competing for attention. The rewards offered by mid-sized economies such as Cameroon, Zambia, Uganda or Tunisia may not be as great, but they offer untapped opportunities with typically manageable risks.

Careful understanding of these markets is required, as appearances can be deceiving. Two key examples of this are Côte d'Ivoire and Senegal. Over the past few years Côte d'Ivoire has enjoyed rapid economic growth; Senegal has been more muted. Looking forward, however, Senegal's relationship between risk and reward marks it out as a promising investment destination.

Stuck in the middle – Senegal and Côte d'Ivoire

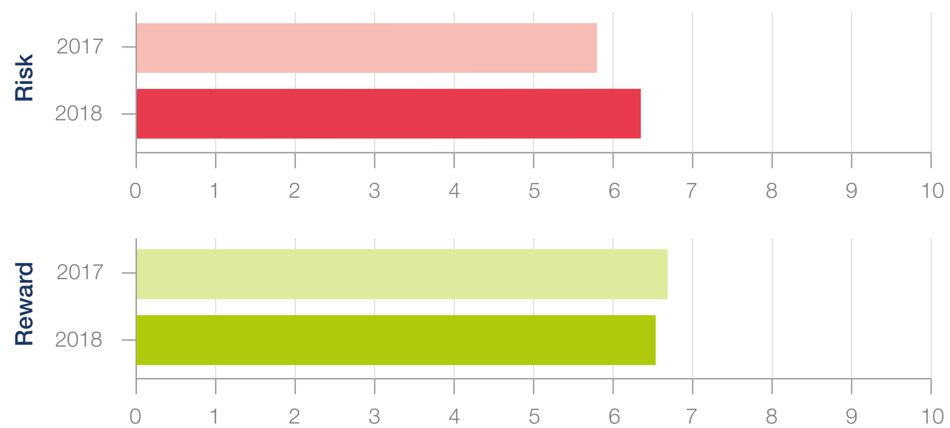
Côte d'Ivoire has experienced an impressive recovery since the 2010-11 crisis, in which a disputed election result led to a civil conflict. Prioritising economic growth, the government has collaborated with international institutions; improved macroeconomic management; invested in infrastructure; adopted new investment, petroleum and mining codes; reformed the agricultural sector; and simplified bureaucratic procedures. Côte d'Ivoire has ranked as one of the top business reformers in recent years according to the World Bank. Investors have flocked back to the country, with the construction, telecommunications, banking, retail and mining sectors seeing considerable growth. Côte d'Ivoire has achieved one of the highest growth rates in the world, averaging 8.5% annually between 2012 and 2017.

Major obstacles to a full recovery persist. President Alassane Ouattara has struggled to establish a truly technocratic government, and political interference and corruption continue to permeate the business environment. Growth has not been inclusive – unemployment and poverty rates remain high and socioeconomic discontent fuelled protests in 2017. Political and national reconciliation have also stalled, undermining Ouattara's legitimacy.

Shortcomings in disarmament and security sector reform pose longer-term threats to security and national stability, as highlighted by army mutinies, protests by former combatants, clashes between rival security forces and attacks on security posts in 2017. Finally, competition is increasing over Ouattara's succession in 2020, with rivalries within and between the ruling coalition and opposition likely to provide for a volatile election cycle. Côte d'Ivoire will need to carefully navigate these challenges in the coming years to ensure continued foreign investment and high economic growth.

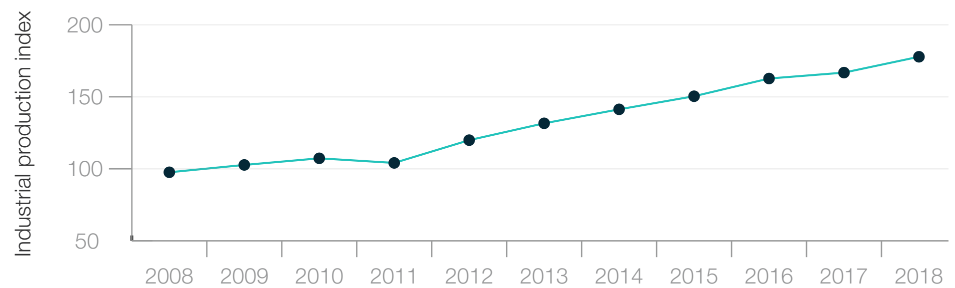
Source: Control Risks and Oxford Economics

Fig.7 ▸ Risk-Reward Index in Côte d'Ivoire – 2017 & 2018



Source: Oxford Economics

Fig.8 ▸ Industrial Production Index (Côte d'Ivoire)



The economic perspective

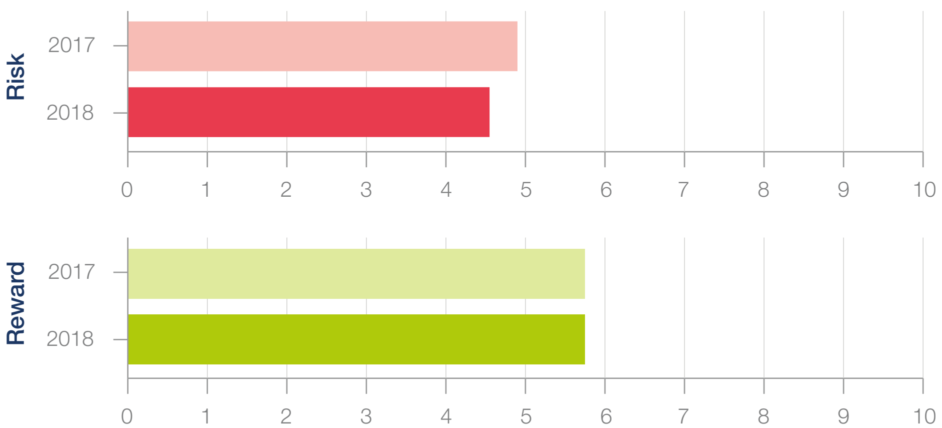
Strong economic growth is supported by continued government spending in line with the implementation of the 2016-20 National Development Plan (NDP), which includes efforts to improve infrastructure spending and create a better business environment. An improved business climate has the potential to attract more foreign investment, an imperative for future economic growth. Foreign direct investment (FDI) prospects are promising, and the relatively stable macroeconomic environment and high economic growth rates are expected to continue attracting foreign investor interest. Despite the projection of strong fiscal spending, we expect the fiscal deficit to remain sustainable, largely due to continued efforts to widen the tax base. The short-term economic growth outlook remains positive: we forecast a real GDP growth rate of 7% for 2018.

Senegal has enjoyed a positive reputation for stability and democratic tradition, having never experienced a coup since independence and managing several peaceful transfers of power since the 1990s. Nonetheless, the country has long struggled to attract high levels of foreign investment in light of a lack of exploitable natural resources and a range of operational issues, including a cumbersome bureaucracy and a power sector crisis. Growth rates barely reached 3%-4% annually during the last two decades, with the Senegalese economy remaining much smaller than those of Côte d'Ivoire and Ghana, for example.

However, Senegal's economic trajectory has followed a positive trend in recent years. President Macky Sall in 2014 launched a USD 19bn economic development plan, the Emerging Senegal Plan (PSE), which includes a series of reforms and public infrastructure projects to improve the business environment. The PSE is starting to pay off, with growth rates nearing 7% annually since 2016, making Senegal one of the continent's strongest performers. Meanwhile, promising offshore oil and gas discoveries since 2014 have attracted growing interest from international majors, and could bring significant additional revenue in the longer term.

Source: Control Risks and Oxford Economics

Fig.9 ▶ Risk-Reward Index in Senegal – 2017 & 2018



The economic perspective

Under the PSE, growth has increased steadily over the last three years, reaching close to 6.4% in 2017. Besides strong public spending, other factors that positively influenced growth were growing exports, buoyed by a more diversified base in fishing, agriculture and mining, as well as more favourable terms of trade. Senegal's economic outlook remains positive. We forecast growth to remain buoyant at 6.7% in 2018 and 6.9% in 2019 while authorities continue to invest in infrastructure and implement structural reforms to improve the business environment. It is an imperative for the country to create a more favourable investment environment so that future growth is led by the private sector.

Promising news in the north – Morocco

For the second year in a row, **Morocco** has the lowest risk score (4.09) of any large economy in the Africa Risk-Reward Index. Its reward score (5.77) may not dazzle, but it remains comfortably above the regional average. Investors are beginning to take notice.

Morocco remains politically more stable than its neighbours in North Africa. The elected government under the authority of King Mohammed VI continues to gradually implement economic and social reforms aiming at improving the country's resilience to external shocks, making its exports more competitive, and enabling it to become less reliant on imports. These efforts improved the business environment and turned Morocco into the leading destination for FDI in North Africa. The automotive and aeronautical industries continue to thrive as authorities aim to position the kingdom as a regional industrial hub.

There are challenges though. Social tensions in less developed regions remain a key concern for the government, and efforts to address social grievances – including reducing the economic disparities between rural and urban areas – have had limited results. Localised protests against high unemployment rates and poor living conditions occur on a daily basis. Establishing stronger ties between Morocco and West Africa continues to drive the kingdom's foreign and trade policy at the regional level, and these efforts were bolstered when the Economic Community of West African States (ECOWAS) agreed in principle to Morocco's accession in June 2017. However, concerns among member states over the regional diplomatic balance of power, customs tariffs and freedom of movement are likely to lead to a postponement of Morocco's full admission beyond 2018.

Despite these issues, Morocco remains on track to consolidate its position as North Africa's investment hub and the gateway between Europe and Africa.

The economic perspective

After averaging 4.1% in 2017, economic growth is forecast to ease to 3.2% in 2018 due to a cyclical downturn in agricultural production, which continues to make the difference between a good and bad economic year in Morocco. Lower agricultural activity coupled with higher inflation will weigh on private sector consumption and weaken real GDP growth. Nonetheless, the industrial sector will be supported by strong investment, as well as continued development of high value-added manufacturing industries, while the services sector will be boosted by noticeable efforts to increase tourism. Medium-term growth will be enhanced by continued reforms to improve labour participation and efficiency, access to finance, quality of education and the business environment, as these represent the primary constraints to competitiveness and doing business, and it is positive that decision-makers recognise this.

Annex

Methodology

The Africa Risk-Reward Index is defined by the combination of risk and reward scores, integrating economic and political risk analysis by Control Risks and NKC African Economics.

Risk scores

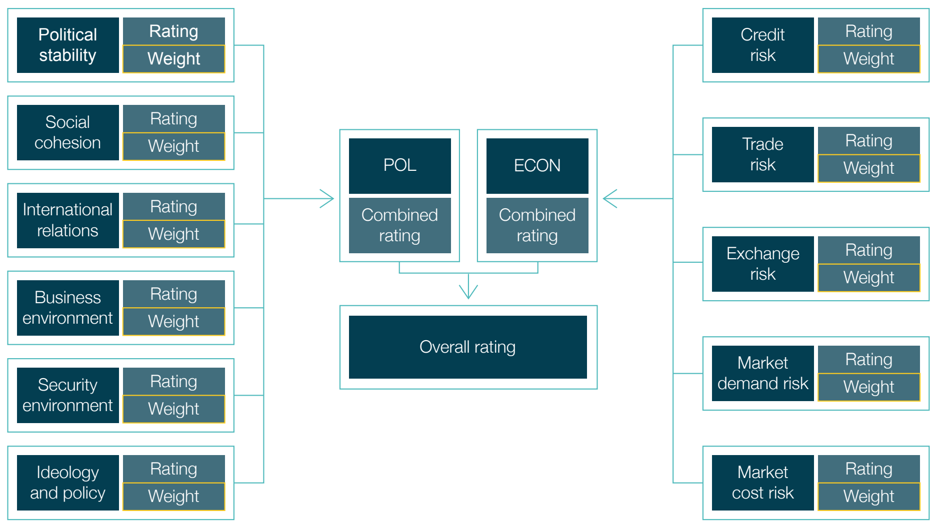
The risk scores replicate the scoring of each country within the joint product offering Economic and Political Risk Evaluator (EPRE) of Control Risks and Oxford Economics, the majority shareholder of NKC African Economics. Control Risks and Oxford Economics analysts rate a series of political and economic risk factors on a scale from 1 to 10, with 10 representing the highest level of risk. Each political and economic rating is assigned a default weight, based on its significance in the country context and its potential impact on business. The individual political and economic risk variables are then combined – multiplying rating by weighting – into the overall risk rating of a country.

Reward scores

The reward scores incorporate medium-term economic growth forecasts, economic size, economic structure and demographics. The economic growth outlook has the biggest weight in the reward score, as investment opportunities

Source: Control Risks and Oxford Economics

Fig.10 ▸ EPRE methodology



multiply where economic growth is strong. But the absolute size of the economy makes a difference, too: 0.3% GDP growth in South Africa in 2016, for example, represented extra value added of USD 830m, while 5.9% growth in Rwanda translated into just over USD 500m in new value added. So our score also incorporates a weight for economy size.

The economic structure indicator derives from the 'economic structure risk' component of NKC's sovereign risk rating model, which takes into account debt metrics, the current account, financial structure (including banking sector stability) and investment. Demographics are incorporated through the formulation of a demographic dividend, which incorporates population size, urbanisation and dependency ratios.

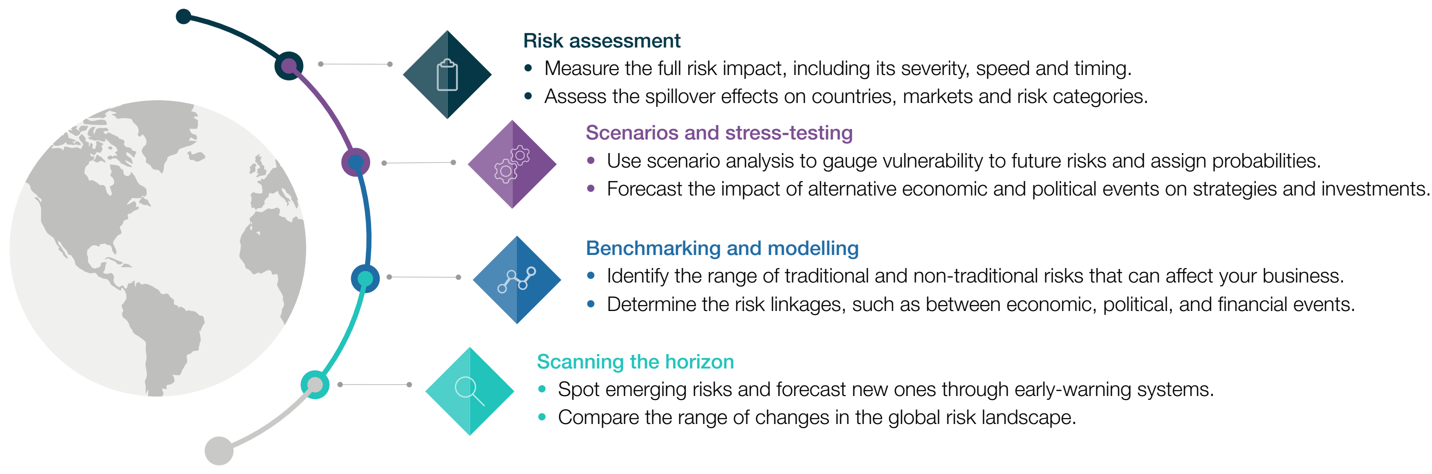
For details on the individual risk and reward definitions, please contact us.

enquiries@controlrisks.com or africa@oxfordeconomics.com

About us

Source: Control Risks and Oxford Economics

Fig.11 ▸ About us



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NKC African Economics

NKC African Economics, based in South Africa, is a majority-owned subsidiary of Oxford Economics that specialises in political and macroeconomic research in Africa. NKC investigates and interprets the sovereign risk, and political and macroeconomic conditions, of 30 African countries to caution against pitfalls and guide investors towards opportunities.

NKC has a strong reputation for independence and quality with a team of 31 staff, including 21 analysts. The analysis team includes economists, econometricians, political analysts and a financial economist.

Apart from the sovereign risk rating model service, NKC provides bespoke ad-hoc research on any topic that requires analysis of the political or macroeconomic environment of Africa, or any African country.

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Control Risks and Oxford Economics

Control Risks and Oxford Economics have joined forces to provide an innovative political and economic risk forecasting service that takes a holistic view of risk in a complex, rapidly changing, globalised world.

Control Risks and Oxford Economics combine extensive geopolitical, operational and security expertise with rigorous economic forecasts and models on 200 countries and 100 industries.

Together, we offer full-spectrum consulting that enables your organisation to navigate the world of political and economic risk. Covering all aspects of the investment journey, including security and integrity risk, our joint consultancy practice can overlay geopolitical and economic scenarios to bring new insights and direction.