Absa Africa Financial Markets Index 2018

Taking you further into Africa than ever before.

OMFIF

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The Absa Africa Financial Markets Index was produced by OMFIF in association with Absa Group Limited. The scores on p.7 and elsewhere record the total result (max=100) of assessments accross Pillars 1-6. For methodology see individual Pillar assessments and p.38-39.

OMFIF conducted extensive quantitative research and data analysis with additional data input from Absa. Qualitative survey data were collected and analysed by OMFIF with significant in-country expertise provided by Absa. The report was written by OMFIF, with Absa acting in an advisory capacity.

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Absa Group Limited ('Absa Group') is listed on the Johannesburg Stock Exchange and is one of Africa's largest diversified financial services groups.

Absa Group offers an integrated set of products and services across personal and business banking, corporate and investment banking, wealth and investment management and insurance.

Absa Group has a presence in 12 countries in Africa, with approximately 42,000 employees.

The Group's registered head office is in Johannesburg, South Africa, and it owns majority stakes in banks in Botswana, Ghana, Kenya, Mauritius, Mozambique, Seychelles, South Africa (Absa Bank), Tanzania (Barclays Bank Tanzania and National Bank of Commerce), Uganda and Zambia. The Group also has representative offices in Namibia and Nigeria, as well as insurance operations in Botswana, Kenya, Mozambique, South Africa, Tanzania and Zambia.

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The Official Monetary and Financial Institutions Forum is an independent think tank for central banking, economic policy and public investment – a non-lobbying network for best practice in worldwide publicprivate sector exchanges. At its heart are Global Public Investors – central banks, sovereign funds and public pension funds – with investable assets of $33.8tn, equivalent to 45% of world GDP. With offices in both London and Singapore, OMFIF focuses on global policy and investment themes – particularly in asset management, capital markets and financial supervision/regulation – relating to central banks, sovereign funds, pension funds, regulators and treasuries. OMFIF promotes higher standards, performance-enhancing exchanges between public and private sectors and a better understanding of the world economy, in an atmosphere of mutual trust.

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Contents

Aim of index

African economies are undergoing a significant period of transition and appraisal, with growing foreign investment interest and much examination of the continent's potential for mobilising local resources. Now in its second year, the index has become a benchmark for the investment community and Africa generally to gauge countries' performance and highlight how they can learn from others.

Vital role for the future

Akinwumi Adesina
President of the African Development Bank

Capital markets play a vital role in Africa's future. The continent's financial markets have remained resilient and innovative amid slowing worldwide growth after the synchronised upturn of 2017. However, they remain fragmented and shallow compared to their equivalents in Latin America and Asia. The second edition of the Absa Africa Financial Markets Index, produced by OMFIF, draws attention to the considerable investment opportunities and untapped market potential of countries across the continent.

The African Development Bank's African Financial Markets Initiative was launched in 2008 to develop local currency bond markets. Africa's capital markets have grown significantly over the past few decades, with around 30 stock exchanges in 2018 against just five in the 1980s. Total local currency sovereign bond issues increased to more than $240bn in 2017 from $28bn in 2000. This includes 94% of Treasury bills with original maturity of less than one year in 2000 v. around 80% in 2017. The Bank's African Financial Market Database expanded to 43 countries in 2015 from 22 in 2012.

Resilient and deeper financial markets are essential to Africa's transformation. Achieving the Bank's 'High 5' objectives for accelerating Africa's transformation (light up and power, feed, integrate, industrialise and improve the quality of life for the people of Africa) depends on financial markets playing a greater role in financing the real economy.

The Bank's goal is to support 20 capital markets over the next decade and address market development challenges, including those identified in the various indicators of the six pillars of this index. That is why the Bank engages with the public and private sectors to support market reforms, such as policy modernisation and frameworks governing capital markets. Flexibility in accessing capital markets is key to unlocking domestic savings and attracting investment.

Africa's transformation requires significant resources. To achieve universal energy access by 2025, for example, policy-makers must mobilise $30bn-$55bn annually in domestic and international capital. This calls for a shift of resource mobilisation, deploying robust financial systems and capital markets. The private sector will need to bear much of the load. This latest OMFIF report provides an excellent basis for the acceleration of the delivery of the Bank's 'High 5' strategy and I strongly commend its publication.

Resilient capital markets are a necessity, not a luxury

Jingdong Hua

Vice-President and Treasurer,
International Finance Corporation

Delve into the history of countries that have achieved transformative economic growth and a common denominator emerges: in nearly every case they relied on sound financial architecture to effectively build and connect savings to investments. Africa's potential, if it harnesses the power of resilient financial architecture, is likewise, enormous.

Policy-makers must recognise that capital markets are as important as social and physical infrastructure. The good news is that a new generation of African leaders are embracing the long-term view, acknowledging the development paradigm has changed, and prioritising the private sector.

As this second Absa Africa Financial Markets Index reveals, important steps are being taken to develop financial systems that are robust and large enough to entrench resilience. Still, Africa's corporate bond market is markedly small, and many countries face financial, security or humanitarian challenges, and an urgent need to diversity their economies.

Without significant shifts in policy, the world is not on track to achieve the target of less than 3% of people living in extreme poverty by 2030. In some places, including sub-Saharan Africa, poverty could remain in double digits percentages. To create an enabling environment for job creation and shared prosperity, Africa must develop deep, liquid and open capital markets both domestically and regionally – ensuring efficient channelling of savings towards entrepreneurs and financing vital rail, road, power and housing infrastructure.

IFC – a sister organisation of the World Bank and member of the World Bank Group – is the largest global development institution focused exclusively on the private sector in developing countries. More and more of our clients in Africa are demanding local currency financing. As a triple A-rated institution, we are increasingly offering local currency solutions and access to local capital markets so they can focus on growing business instead of worrying about exchange rate volatility.

We are also committed to building capacity, and recently welcomed our third class of fellows for the Capital Markets Program we have developed with the Milken Institute and the George Washington University, forming champions for capital markets development in emerging economies. Capital markets are not a luxury – they are a necessity.

Co-operation underpins inclusive growth

Maria Ramos

Chief Executive Officer,
Absa Group

Greater co-operation and collaboration between African countries will be the fundamental building blocks for sustainable economic development, accelerating industrialisation and the achievement of inclusive growth. The recent signing of the African Continental Free Trade Agreement by most member states of the African Union has ushered in an era of enhanced intraregional co-operation and was an important signpost on Africa's journey towards building the institutions and financial infrastructure that will attract local and international investors.

The second edition of the Absa Africa Financial Markets Index comes at a time when emerging market economies are under intense pressure with currencies depreciating, growth slowing and interest rates rising. The impact has been driven in part by economic developments in advanced economies but also local factors. The current period has only highlighted the importance of strong domestic financial markets in improving economic resilience.

The 2018 edition of the index takes us further into Africa's financial markets than ever before. The report assesses progress and potential across six key areas: market depth; access to foreign exchange; market transparency, tax and regulatory environment; macroeconomic opportunity; and the legality and enforceability of standard financial markets master agreements.

We believe the index is an important tool that can be used by policy-makers and market participants to guide their efforts in building robust financial markets that can drive inclusive growth. We are proud to be relaunching the index as part of the Absa Group's commitment to contributing to pan-African growth and prosperity.

Signs of progress amid regional economic weakness

The Absa Africa Financial Markets Index, produced by OMFIF, provides a toolkit for countries seeking to strengthen their financial markets infrastructure. It tracks progress on financial market developments annually across a range of countries and indicators. This year's edition extends coverage to three additional countries – Angola, Cameroon and Senegal – and pays special attention to policies to enhance market growth, including financial inclusion and investor education. Kenya, Morocco and the Seychelles have improved their scores most over the last year, particularly in terms of openness to foreign exchange. Nigeria's score has also strengthened, thanks to policies augmenting market depth and enhancing the capacity of local investors. Mauritius and Namibia, while still among the top performers, have seen their scores deteriorate across most pillars. Improvements in market infrastructure and regulatory frameworks could boost the performance of countries in the middle of the index over coming years.

2018	2017		Score	Comments
1	1	South Africa	**93**	Deep and liquid financial markets but shows weaker macroeconomic outlook
2	3	Botswana	**65**	Stable performance across pillars with efforts made to improve local investor base
3	5	Kenya	**65**	Top place for access to foreign exchange but limited product diversity
4	2	Mauritius	**62**	Strong regulatory and legal framework but shallow foreign exchange market
5	6	Nigeria	**61**	Improvements in administrative efficiency and tax incentives boost regulatory environment
6	4	Namibia	**57**	Strong local investor base but low liquidity in domestic market
7	7	Ghana	**55**	Markets benefit from regulatory reforms but have weak insolvency framework
8	9	Zambia	**53**	Relaxation of capital controls supports growth of foreign exchange market
9	12	Morocco	**50**	Broad improvements across all pillars, especially on local investor base
10	10	Uganda	**50**	Stable performance with good foreign exchange access but low local investor capacity
11	8	Rwanda	**49**	Discrepancies between strong official rules on transparency and reality of implementation
12	16	Seychelles	**45**	Liberalisation of capital account boosts foreign investment opportunities
13	13	Ivory Coast	**44**	Improving reporting standards but weak foreign participation in the market
14	-	Senegal	**44**	Regional exchange provides opportunities for growth but legal framework lags behind peers
15	11	Tanzania	**43**	Mining sector regulations help market deepen but local investors continue to lack capacity
16	14	Egypt	**42**	Improving foreign exchange environment but problems with contract enforcing
17	-	Cameroon	**41**	Low market depth and weak legal framework
18	15	Mozambique	**36**	Improved reporting standard but poor access to foreign exchange
19	-	Angola	**34**	Move to more flexible exchange rate encourages foreign investment but capital controls still in place
20	17	Ethiopia	**26**	Underdeveloped financial system lacking security exchange and corporate bond market

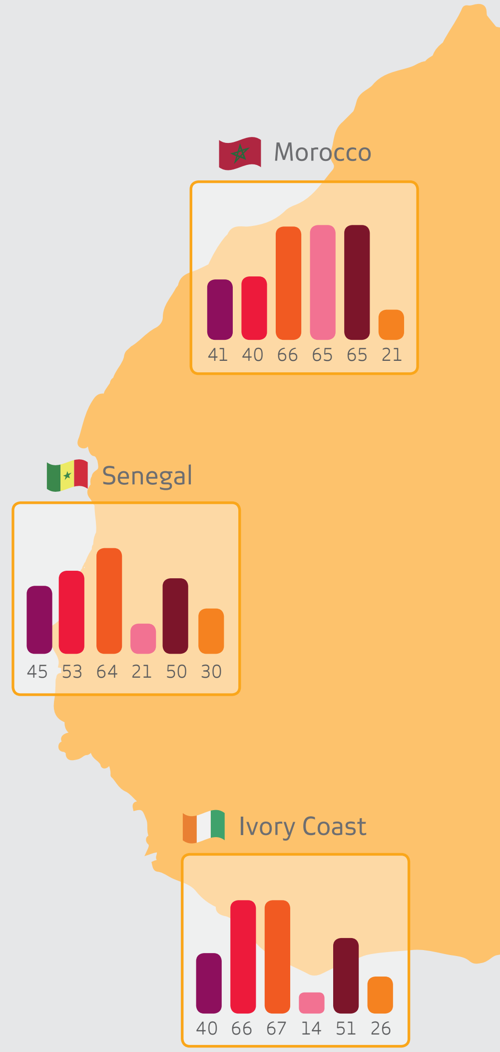
Score across all pillars, max = 100. The second edition of the index adds three additional countries (Angola, Cameroon and Senegal). The scope for direct comparison of countries' position in the index between 2017 and 2018 is therefore limited.

Building Africa's financial markets

The Absa Africa Financial Markets Index evaluates financial market development in 20 countries, as well as highlighting economies with clearest growth prospects. The aim is to show not just present positions but also how economies can improve market frameworks to meet yardsticks for investor access and sustainable growth. The Index assesses countries according to six pillars: market depth; access to foreign exchange; tax and regulatory environment and market transparency; capacity of local investors; macroeconomic opportunity; and enforceability of financial contracts, collateral positions and insolvency frameworks.

In addition to quantitative analysis, OMFIF gained additional insights by surveying over 50 policy-makers and top executives from financial institutions operating across the 20 countries, including banks, investors, securities exchanges, central banks, regulators, audit and accounting firms and international financial and development institutions.

Continued on p.10 >>



Overall pillar scores max = 100

Pillar 1: Market depth

South Africa	100
Nigeria	66
Mauritius	56
Ghana	55
Botswana	48
Zambia	48
Senegal	45
Kenya	44
Namibia	43
Uganda	43
Egypt	42
Morocco	41
Ivory Coast	40
Mozambique	38
Tanzania	35
Angola	29
Cameroon	28
Seychelles	24
Rwanda	21
Ethiopia	10

Pillar 2: Access to foreign exchange

Kenya	93
South Africa	91
Uganda	83
Botswana	79
Zambia	77
Seychelles	75
Namibia	72
Ivory Coast	66
Cameroon	62
Ghana	58
Nigeria	53
Senegal	53
Mauritius	52
Morocco	40
Egypt	37
Tanzania	36
Rwanda	35
Ethiopia	30
Mozambique	29
Angola	29

Pillar 3: Market transparency, tax and regulatory environment

Nigeria	94
South Africa	94
Rwanda	90
Mauritius	89
Botswana	78
Ghana	71
Tanzania	70
Kenya	70
Ivory Coast	67
Morocco	66
Senegal	64
Uganda	60
Namibia	57
Zambia	56
Angola	52
Mozambique	49
Egypt	45
Cameroon	45
Seychelles	26
Ethiopia	22

Pillar 4: Capacity of local investors

South Africa	95
Namibia	71
Morocco	65
Botswana	64
Nigeria	50
Seychelles	49
Kenya	33
Egypt	30
Cameroon	29
Angola	29
Senegal	21
Tanzania	19
Mauritius	18
Mozambique	17
Ivory Coast	14
Rwanda	14
Zambia	14
Ghana	13
Uganda	13
Ethiopia	10

Pillar 5: Macroeconomic opportunity

South Africa	75
Egypt	71
Namibia	70
Botswana	69
Morocco	65
Kenya	65
Uganda	63
Mauritius	63
Ethiopia	62
Seychelles	61
Nigeria	59
Tanzania	58
Angola	57
Ghana	57
Rwanda	56
Cameroon	55
Ivory Coast	51
Senegal	50
Mozambique	50
Zambia	44

KEY

Pillar 1 Market depth

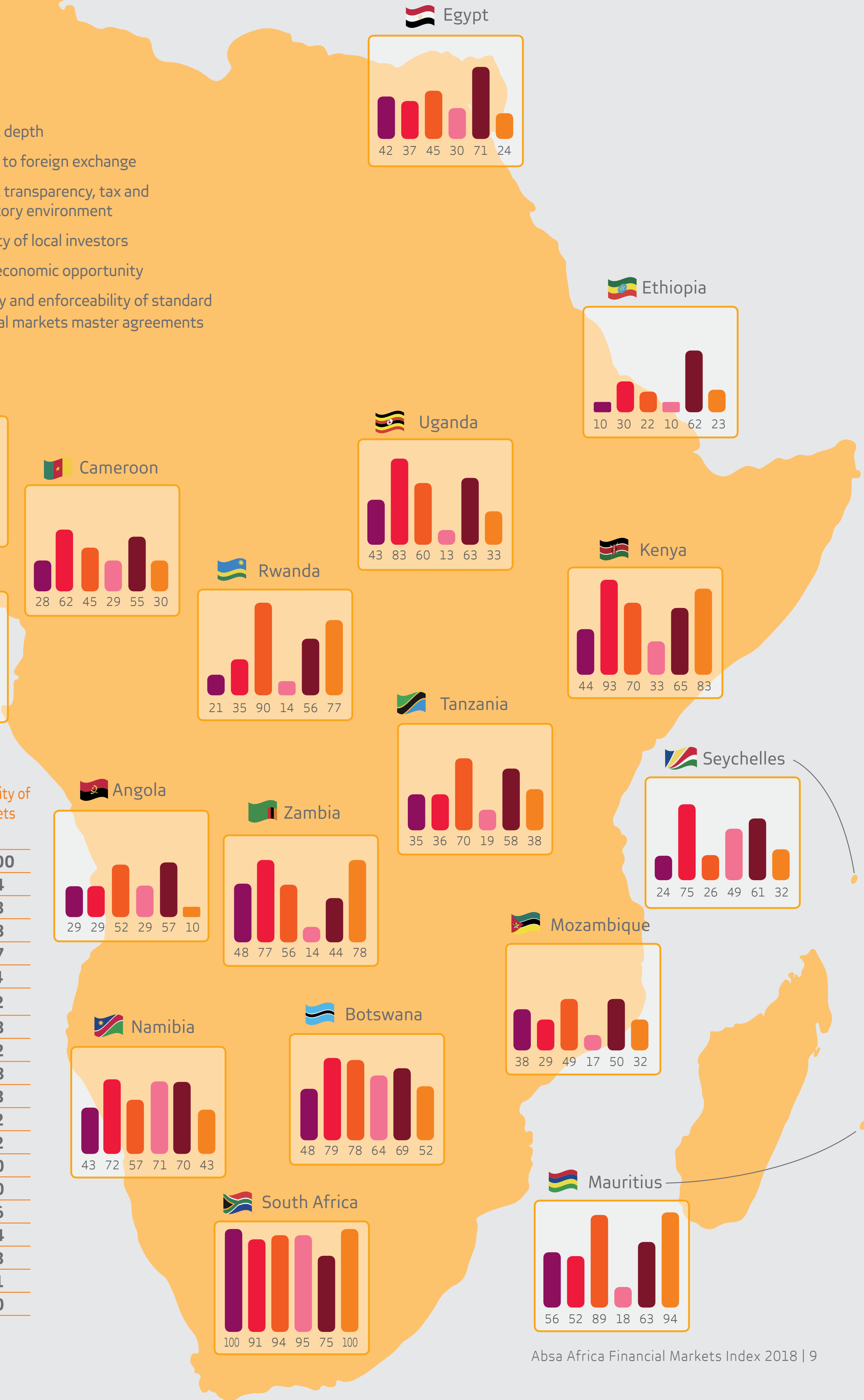
Pillar 2 Access to foreign exchange

Pillar 3 Market transparency, tax and regulatory environment

Pillar 4 Capacity of local investors

Pillar 5 Macroeconomic opportunity

Pillar 6 Legality and enforceability of standard financial markets master agreements



Pillar 6:
Legality and enforceability of standard financial markets master agreements

South Africa	100
Mauritius	94
Kenya	83
Zambia	78
Rwanda	77
Ghana	74
Botswana	52
Namibia	43
Nigeria	42
Tanzania	38
Uganda	33
Seychelles	32
Mozambique	32
Senegal	30
Cameroon	30
Ivory Coast	26
Egypt	24
Ethiopia	23
Morocco	21
Angola	10

The report finds that:

- Countries are progressing with policies that support the development of financial markets across the continent. South Africa's 'twin peaks' strategy for improving financial regulation and Mozambique's 'financial sector development strategy' stand out among the frameworks introduced over the past year. Such initiatives have boosted performance for the index as a whole.

- While year-on-year comparisons can be problematic given the introduction of three additional countries to the group (see Methodology on p.38-39 for more information), some broad trends can be noted: Kenya, Morocco and the Seychelles have improved their scores across the index, while those of Mauritius, Namibia and Tanzania have deteriorated.

- South Africa continues to lead the index, supported by strong financial market infrastructure and a robust legal framework. However, its macroeconomic performance has worsened. Additionally, it no longer tops the index across all six pillars, having been overtaken by Kenya on 'access to foreign exchange' and by Nigeria in 'market transparency, tax and regulatory environment'.

- The greatest area for improvement for the continent remains the 'capacity of local investors'. Excluding the top-five scorers, the remaining countries average a score of just 22 in Pillar 4. Survey respondents highlighted that the lack of knowledge and expertise of pension fund trustees and other asset owners hinders the development of new financial products, by reducing their demand for more sophisticated assets and strategies to diversify returns. Investor education is a major component of these countries' financial development frameworks.

- 'Market transparency, tax and regulatory environment' and 'macroeconomic opportunity' are the highest-ranking pillars. They are also the ones with the smallest degree of variation among countries. Nigeria's score has jumped considerably, reflecting improvements in administrative efficiency of the tax system, as well as the implementation of tax incentives and exemptions for capital markets activities. In contrast, Uganda's above-average withholding tax rate and other policies 'discourage market growth and development', according to survey respondents.

- International financial reporting standards are required for domestic companies in 17 out of the 20 countries in the index. Both Ivory Coast and Mozambique have transitioned from 'permitted but not required' to 'required' in the space of a year.

- Only South Africa, Nigeria and Namibia use the Master Agreement of the International Swaps and Derivatives Association, the Global Master Repurchase Agreement and the Global Master Securities Lending Agreement, making them more prepared to drive product innovation and growth in the derivatives market. Other countries aiming to attract outside investment must look at encouraging financial institutions to adopt international standard master agreements. Increasing the size and volume of intraregional transactions can be a step towards wider use of these.

- Foreign exchange liquidity remains low in Africa, with just three countries (South Africa, Kenya and Ghana) recording interbank foreign exchange turnover above $20bn. But markets are becoming more open. The central banks of Nigeria, Morocco and Egypt are taking steps to liberalise their exchange rates, while Kenya, the Seychelles and Zambia are relaxing capital controls.

• Overall liquidity is generally low, with 15 countries having equity market turnover of less than 10% of market capitalisation, and 10 countries having bond turnover of less than 10% of outstanding bonds. However, policies to improve market depth and activity are being implemented. Online trading platforms and the development of derivatives products have improved Nigeria's performance.

• Liberalising financial structures and pursuing greater integration with global markets can have disruptive effects in the short term. South Africa's open and highly liquid foreign exchange market has exposed it to capital outflows, reflecting' concerns about the country's macroeconomic trajectory. However, supporting liberalisation and openness is necessary to help the continent transition, diversify and develop. Survey respondents highlighted the importance of a gradual and coordinated approach to developing financial markets.

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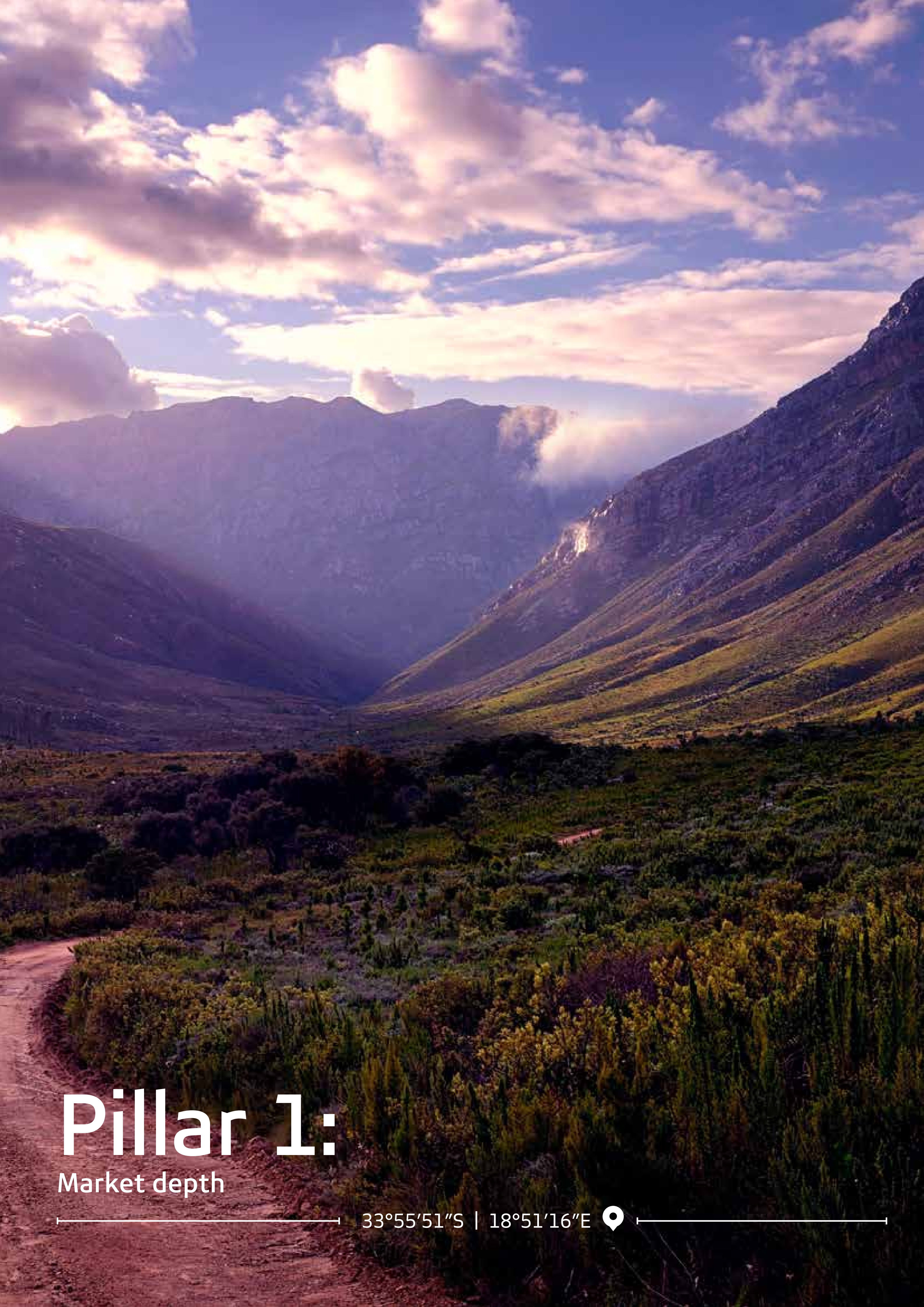


Pillar 1:

Market depth

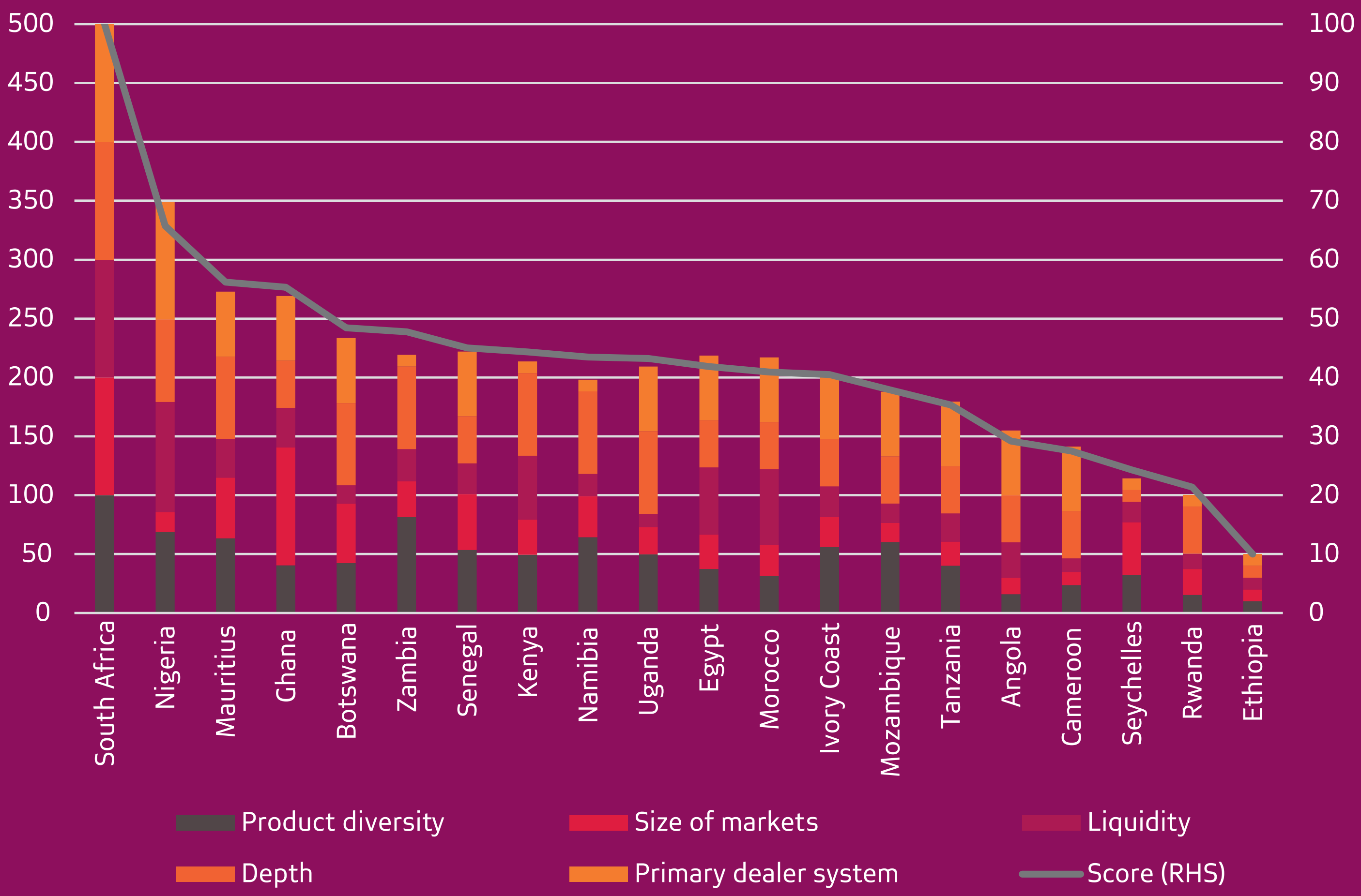
33°55′51″S | 18°51′16″E

Regional effort to boost listings and liquidity

African countries are implementing policies to bolster regional stock market integration and encourage expansion. However, low liquidity, few prospects for new listings and lack of product diversity present significant obstacles to capital market growth across the continent.

Figure 1.1: Direct market access improves Nigeria's score

Ranking of Pillar 1 categories, max = 500 (LHS) Harmonised score, max = 100 (RHS)



Sources: National securities exchanges, national central banks, Absa, OMFIF analysis. Note: Individual category totals (LHS) provide average scores for the indicators within each category. For full list of indicators, see Methodology on p.38-39. The harmonised score (RHS) is the average of all indicators across all categories, giving a total pillar score.

Deep and liquid capital markets are fundamental to supporting economic growth, creating domestic investment opportunities and attracting foreign and local capital. Pillar 1 measures this by looking at market capitalisation and product diversity. The average market capitalisation of the 20 countries covered by the index is just 56% of GDP; even this low figure masks large variations between countries.

Only three countries (South Africa, Botswana and Ghana) have a market capitalisation greater than 100% of GDP, while in 14 countries it is lower than 50%. Ethiopia lacks a securities exchange, apart from one for commodities. There are no equities listed on Angola's exchange, and both Cameroon and Mozambique have a market capitalisation of less than 5% of GDP. South Africa is the only country where the total value of listed equities is more than $100bn, at $1.1tn.

Almost all countries (except Angola, Cameroon and Ethiopia) have some form of corporate bond market. These, however, are typically small. Excluding South Africa, with more than $40bn worth of listed corporate bonds, the average value is just $707m. Total listed government bonds outvalue corporate bonds by around six-to-one, at $313bn against $54bn.

Given the relatively small volume of outstanding securities, trading values are generally low, with a lack of market makers and investors tending to buy bonds and holding them to maturity. Excluding South Africa, which has a bond turnover of almost 300% of market capitalisation, the average value of traded bonds to those outstanding was just 20% between July 2017-July 2018. For all countries in the index, the average value of traded equities to market capitalisation over those 12 months was even lower, at 6.4%.

Domestic limitations

Structural issues contribute to the low level of African capital market development. Many countries lack a benchmark yield curve for liquid, long-dated government bonds against which other securities can be priced. According to a multilateral financial institution operating in Kenya, 'Instead of issuance of a few large bonds in key maturities that could provide good reference points, the primary market consists of many small-sized bonds concentrated in the short end of the yield curve.' Short-term treasury bills account for around 40% of all local currency debt in Kenya. This makes it harder to build a broader market.

Secondary markets are generally fragmented and illiquid, hindering transparency and price formation. This is reflected in low turnover figures for bonds and equities. Ten countries have total bond market turnover of less than 10%, and 15 countries have equity turnover of less than 10%. Overbearing or inadequate regulation and oversight of capital markets play a major role. Regulators in one southern African country reported they 'do not have full capacity to supervise the securities business due to shortage of staff'.

Stringent, inflexible and outdated regulation adds significantly to costs. This makes it less attractive for companies to list. 'Cultivating a pipeline of new prospective issuers remains a stumbling block,' according to survey respondents in Kenya. Respondents in all countries highlighted this as a concern, even in relatively advanced markets like South Africa, where local financial firms complain 'there are very few new entrants' and that the main issuers are 'the normal suspects'.

Figure 1.2: Market size and liquidity

	Market capitalisation, % of GDP	Total turnover of equities, % of market capitalisation	Total turnover in bond market, % bonds outstanding	Total sovereign and corporate bonds outstanding, listed on exchanges, $bn
South Africa	316	40	294	203.3
Botswana	228	1	8	1.4
Ghana	118	1	53	46.5
Mauritius	91	5	5	0.9
Senegal	64	4	1	5.3
Morocco	57	11	26	0.8
Rwanda	38	1	2	0.2
Kenya	31	7	40	12.4
Uganda	29	0	0	2.2
Ivory Coast	26	4	1	5.3
Zambia	24	2	26	5.5
Namibia	22	2	2	2.7
Egypt	20	36	6	43.8
Tanzania	19	2	12	4.4
Seychelles	18	1	5	0.2
Nigeria	10	10	126	23.8
Mozambique	4	1	4	0.8
Cameroon	1	0	2	0.5
Angola	0	0	56	7.5
Ethiopia	-	-	-	-

Sources: Thomson Reuters, National Stock Exchanges, African Securities Exchanges Association, OMFIF analysis

Thin secondary markets

This encourages buy-and-hold strategies, hindering secondary market liquidity. There were no trades in corporate bonds in Zambia, Uganda, Rwanda, Namibia, Egypt, Cameroon and Angola over the last 12 months at least. This is because of the lack of active market makers and investors holding on to assets that are scarce, according to respondents.

While most countries have a primary dealer system in place for government bonds, the value of 'horizontal repo' (transactions between commercial banks) is low, resulting in an inactive market. The lack of centralised collection of data on these transactions means the total value of horizontal repo is unclear. However, beyond South Africa and Nigeria (with average daily turnover of around $6.5bn and $300m, respectively), all other markets are largely inactive. High costs, unclear property rights and lack of information are some of the reasons cited by survey respondents for this low uptake.

Some national policies aim to address these shortcomings. Telecommunications and mining companies in Tanzania are required to list on the Dar es Salaam Stock Exchange and float 25% of their shares to local investors, adding substantially to market capitalisation. However, local investors often lack the capacity to guarantee a full take-up, as in the case of Vodacom in Tanzania and MTN in Ghana. Other countries require domestic institutional investors to hold large amounts of their portfolios in local assets, boosting demand. As an example, new rules require insurance and pension funds in Namibia to invest a minimum of 45% of their assets in domestic securities by October 2018.

Improvements in capital market development

Several countries are implementing policies to encourage capital market growth. Ghana, Kenya, South Africa and the Bourse Régionale des Valeurs Mobilières (the stock exchange for eight West African countries) are lowering barriers to entry for small firms to try to expand the pipeline of new listed companies. One way of achieving this is the introduction of an alternative market for small and medium-sized enterprises, which can act as an 'incubator' for these companies before they list on the main board.

Rwanda, Botswana and Ghana are among the countries introducing measures to bring companies into the formal sector and to encourage them to list on alternative exchanges. This long-term approach requires providing significant education and training to companies about financial markets and the benefits of listing. Education is one of the principle areas of focus for all countries in this index.

Creating new products that are attractive to local and international investors is another key focus. Ghana plans to introduce real estate investment trusts on the exchange by the end of 2018, according to the country's Securities and Exchange Commission. Sukuk bonds are being developed in Nigeria, the West African Economic and Monetary Union, Mauritius and Kenya, among others. The BRVM is targeting 16 new sukuk listings by 2020 to raise finance across a range of sectors including telecoms, finance, agribusiness, construction, mining and energy.

Market infrastructure is also improving. The South African Reserve Bank has set up an electronic trading platform for primary dealers in an effort to improve liquidity and transparency in the government bond market. There are plans to expand this to other market participants and for other securities, including corporate bonds.

Nigeria has introduced online trading platforms that allow investors to execute trades on their own during trading hours. Direct market access, whereby institutional investors can trade without passing their mandates through brokers, is another important step. The introduction of electronic initial public offerings and progress towards derivatives trading will deepen the Nigerian market over coming years. Automated trading, which has already been introduced in Uganda, Rwanda and other countries, will also boost activity.

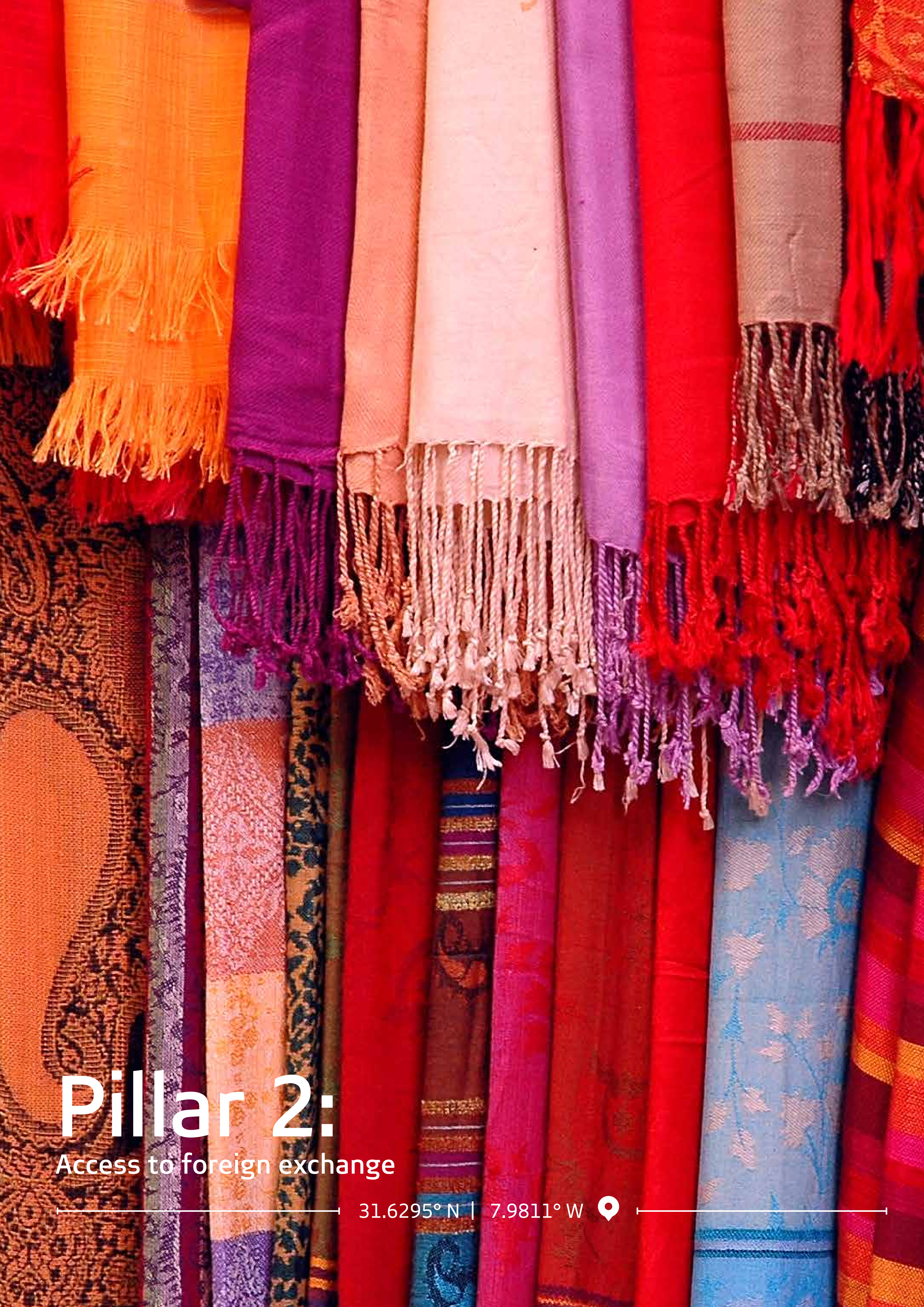
Regional integration

Many national exchanges in Africa are small, illiquid and inefficient, and local investor capacity is often limited. Therefore, fostering closer integration between national exchanges, or creating and strengthening regional ones, is an important area of focus.

Ghana, Ivory Coast, Nigeria and the regional BRVM are exploring closer alignment between their exchanges to allow brokers from each to trade directly on any of the other bourses. This is being considered through the West African Capital Markets Integration programme.

A committee of stock exchanges from the 16 countries that comprise the Southern African Development Community is pursuing capacity-building initiatives to stimulate cross-border trades. This includes harmonising listing requirements and improving data dissemination to attract local and international investment. In July 2018, finance ministers from SADC countries approved the centralisation of secondary trading of government securities on their exchanges.

'Secondary markets are generally fragmented and illiquid, hindering transparency and price formation. This is reflected in low turnover figures for bonds and equities. Ten countries have total bond market turnover of less than 10%, and 15 countries have equity turnover of less than 10%.'



Pillar 2:

Access to foreign exchange

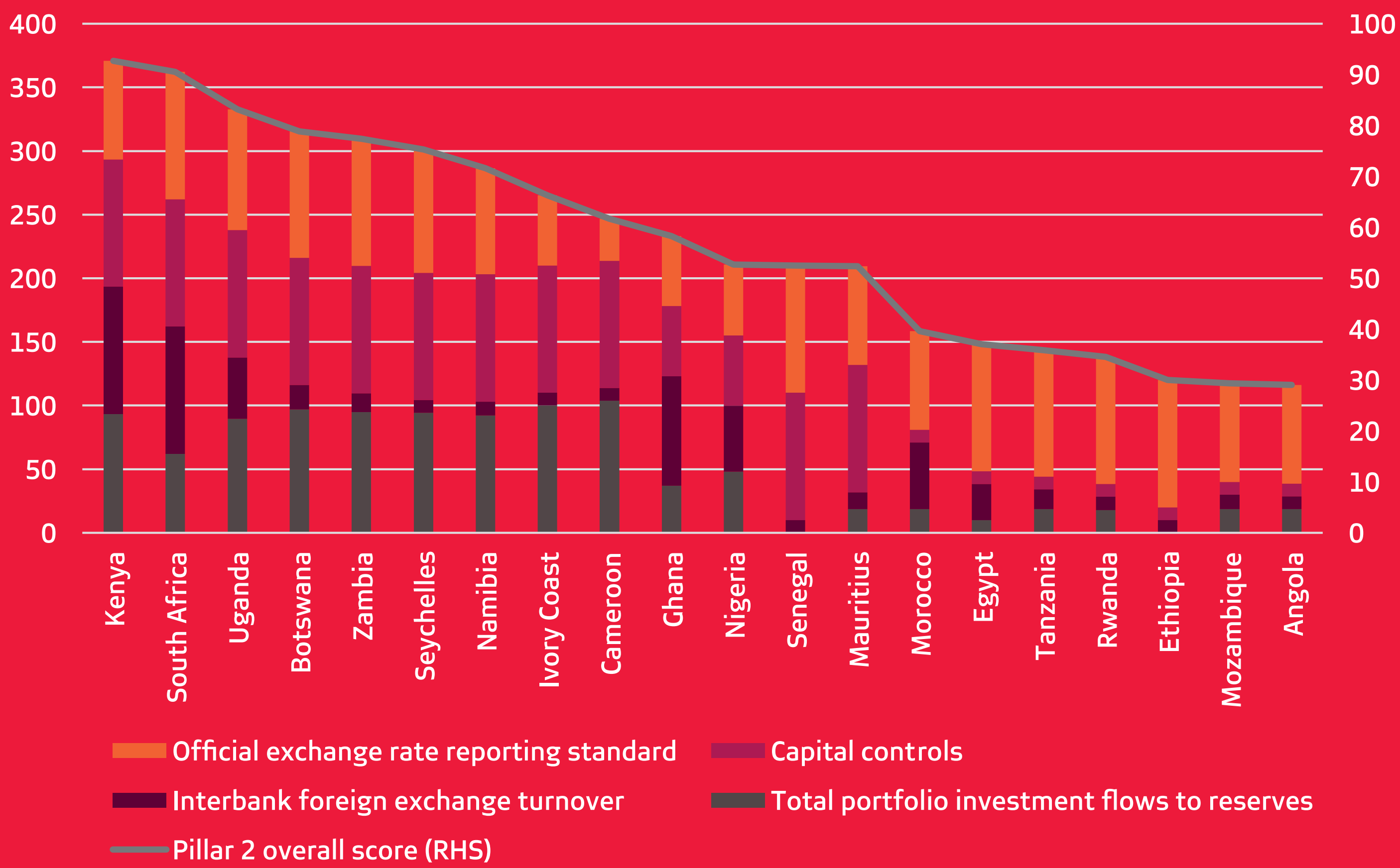
31.6295° N | 7.9811° W

On the path towards liberalisation

Economies are becoming more open as central banks take steps to liberalise exchange rates and relax capital controls. Egypt and Nigeria show progress, but South Africa's experience highlights the need for active management of vulnerabilities resulting from open markets.

Figure 2.1: Volatile capital flows cost South Africa top spot

Ranking of individual categories, max=100 (LHS); harmonised score, max=100 (RHS)



Sources: International Monetary Fund, national central banks, Absa, OMFIF analysis. Note: Individual category totals (LHS) provide rankings for the exchange rate reporting standard, capital controls, interbank foreign exchange turnover and the total portfolio investment flows to reserves. The harmonised score (RHS) represents the average of all categories' indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Given their relatively restricted sources of domestic capital, African financial markets are highly reliant on foreign investment. This is especially pronounced against a background of improving growth in advanced economies and continuing challenges across emerging markets.

Pillar 2 measures some of the factors that determine markets' potential attractiveness to international investors. These range from the level of capital controls and exchange rate reporting standards that define the ease with which investors can access them, to the level of foreign exchange liquidity that affects investors' ability to deploy and repatriate capital.

The need to manage volatility resulting from openness is also addressed in the pillar, as measured by central banks' ability to meet demand for currency by looking at the ratio of net portfolio flows to reserves.

Kenya earns the highest marks in this pillar, a significant improvement from ranking sixth last year. The relaxation of capital controls boosted its performance, as did improvement of the country's net portfolio flows to reserves ratio. South Africa has fallen to second place this year. While South Africa is top in the interbank foreign exchange turnover, capital controls and official exchange rate reporting categories, it suffers from a fairly high ratio of net portfolio flows to reserves. Over 2017, it experienced portfolio investment outflows of $16.4bn, against $50.5bn of reserves held by the South African Reserve Bank.

South Africa has the highest daily foreign exchange turnover to annual GDP ratio among emerging markets, at 17.1%. This is significantly above average and around five times higher than that recorded in other Brics countries (Brazil, Russia, India and China). In the light of global trade tensions, a slowdown in China and an unorthodox policy mix in the US, being one of the most liquid emerging markets has created vulnerabilities in South Africa, as was demonstrated during this year's emerging market sell-off.

Strategies for boosting interbank foreign exchange liquidity

South Africa's experience highlights the risks of open capital markets. With the US Federal Reserve raising interest rates, pressures on emerging markets are high. Africa, home to many commodity-exporting economies, is especially exposed.

Foreign exchange liquidity as measured by the amount of foreign exchange traded in the interbank market is low across the continent, making this one of the key differentiating factors for variation in countries' scores in this pillar.

The most active foreign exchange market is in South Africa, with more than $1.2tn annual turnover over 2017, according to central bank data. Kenya comes second with around $34bn and Ghana follows with $29bn, a significant increase from last year's $18bn. Morocco, Nigeria and Uganda also have strong levels of turnover above $10bn.

Beyond these countries, foreign exchange turnover is relatively low. Some states are taking steps to improve the environment for foreign exchange transactions. In 2017, Mozambique introduced its financial sector development strategy, which approves the standards and procedures for foreign exchange transactions, and changes processes regarding their registration and authorisation.

The index rewards countries with a high level of foreign exchange liquidity. However, while this can be an important element of well-functioning and resilient markets, it is also important that central banks observe prudent reserve management strategies and can cope with sudden capital outflows. In response to this need, index countries bolstered their collective reserves to $233.4bn in 2017 from $192.6bn in 2012.

More than half the reserves were held by three of the continent's largest economies: South Africa, Nigeria and Egypt. However, reserves as a share of GDP are highest in Africa's smaller but more developed economies. Over 2017, this metric grew substantially in Mauritius, which overtook Botswana to top the list with 44%, from around 36% last year.

Foreign reserves have been steady in most index economies since 2012, with some exceptions. Oil-dependent Nigeria and Angola have suffered from weak commodity prices over the past few years, and have drawn on foreign reserves to defend their currencies. Between 2012-17, Angola's reserves fell by $14bn (45%), and Nigeria's fell by $7bn (15%). Conversely, Egypt, Morocco and Mauritius have seen strong growth in reserves.

The case of Egypt is the most impressive; reserves almost tripled between 2012-17, growing by $22bn. Its reserves have reached record levels in 2018, aided by a $4bn Eurobond sale in January that helped provide a cash cushion and by setting up the 'Egypt Fund' in July to help manage the country's sovereign wealth.

Towards a more open environment

Despite the short-term risks arising from open markets, underdeveloped foreign exchange markets can be sources of instability and obstacles to long-term development. Investors who participated in OMFIF's survey consider a gradual opening of capital markets underpinned by solid market infrastructure as an important step in strengthening Africa's financial markets. The exchange rate regime and degree of openness to the flow of capital are crucial in shaping the foreign investment environment.

Of the 20 index economies, five have a fixed regime, five an intermediate regime, and 10 have freely floating currencies. Among those with fixed regimes, Ivory Coast and Senegal use the West African CFA franc, and Cameroon uses the Central African CFA franc, both of which are pegged to the euro. The Namibian dollar is fixed to the South African rand as part of the Common Monetary Area, while Botswana's pula is on a crawling peg against a basket of currencies. Intermediate regimes exhibit greater variation, from managed floats (Ethiopia), to floating systems with bands (Morocco, Angola) to yet other arrangements closer to flexible rates (Egypt, Rwanda).

However, even those with floating currencies do not always exhibit full flexibility in movement of capital, and many index countries display high degrees of capital controls. These include Angola, Egypt, Ethiopia, Morocco, Mozambique, Rwanda and Tanzania. The degree of capital controls has a relatively high correlation with countries' performance in the index.

Exchange rate regimes and capital controls in index countries have remained broadly steady – such systems change rarely. Still, there have been some developments indicating a move towards greater openness.

The National Bank of Angola in January 2018 replaced its fixed exchange regime with a floating exchange system with bands. Bank Al Maghrib, Morocco's central bank, also moved towards a more flexible regime. In 2017 the Central Bank of Nigeria decided to float the naira (though many restrictions still apply), while the Central Bank of Egypt did the same to the Egyptian pound in 2016. Kenya, the Seychelles and Zambia have all taken steps to lower capital controls over the past year.

Greater flexibility has raised the possibility of heightened vulnerability and volatility. The more flexible the regime, the greater the impact of market forces in determining the exchange rate. A move to a new regime can also cause sharp corrections in other economic indicators. In Egypt, the liberalisation of the pound resulted in a sharp depreciation that led to soaring inflation, especially in commodities. Some products recorded price rises of more than 50%.

Two years later, the situation is more stable. While the pound has halved in value since the float, its level has been steady for around a year. Additionally, the move towards a floating pound, together with the gradual lifting of capital controls (which included the lifting of caps on foreign exchange transfers), has bolstered dollar trading on the interbank market. This is a significant improvement compared with previous dollar shortages that created problems for investors wishing to repatriate profits. Capital inflows also grew, as evidenced by the demand for January 2018's $4bn Eurobond sale, which was three times oversubscribed.

The Central Bank of Nigeria has taken steps to improve liquidity and reduce vulnerabilities arising from the floating of the naira. In April 2017 the CNB introduced the 'investor and exporter foreign exchange window' to support exchange rate flexibility and the convergence of different exchange rate levels on the parallel market. This is reported to have significantly boosted portfolio inflows.

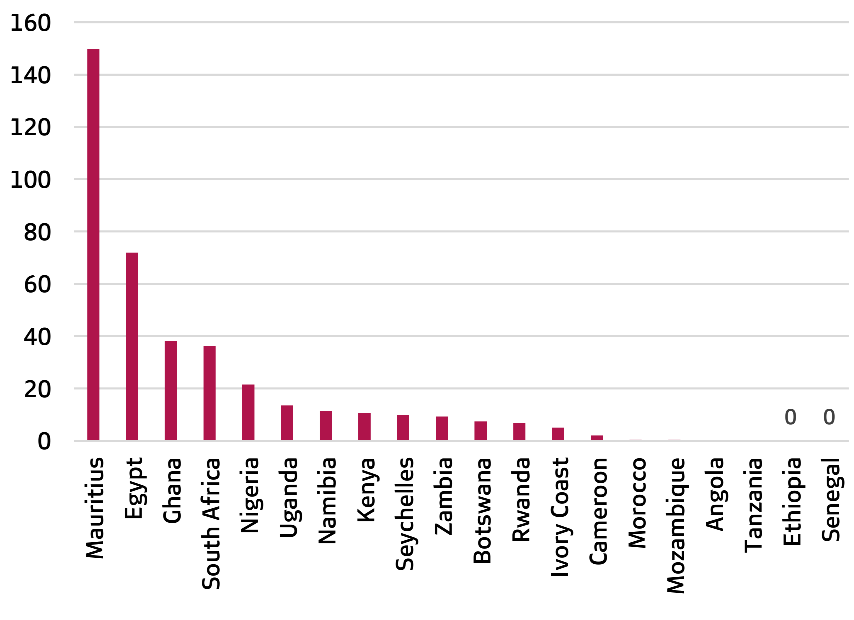
Nigeria's economic structure, characterised by an external sector dependent on basic commodities, makes it an exceptional case. An exchange rate determined by market forces could be highly volatile in this structure, stressing the importance of diversification policies to complement moves towards openness.

Gaps in exchange rate reporting are not unique to Nigeria. Ghana and Angola also suffer from dual and multiple exchange rates, respectively. Over the last year, Ivory Coast and Ethiopia moved towards single exchange rates, boosting their score in this pillar. The presence of multiple exchange rates (often a mix of official and unofficial rates) can impede asset valuations and exacerbate exchange rate risks. The quality and frequency of exchange rate reporting also plays an important role. Exchange rates are reported daily and in a timely manner in most index countries, with some exceptions.

Against the backdrop of improving financial market infrastructure to facilitate foreign capital inflows, some countries are taking measures to attract investors. The Bourse Régionale des Valeurs Mobilières (the stock exchange for eight West African countries) organised several investment days with three roadshows in London, Johannesburg and New York over 2018. But, as analysis in Pillars 3 and 4 shows, the presence of a local investor base and a strong tax and regulatory regime are also crucial to engendering confidence in foreign investors to deploy their capital.

Figure 2.2: Mauritius and Egypt most vulnerable to capital outflows

Net portfolio investment to reserves, %



Sources: International Monetary Fund, World Bank, national central banks, OMFIF analysis

Pillar 3:

Market transparency, tax and regulatory environment

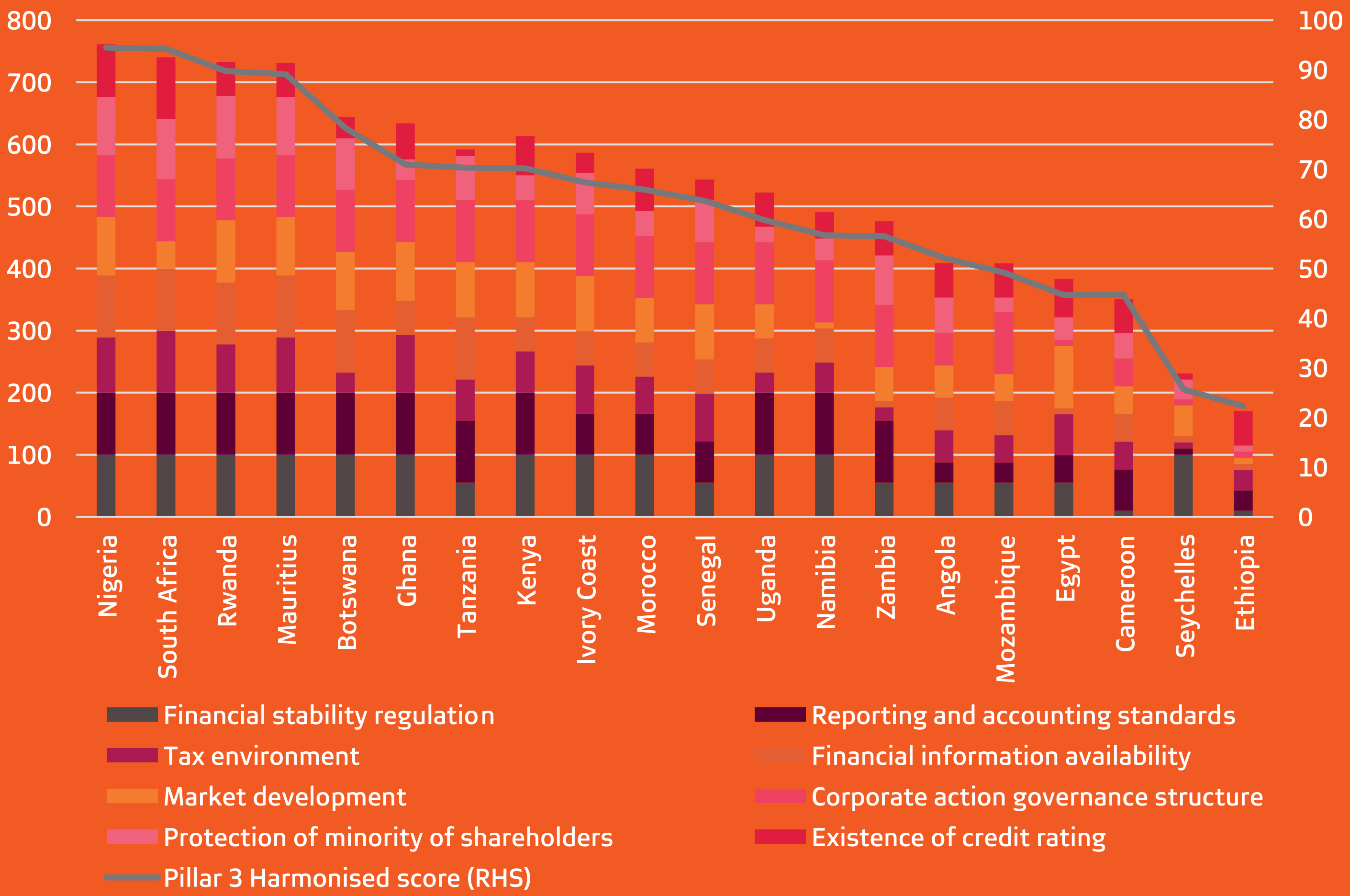
24°32’47° S | 15°19’47° E

Reforms spur improvements in regulation and transparency

Several countries are creating a more transparent and well-regulated market, supported by an improving tax environment. This is vital for attracting foreign investment, encouraging domestic participation and aiding market development.

Figure 3.1: Nigeria boasts most favourable market environment

Ranking of individual categories, max = 800; harmonised score, max = 100 (RHS)



Sources: Bank for International Settlements, International Financial Reporting Standards, Deloitte International Accounting Standard plus, World Bank Ease of Doing Business, Standard & Poor's, Moody's, Fitch, ABSA, OMFIF analysis. Note: Individual category totals (LHS) provide rankings for financial stability regulation, tax environment, market development, minority shareholder protection, reporting/accounting standards, financial information availability, corporate action governance structure, existence of credit rating. The harmonised score (RHS) represents the average of all categories' indicators, and is used to compile the total scores for Pillars 1-6. More information on p38-39.

Pillar 3 addresses improvements in Africa's regulatory and tax environments, which play a critical role in developing an attractive domestic capital market. A handful of countries in Africa have focused on regulation to bolster market development and attract foreign investors.

Nigeria and South Africa score highly in this pillar. The former has made changes to its tax system which, according to the central bank, will 'broaden the tax base while improving the efficiency of tax administration and regulation'. A large securities firm in Nigeria noted that 'ongoing amendments are likely to improve the system'. Capital market transactions are exempt from withholding taxes, while there are more than 20 tax treaties and agreements on double taxation with third countries. Government bonds are subject to a tax holiday on income earned.

A senior figure in a Big Four accountancy firm in Ghana, responding to the survey, said the regulatory environment is heading in the right direction, citing the use of simple and relatively low tax rates applied to returns on some investments. They also noted that government bonds for non-residents are not subject to income tax. However, a respondent from another Big Four firm highlighted room for improvement, saying 'the tax regime is good for multinationals, but for smaller companies with second-tier audit firms there may be questions. The tax system is reasonably sophisticated, but I believe it actually inhibits growth. It should encourage more foreign investment.'

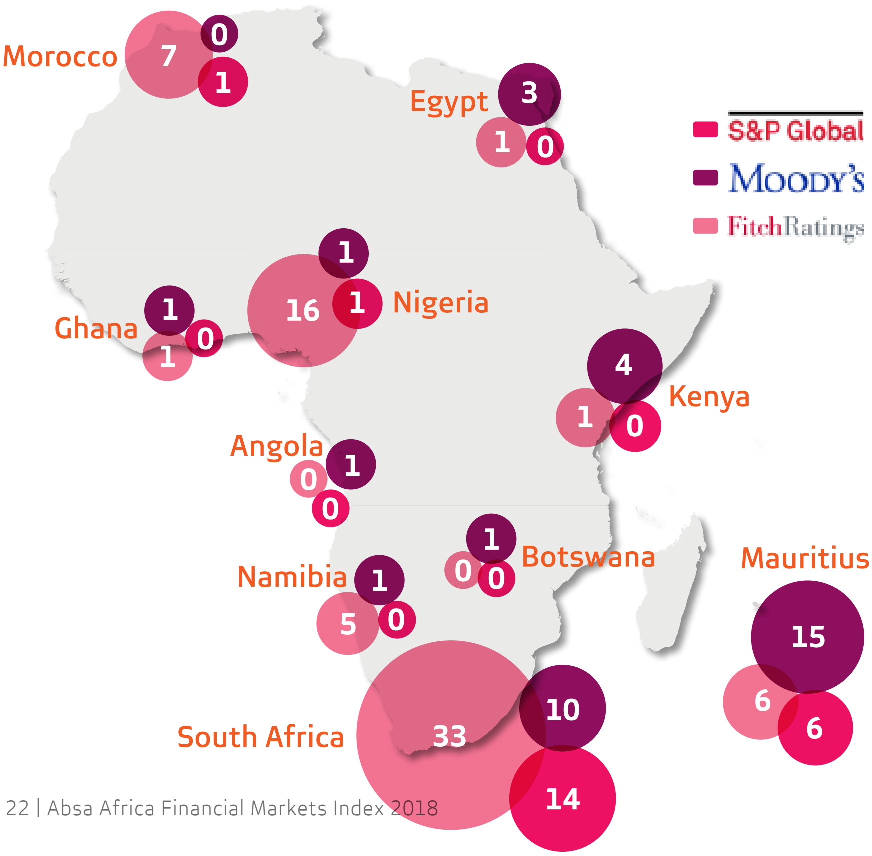
Uganda, which scores low on the tax indicator, has not undertaken significant reforms. Public sector respondents noted that the current system's structure discourages market growth and development. The withholding tax on government securities is 20%, against a regional average of 15%, and capital market transactions lack a framework for exemptions. This view was reiterated by respondents in the Ugandan securities market.

Corporate governance, protection of minority shareholders and quality financial reporting are prerequisites for capital market development. To support price discovery, timely, accurate and relevant data must be available. International credit ratings also aid transparency.

Rwanda fares well in terms of transparency and regulatory strength, receiving the highest score possible in the index for protection of minority shareholders. However, there are discrepancies between the official rules and regulations on transparency and the reality of their implementation. The country also lacks any corporate credit ratings from the main agencies, and scores relatively low for tax environment. Mauritius has 27 corporate ratings but only one sovereign rating.

Figure 3.2: Only 10 index countries have corporate ratings

The number of corporates rated by S&P, Moody's and Fitch. Unlisted countries scored zero.



Ensuring regulatory consistency

In South Africa there is the perceived risk of 'fragmentation' of trading on the Johannesburg Stock Exchange due to the introduction of four new domestic exchanges since 2016. The country is, however, in the closing stages of implementing a 'twin peaks' regulatory framework to strengthen capital markets and aid their development. This model separates regulatory functions between a regulator that performs prudential supervision and one that performs market conduct supervision.

Instead of having a separate regulator for banks, South Africa's new structure creates two 'peaks', 'prudential regulation' and 'good conduct'. The legislation is bolstered by the launch of the Financial Sector Conduct Authority, which has a broader scope than its precursor, the Financial Services Board.

As one senior South African regulator

said, 'The financial sector will be made safer through a tougher prudential and market conduct framework. Many of these standards are in line with international commitments agreed via the G20 and other processes.' Regulatory strength and consistency are essential for creating confidence and motivating new participants, especially foreign investors, to enter the market.

Financial reporting

Financial reporting levels vary across the continent, though there have been widespread improvements over recent years. International financial reporting standards are required for domestic public companies in 17 out of the 20 countries in the index. Both Ivory Coast and Mozambique have transitioned from 'permitted but not required' to 'required' in the space of a year. Of the three countries where IFRS are not required – Ethiopia, Egypt and the Seychelles – only the latter two have generally accepted accounting principles in place.

Technological limitations and issues with human resources hamper institutions' ability to report in an effective and timely manner. As one central bank official said, 'Reporting skills and tools are just evolving, data rendition processes are in some cases manual, and regulators are overwhelmed by manpower limitations and oversight tools.'

Nevertheless, financial stability regulations have improved significantly in many jurisdictions. Last year only seven countries in the index were implementing the Basel III international regulatory banking framework. This year there are 12, with Uganda, Rwanda, Namibia, Egypt and Ghana joining the ranks of the highest scorers. Angola and Senegal, new additions to the index, have implemented Basel II. Cameroon and Ethiopia achieve low scores, having only implemented Basel I.

Implementing international financial standards at too early a stage can hamper expansion by raising costs and complicating the transition. Creating a supportive regulatory environment requires sensitivity and flexibility, enabling market growth by ensuring regulations are not excessively burdensome, while maintaining financial stability and best practices. Countries do not always get the balance right, but those that do adjust their policies accordingly tend to fare well. Nigeria, which has been criticised by survey respondents for heavy regulation, has made a concerted effort to alleviate the constraints on small and medium-sized enterprise financing by expanding the parameters for what constitutes collateral for credit, for example. It has also improved its derivatives trading framework.

Despite this need for flexibility, a robust regulatory environment is vital to attracting foreign investors, a point repeated by many survey respondents. International investors face higher costs and greater uncertainty when they have to follow different sets of requirements across different markets. This can dissuade investors from entering or increasing their presence in these locations. Attracting foreign investors is essential for facilitating growth, increasing access to credit and supporting business in less developed markets.

Investor diversification and the ability to attract foreign capital are critical for providing a stable base for capital markets. The presence of foreign investors can, in turn, help influence policy-makers to undertake reforms.

The need for participation of local investors is equally important in creating a larger and more liquid market, and can provide stability during periods of international capital flight. Achieving this investor mix requires building an attractive regulatory and tax environment.

'Creating a supportive regulatory environment requires sensitivity and flexibility, enabling market growth by ensuring regulations are not excessively burdensome, while maintaining financial stability and best practices.'

Pillar 4:

Capacity of local investors

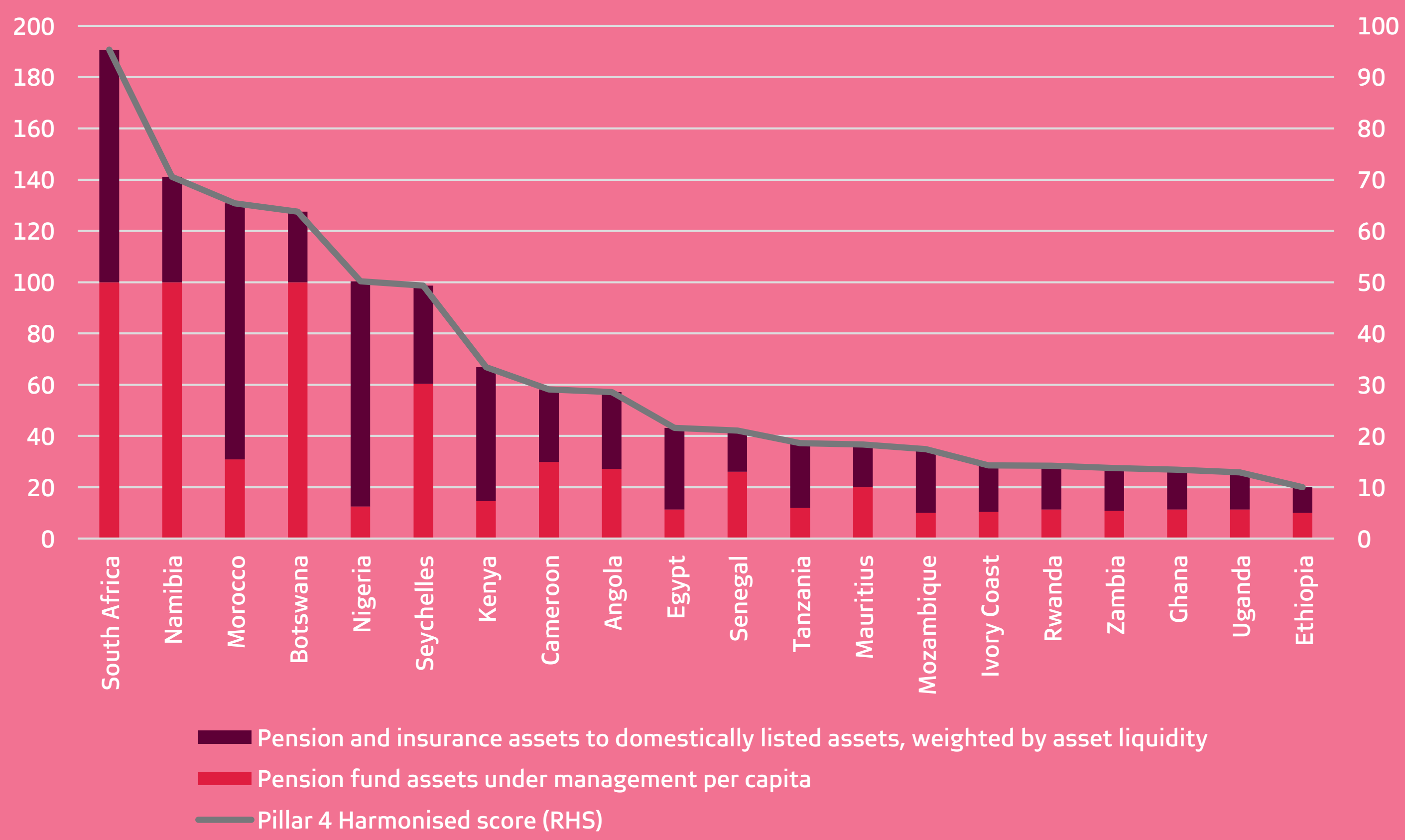
13° 40′ 53″ N | 3° 37′ 04″ W

Improving financial inclusion to support domestic growth

Focusing on domestic institutional investor capacity and financial inclusion should bolster markets, but regulatory restrictions and lack of education hold back broader advances.

Figure 4.1: South Africa, Nigeria and Morocco have dominant pension/insurance funds relative to market size

Ranking of individual categories, max = 200; harmonised score, max = 100 (RHS)



Sources: African Development Bank, Organisation for Economic Co-operation and Development, national stock exchanges, Thomson Reuters. Note: Individual category totals (LHS) provide rankings for pension and insurance assets as a ratio of domestically listed assets weighted by liquidity, and pension fund assets under management per capita. The harmonised score (RHS) represents the average of all categories' indicators, and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Domestic institutional investors across Africa, particularly pension funds, are an important part of the financial landscape. Better design, implementation and regulation of savings institutions has increased population coverage and created new vehicles for citizens to access capital markets. Policies to bolster financial inclusion have increased the size of assets held by local investors, creating opportunities to develop financial products and enhance liquidity.

Educational strategies and the introduction of mobile money infrastructures, as well as improved pension and investment regulations over the last decade, have boosted the assets of domestic institutional investors. However, weak commodity prices and currency depreciations against a rising dollar have reversed this trend somewhat. The value of assets held by pension funds in the 20 countries covered by this index fell by 22% to $401bn in 2016 (the latest available data) from $512bn in 2015. This underscores the need for multicurrency products to enable risk diversification.

Pension funds must allocate a large proportion of their portfolios towards the domestic market. In conjunction with capital restrictions mentioned in Pillar 2, index countries as a whole are limited in their diversification strategy.

The scores in Pillar 4 track the capacity of local institutional investors (pension and insurance companies) according to their per capita assets under management and the size of their AUM against the total value of domestic financial market assets, weighted by liquidity.

Low local capacity hinders market liquidity and growth

Local investor capacity in many African countries is low, with pension funds, insurance firms and other investors lacking sizeable AUM. In Ivory Coast, Egypt, Ethiopia, Ghana, Mauritius, Zambia and Senegal, the ratio of institutional AUM to domestically listed assets is below 20%. This contributes to low demand for new products and results in small and relatively inactive local exchanges.

The size of South African pension fund assets per capita, at $5,411, makes the country an outlier in this sample. Its ratio of total pension and insurance AUM to domestically listed assets is 39%. As South Africa's market is highly liquid, with equity market turnover of 40% and corporate bond turnover of 106%, it achieves the maximum score of 100 in the index.

Namibia ranks second in Pillar 4, with a score of 71. The value of pension assets in Namibia was $13.4bn in 2016 (latest available data). This is lower than the index average of $20bn, but is high in per capita terms, at $4,135 against an average of $974 for the countries tracked in the index.

Asset liquidity is an important determinant for scores in Pillar 4. Botswana, Namibia and the Seychelles all have large domestic institutional investors relative to domestic listed assets. In addition, there is low liquidity in the domestic market as assets are held by long-term buy-and-hold investors, which has lowered these countries' overall pillar score.

Access to varied products

Several countries in the index require local investors to invest a large portion of their assets in the domestic market. As discussed in Pillar 1, Namibian investors are required to invest at least 45% of their assets in domestic securities. Similarly, Ugandan investors must allocate most of their investments domestically or in the region. Given the 'high risk and poor returns' associated with domestic assets, according to one local regulator, fund performance suffers.

Several countries have relaxed these requirements. In April 2018, the offshore allocation limits for South African funds increased to 30% from 25% and the allocation to African investments outside South Africa to 10% from 5%. This means that investors may allocate up to 40% of assets outside South Africa, potentially boosting returns.

Restrictions on the type of assets investors can access are prevalent, with many funds able to invest only in simple products. Lack of expertise of more complex asset classes and strategies among pension fund trustees and other local investors is one factor impeding the growth of financial markets and new financial products. Survey respondents in Tanzania, Uganda and other countries indicated this results in 'a tendency to stick to asset classes that are familiar such as government bonds and equities'.

Expertise of asset owners and trustees

Respondents in around half the countries in the index emphasised that lack of in-depth expertise among pension fund trustees and other asset owners as an obstacle to market development. Respondents in several countries, including Botswana and Namibia, said that despite local investors not having the necessary knowledge, the existence of international investment advisory services mitigated this to an extent.

However, all respondents in these countries said a lack of expertise hindered the development of new financial products, by reducing their willingness or ability to invest in more complex and 'adventurous' assets and strategies while pursuing stable returns. This includes Botswana, Ivory Coast, Ethiopia, Ghana, Kenya, Namibia, Senegal and South Africa.

Although South Africa has a sophisticated capital market, respondents in the country emphasised that knowledge and expertise is 'limited to a few very large players only'. This results in most investors 'sticking to the vanilla strategies'. Respondents from Botswana said the lack of knowledge creates 'a risk-averse mindset among trustees and others towards the more complex instruments'.

In Nigeria, Tanzania and Namibia, respondents highlighted the presence of some 'highly qualified and experienced people' working in professional asset management, despite 'knowledge of capital markets among the general population' being 'very low'. Yet, due to constraints such as high costs, illiquidity, thin secondary markets and the small size of the domestic economy (in the cases of Namibia and Tanzania), adventurous capital market activities are not attractive. As a result, according to one Tanzanian securities company, 'most small businesses do not consider the capital market as a useful way to raise sufficient capital'.

Respondents in many countries also highlighted regulatory issues as inhibitors of market growth. One official from a Zambian banking association said 'even regulators are ill-equipped to understand the complexity of financial markets', so they are unable to encourage market development and, in many cases, implement harmful rules. Indeed, Nigerian pension funds are generally barred from diversifying into novel products, and there is a limit of 25% for equities and unsecured instruments, according to the central bank. One large securities firm said 'regulation discourages investments in complex asset classes, which are often perceived as "too risky"'. Insurers in the West African Economic and Monetary Union, in particular, are restricted from investing in more diverse asset classes.

Mauritius is a notable exception. There is a wide range of investment options and relatively 'strong demand for more complex assets, including different types of derivatives products', according to the exchange.

In countries with a more sophisticated domestic investor base, such as Kenya, the main issue is 'a shortage of investment vehicles tailored to investor needs', according to survey respondents. This hampers pension funds' ability 'to fulfil their roles as contractual savings institutions', by forcing them to 'overinvest in asset classes with maturities that are not well matched to their longer-term liabilities'. It also results in local capital markets being unable to raise enough funds from domestic investors to finance long-term infrastructure and other development projects. This can inhibit overall economic prospects.

Financial inclusion

Achieving sustainable growth across the region requires improving financial literacy. Widening the scope of banking services to capture as many individuals and small and medium-sized enterprises as possible, especially women and the rural population, is critical to improving financial inclusion. Better financial education will direct greater savings towards a country's capital market, supporting market development.

'A vast majority of the adult population in Nigeria has little or no knowledge of financial market products and capital markets in general,' said a representative of the country's over-the-counter securities exchange.

South Africa's newly-created Financial Sector Conduct Authority was established to supervise financial markets and promote financial education. Its consumer education department holds workshops on financial literacy and investor education, particularly in rural areas and among groups that have been excluded from financial services.

Across the region, mobile banking has helped promote financial services in informal sectors of the economy and unbanked areas. The technology and infrastructure supporting mobile banking is being built up. Uganda's National Financial Inclusion Strategy 2017-22 aims to lower barriers to financial services and build the infrastructure needed to support the mobile banking market.

Despite recent progress, 'capital markets remain a relatively new phenomenon and there is limited expertise in the market for product development,' according to one Ugandan securities regulator, echoing sentiment from several countries. 'This hinders participation by the population which is not very knowledgeable about these products.'

Figure 4.2: On average countries' local funds are 55% the size of their locally listed assets

Local pension and insurance fund assets, and total value of bonds and equities listed

	Pension and insurance assets, $bn	Total bonds outstanding and market capitalisation, $bn
South Africa	517.2	1,309.6
Morocco	48.1	63.2
Botswana	26.0	40.0
Nigeria	25.2	61.3
Kenya	14.2	36.7
Namibia	13.4	5.1
Egypt	13.1	89.9
Tanzania	4.5	14.0
Angola	2.5	7.5
Ghana	2.4	96.0
Uganda	2.3	9.8
Ivory Coast	1.9	15.8
Cameroon	1.6	0.7
Senegal	1.2	15.8
Rwanda	1.1	3.7
Zambia	1.0	11.7
Ethiopia	0.7	-
Mozambique	0.6	1.2
Mauritius	0.6	11.3
Seychelles	0.3	0.3

Sources: African Development Bank, Organisation for Economic Co-operation and Development, national securities exchanges, OMFIF analysis

'Lack of expertise of more complex asset classes and strategies among pension fund trustees and other local investors is one factor impeding the growth of financial markets and new financial products.'

Pillar 5:

Macroeconomic opportunity

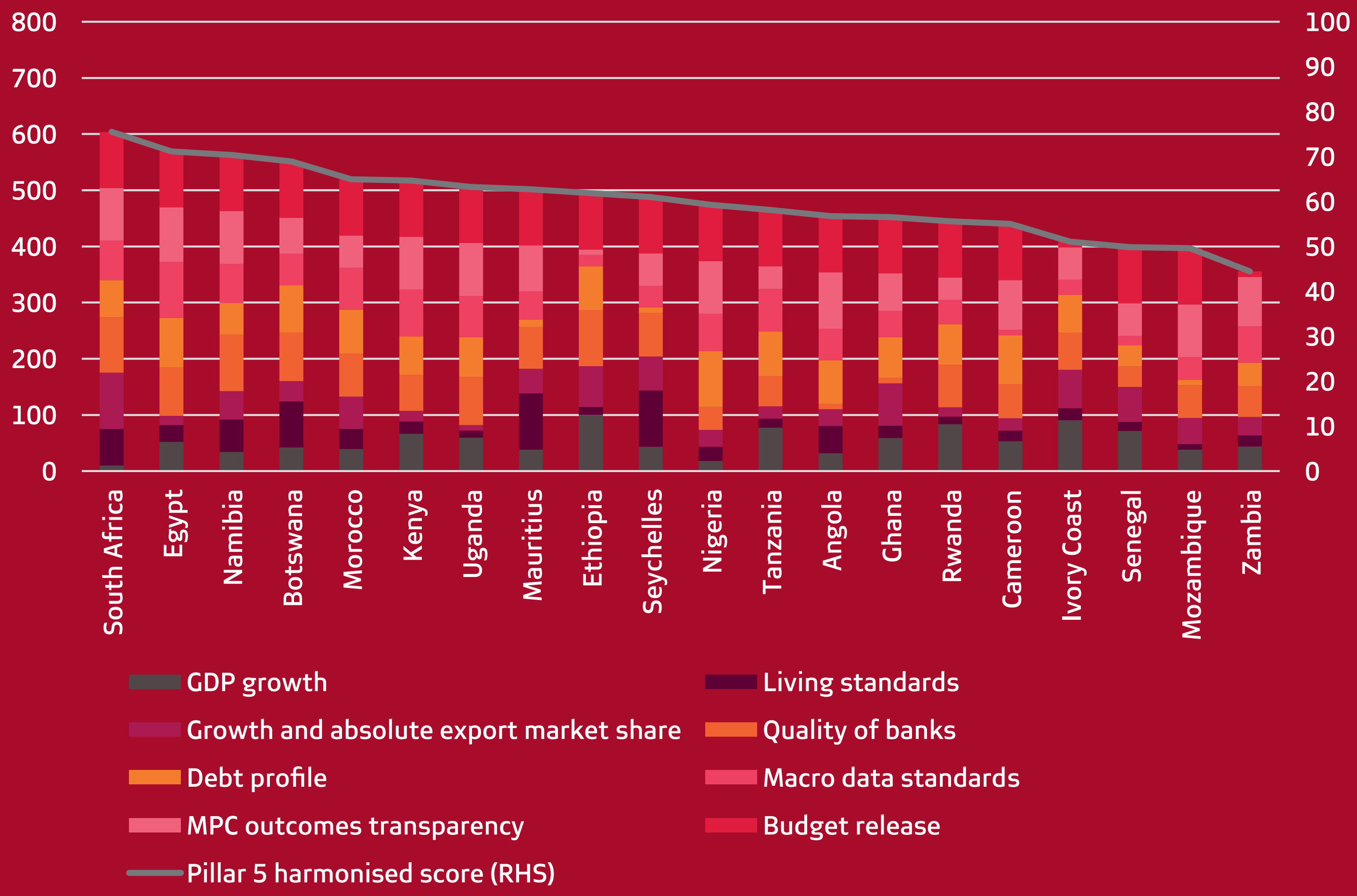
17° 30′ 0° S | 48° 30′ 0° E

Policy focus on sustainable and inclusive growth

Economic growth across the region is promising, but maintaining this trajectory and attracting investors requires attention to infrastructure and trade diversification while ensuring financial transparency and good governance.

Figure 5.1: Steady growth and financial transparency propel Egypt

Ranking of individual categories, max=700; harmonised score, max=100 (RHS)



Sources: International Monetary Fund, World Bank, national central banks, national finance ministries, African Development Bank, Absa, OMFIF analysis. Note: Individual category totals (LHS) provide rankings for GDP growth, growth and export market share, debt profile, MPC outcomes transparency, living standards, quality of banks, macro data standards and budget release. The harmonised score (RHS) represents the average of all categories' indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Growth across African economies rebounded to 3.7% in 2017 following a slump to 2.2% the previous year, based on data from the International Monetary Fund. However, growth prospects across the region remain uneven.

Pillar 5 evaluates economic performance (GDP growth, living standards and export competitiveness), financial risks (non-performing loans and external debt ratios) and financial transparency (demonstrated by availability of data, open monetary policy communication and the timely release of state budgets).

Egypt's moderate growth, low financial risk and clear financial reporting boost its score, making it the most improved country for Pillar 5. From 12th in last year's ranking among 17 African economies, it is now second (after South Africa) out of 20 countries. Egypt's GDP per capita remains modest, requiring more effort to ensure growth is spread out evenly.

The country must also improve its export competitiveness – Egypt's export market share has fallen by more than 56% over the last five years.

With a weak macroeconomic environment, South Africa faces rising financial risks. The country slipped into recession in 2018 for the first time since 2009 after two consecutive quarters of economic contraction earlier this year. When Standard & Poor's downgraded the country's debt in late 2017, the rating agency cited a growing budget deficit and rising government debt as contributing factors. However, compared to other countries, South Africa's financial risks remain low. Its external debt to GDP ratio is 46%, against an average of more than 51% for index countries. Its non-performing loan ratio, at 2.8%, is far below the 10.1% average. It also scores highly for transparency.

Mozambique's poor score is driven by mounting debt and low living standards, while weak exports and poor financial reporting push Zambia to the bottom of the index. 'This requires a big-picture fix. Zambia needs to stabilise both politically and economically to encourage foreign investment and lower interest rates,' according to one large financial advisory firm in the country.

Promoting inclusive growth amid high levels of inequality

Ensuring that growth is inclusive and sustainable is a persistent challenge for the region. South Africa enjoys one of the highest per capita incomes among countries in the index, but it also has the highest level of inequality, according to the World Bank.

Egypt's economic recovery demonstrates the impact of reforms implemented since 2016 following a period of political uncertainty. Earlier this year, the country received a credit rating upgrade from Standard & Poor's, moving to B from B minus. It also earned a credit outlook boost from Moody's Investor Service, rising from stable to positive.

Ethiopia has been one of the world's fastest growing economies over the last 10 years. Growth is likely to decelerate this year, but is expected to stay above 6% over the next five years.

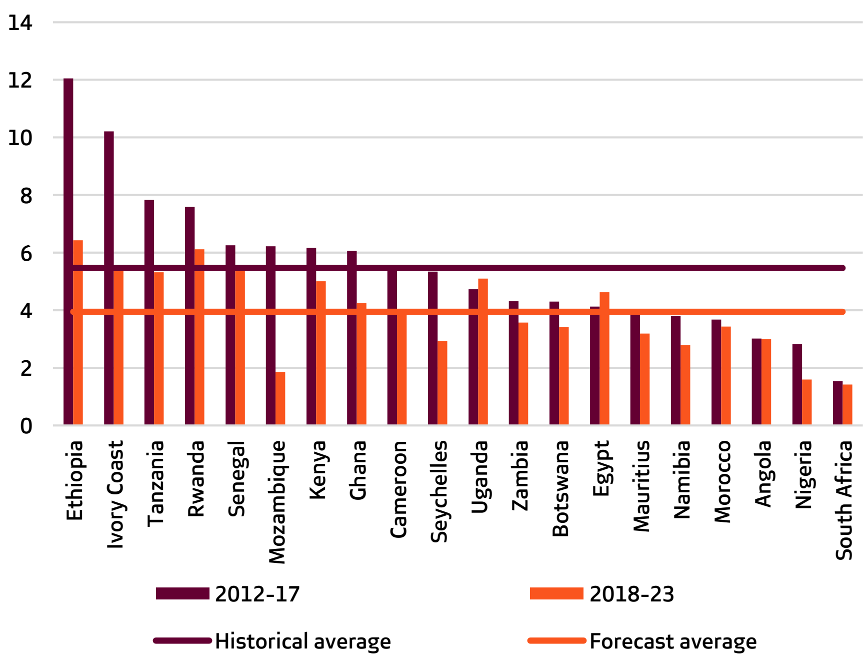
One tool to spur growth is infrastructure. Underdeveloped infrastructure limits productivity, trade and overall mobility. The African Development Bank estimates that the continent's infrastructure needs are as much $170bn per year up to 2025.

Insulating export-dependent countries against external shocks

The region's five largest economies – Nigeria, South Africa, Egypt, Angola and Morocco – also have the largest export market shares. However, all of these countries, except for Morocco, have lost ground over the last five years, vindicating the Moroccan government's focus on industrial exports. In the same period, resource-driven exports have strengthened the rankings of Ghana, Ivory Coast and Ethiopia, though each has been impacted by deteriorating terms of trade over the last few years.

Figure 5.2: Ethiopia and Ivory Coast sustained economic growth, but slowdown expected

Compound annual growth rate, five-year average and forecast %



Sources: International Monetary Fund World Economic Outlook, OMFIF analysis

Rwanda is one of the first countries to have felt tangible effects from changes in US trade policy. Among countries in the index, its export market share has shrunk by 40.2% over the last five years, and it has the lowest overall export market share. It is likely to decline further after Washington reinstated tariffs on Rwandan exports.

The Continental Free Trade Area aims to cut tariffs on 90% of intra-African goods trade between more than 45 countries. In the long term, this could expand the size of regional markets and help insulate Africa from external shocks. Focusing on the development of industrial parks and export-processing zones, as well as education, training and healthcare, will be vital to boosting trade prospects.

Despite the uptick in oil prices, resource-dependent countries like Angola and Nigeria are exposed to significant financial risk. The share of non-performing loans in Angola more than doubled to 28.8% in 2017 from 13.1% in 2016, though refinancing assistance extended to problematic state-owned banks may ease the burden in coming years.

Exchange rate depreciations partly explain worsening external debt levels, which stood at more than 60% of GDP for five countries: Mozambique, Seychelles, Mauritius, Senegal and Zambia. Mozambique's ongoing debt crisis pushed up its foreign borrowings to 140.7% of GDP, almost 10 percentage points higher than last year. Seychelles' debt burden is also creeping up. After decreasing to 98.3% in 2016, the country's external-debt-to-GDP ratio increased to 101.3%.

Transparent reporting bolsters foreign investor sentiment

Clear and timely reporting of macroeconomic indicators and monetary policy actions helps build investor confidence. The promising performance of some countries in parts of Pillar 5 is held back by poor performance in others, notably macroeconomic reporting standards.

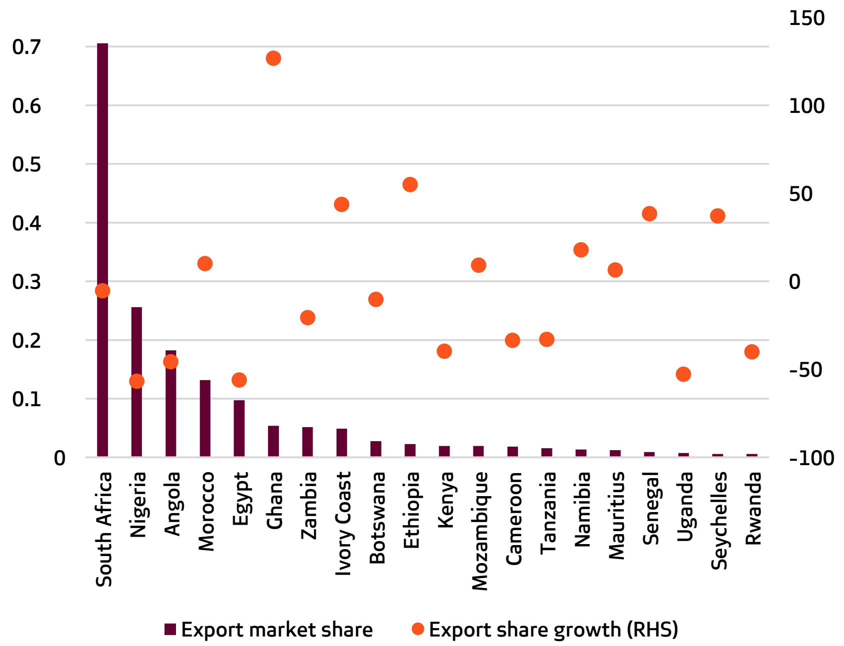
Ethiopia's score, bolstered by its double-digit economic expansion, suffers because of the delayed release of macroeconomic data. It is the only country in the index that does not publish monetary policy committee communications. In contrast, good data availability in Kenya and Uganda help boost their index score. On the Open Budget Index, an independent ranking of central government budget transparency, South Africa is the top-scoring country out of 115 nations globally, tied with New Zealand, for having an open budget with extensive available information. Other African countries do not perform as strongly; Uganda, the second highest African state in the ranking, came in at 29th.

To attract investment, countries must demonstrate robust macroeconomic fundamentals and good governance. Open, transparent and detailed financial reporting demonstrates that the region's financial markets are ready to expand. This also requires adherence to international standards and frameworks for financial market activities.

'Underdeveloped infrastructure limits productivity, trade and overall mobility. The African Development Bank estimates that the continent's infrastructure needs are as much $170bn per year up to 2025.'

Figure 5.3: Biggest economies have largest export market shares, but only Morocco is still growing

Export market share, %, (excluding oil); five-year growth in market share value, % (RHS), 2016



Sources: World Bank Measuring Export Competitiveness, OMFIF analysis

Pillar 6:

Legality and enforceability of standard financial markets master agreements

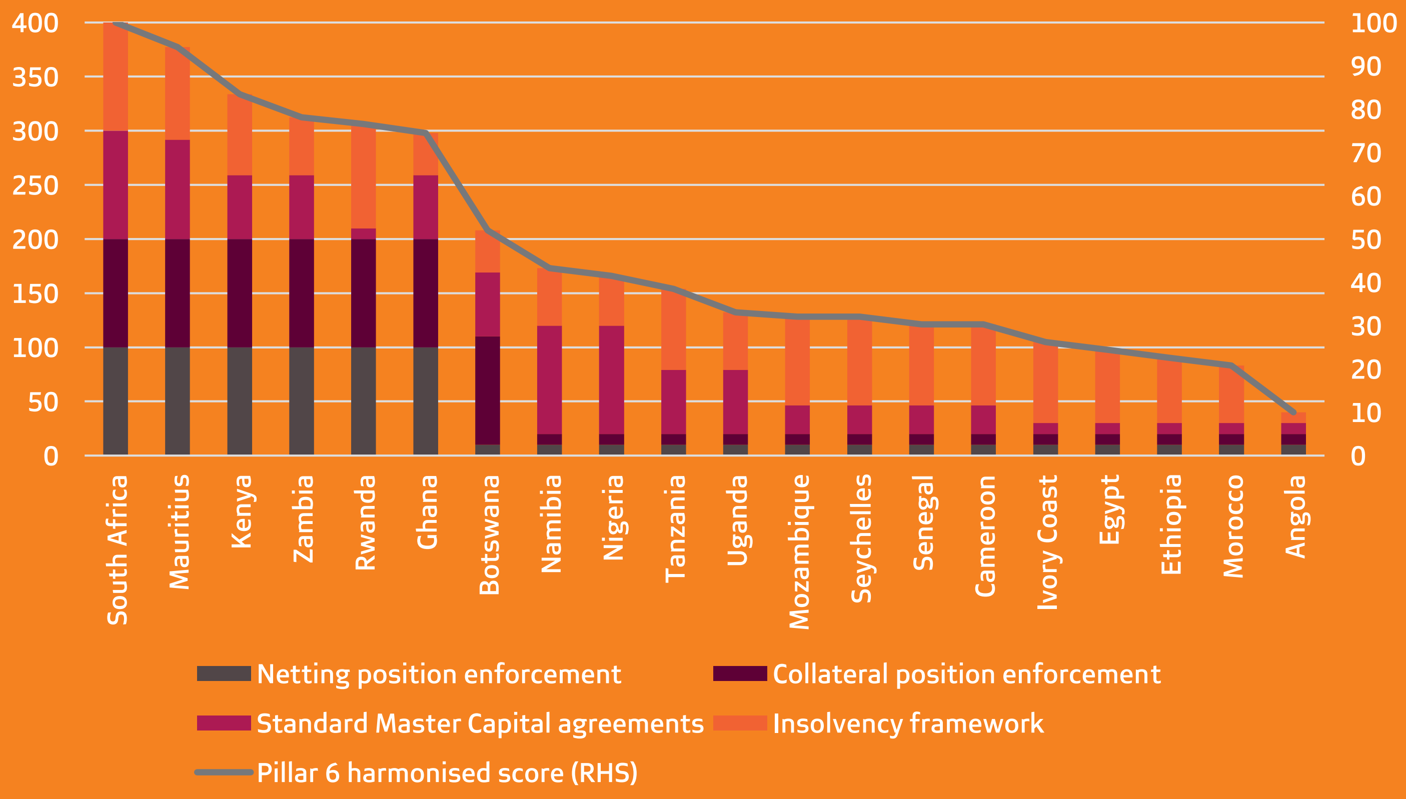
31.6295° N | 7.9811° W

Strengthening legal frameworks to build confidence

Expanding a market requires demonstrating its maturity through the enforceability of financial agreements, clarity on property rights and compatibility with international standards.

Figure 6.1: Most countries still need stronger legal and contractual tools

Ranking of individual categories, max=400; harmonised score, max=100 (RHS)



Sources: World Bank Ease of Doing Business, Absa, OMFIF analysis. The harmonised score (RHS) represents the average of all categories' indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Rapid growth in African markets can provide attractive opportunities to international investors, but volatile political and regulatory environments often discourage new players from entering. To mitigate risk, strong legal and enforcement frameworks that support financial agreements are necessary. The most established African markets already have such regulations in place, while smaller economies looking to expand are in the process of establishing and improving them. Pillar 6 assesses the enforceability of financial agreements around Africa and their compatability with global standards.

Importance of standard agreements for investor protection

Adherence to standard international master agreements signals that financial markets are mature enough to implement global standards. The Master Agreement of the International Swaps and Derivatives Association, the Global Master Repurchase Agreement and the Global Master Securities Lending Agreement are each considered in this index. These agreements were standardised by international financial associations to reduce credit and legal risk and provide assurance on property rights. This makes global exchanges and over-the-counter trading more efficient.

The ISDA master agreement governs OTC derivatives transactions and is the most widely recognised financial agreement among countries in the index. The GMRA and the GMSLA are less common. The former was drawn up for repurchase agreements, while the latter was drafted for securities lending arrangements. These agreements standardise definitions and contractual terms, reducing the likelihood of disputes and providing guidance for resolution when necessary. For investors, standard agreements add a degree of protection and can reduce the costliness of entering a new market.

Figure 6.2: Key financial masters agreements

	ISDA	GMRA	GMSLA
South Africa	Well recognised	Well recognised	Well recognised
Nigeria	Well recognised	Well recognised	Well recognised
Namibia	Well recognised	Well recognised	Well recognised
Mauritius	Well recognised	Well recognised	Limited use
Zambia	Well recognised	Limited use	-
Uganda	Well recognised	Limited use	-
Tanzania	Well recognised	Limited use	-
Kenya	Well recognised	Limited use	-
Ghana	Well recognised	Limited use	-
Botswana	Well recognised	Limited use	-
Seychelles	Limited use	-	-
Senegal	Limited use	-	-
Mozambique	Limited use	-	-
Cameroon	Limited use	-	-
Rwanda	-	-	-
Morocco	-	-	-
Ivory Coast	-	-	-
Ethiopia	-	-	-
Egypt	-	-	-
Angola	-	-	-

Sources: Absa, OMFIF analysis. Note: Own non-standard masters agreement used assumed when there is strictly insufficient recognition of the standard agreement perceived.

'Effective insolvency processes reduce the likelihood of a business failure, especially for smaller companies that may be viable in the long-term but encounter temporary financial difficulty.'

More than half the countries in the index use ISDA master agreements, but only South Africa, Nigeria and Namibia also employ GMRA and GSLA. Mauritius uses GMRA more widely than GMSLA, marginally reducing its score on Pillar 6, where it ranks second. In countries, such as Rwanda, where standard agreements are not commonly used, banks may be using their own non-standard agreements. In most cases, such agreements have proved inadequate when tested in default scenarios.

Building adequate insolvency regimes

Another feature that could minimise uncertainty in relatively unknown financial markets is the presence of adequate insolvency frameworks. Effective insolvency processes reduce the likelihood of a business failure, especially for smaller companies that may be viable in the long-term but encounter temporary financial difficulty. A good insolvency regime should support struggling firms without encouraging excessively risky behaviour, protect contracting parties and prevent systemic risk.

The World Bank evaluates countries' insolvency regimes based on the cost and speed of insolvency proceedings for domestic entities, along with quality of judicial processes for liquidation and reorganisation. In the wider economy, flexible and responsive insolvency frameworks prevent disruptions that can be caused by the closure of businesses, such as creditors losing their investment, employees losing their jobs and reductions in overall output. Countries that perform well on this indicator, such as South Africa, tend to have a healthier and more robust business environment.

Despite Rwanda not adhering to international standard master agreements, it scores well on the insolvency framework indicator due to continuing improvements in its domestic insolvency legislation. Mozambique and Seychelles, despite performing poorly on other indicators, have introduced reorganisation procedures that make it easier to resolve insolvency.

Some countries in the index have weak scores despite the presence of insolvency frameworks. Ghana has an existing insolvency law, but it is considered inflexible to the needs of corporations, since it offers only one option: liquidation. Angola is the weakest on this indicator, with creditors of failed ventures unlikely to recover any investment. Botswana has established insolvency processes, but these are relatively feeble. According to one Botswanan central bank economist, 'The review of the Banking Act is intended to improve bank resolution and crisis management, strengthen powers of the central bank to mandate remedial supervisory actions, as well as ensure effective compliance with anti-money laundering and combating of financing of terrorism protocols.'

To position themselves as desirable investment targets, African countries must show they have suitable legal and contractual frameworks that protect property rights and accommodate international investors. As a start, regional integration efforts to ease cross-border transactions could signal readiness for increased capital inflows from international investors.

'The review of the Banking Act is intended to improve bank resolution and crisis management, strengthen powers of the central bank to mandate remedial supervisory actions, as well as ensure effective compliance with anti-money laundering and combating of financing of terrorism protocols.'

Figure 6.3: Responsive insolvency regimes needed across the region
Strength of insolvency framework score, max=16

Sources: World Bank Ease of Doing Business Index, OMFIF analysis

Country snapshots

Angola

- Increasing exchange rate flexibility
- Weak insolvency framework, restrictive capital controls, high non-performing loan ratio

Botswana

- High market capitalisation as a percentage of GDP. Large domestic institutional investors relative to domestic listed assets
- Fixed exchange rate regime and a weak insolvency framework

Cameroon

- High currency reserves in relation to net portfolio investment and relatively strong insolvency framework
- Weak foreign exchange market activity, slow adoption of financial stability regulations

Egypt

- Efforts to liberalise markets with floating currency and gradual lifting of capital controls
- Weak legal framework with no enforcement of ISDA, GMRA or GMSLA agreements

Ethiopia

- Rapid economic growth, moved to a single exchange rate
- Small market size, weak local investor capacity, low financial reporting standards

Ghana

- Implementation of Basel III, simple and low tax levels
- Weak insolvency framework and low capacity of local investors

Ivory Coast

- Improving financial and exchange rate reporting standards
- Resource-dependence and deteriorating terms of trade reduce appeal to foreign investors

Kenya

- Relaxed capital controls, active foreign exchange market, steady economic growth
- Limited product diversity, relatively low pension assets per capita, declining export market share

Mauritius

- Strong legal and regulatory framework
- High portfolio flows to reserves ratio suggesting vulnerability to external shocks, high debt levels

Morocco

- Large pension and insurance funds relative to market size, high and growing export market share
- Tight capital controls, international standard masters agreements not adopted

- Strengths
- Areas for improvement

Mozambique

+ Improving financial and macro reporting standards, good economic growth forecast

− Low pension assets per capita, low standard of living and high external debt

Seychelles

+ Low foreign exchange restrictions, high standard of living, improving insolvency framework

− No sovereign bond market, unattractive regulatory environment, high debt-to-GDP ratio

Namibia

+ High pension assets per capita, low non-performing loan ratio, stronger financial stability framework

− No secondary market activity, low interbank foreign exchange turnover, relatively slow GDP growth

South Africa

+ Dominant regional financial hub with deep and liquid capital markets

− Challenging macroeconomic environment, highly exposed to external risks

Nigeria

+ Robust bond market activity, low debt burden and strong legal and enforcement frameworks for financial agreements

− Gaps in exchange rate reporting, dependence on oil heightens exchange reserves volatility

Tanzania

+ Improving tax and regulatory environment, promising growth prospects

− Restrictive capital controls, inactive secondary market, low pension and insurance assets

Rwanda

+ High transparency and strong insolvency framework

− No corporate credit ratings, weak export activity and high degree of capital controls

Uganda

+ Good data availability and transparency

− Low turnover of equities and bonds, high tax on government securities

Senegal

+ Above-average GDP growth and moderately high market capitalisation relative to GDP

− Low bond market turnover, low ratio of institutional assets under management to domestically listed assets

Zambia

+ Diverse products and relatively strong legal and contractual tools

− Weak macroeconomic outlook and high debt burden

The Africa Financial Markets Index in focus

Using a variety of parameters, both qualitative and quantitative, the Absa Africa Financial Markets Index records the openness and attractiveness of countries across the continent to foreign investment. The index countries are scored on a scale of 10-100 based on six fundamental pillars comprised of over 40 indicators, covering market depth, openness, transparency, legal environment and macro opportunity.

Pillar 1: Market depth

Product diversity
- Type of assets available
- Currency availability of stock exchange products
- Number of hedging products available

Size of market
- Total sovereign and corporate bonds, market capitalisation, ratio to GDP

Liquidity
- Total turnover of equities and bonds ratio to market capitalisation and bonds outstanding, respectively

Depth
- Ability to clear government instruments denominated in local currency in international markets
- Existence of secondary market makers (bond market)
- Closing auction for fair tradeable market prices

Primary dealer system
- Existence of system
- Size of repo market

Pillar 2: Access to foreign exchange

Net portfolio flows, ratio to reserves
- Total net portfolio flows, ratio to foreign exchange reserves

Foreign exchange liquidity
- Interbank market foreign exchange turnover

Capital restrictions
- Foreign exchange capital controls

Official exchange rate reporting
- Quality of data and frequency of publication
- Existence of multiple or unified exchange rate

Pillar 3: Market transparency, tax and regulatory environment

Financial stability regulation
- Basel accords implementation stage

Quality of financial reporting
- Commitment to international accounting and reporting standards (GAAP, IFRS)

Tax environment
- Existence of withholding taxes, special taxes and tax treaties
- Time taken to rebate withholding taxes on investments

Financial information availability
- Existence of fixed dates and times for market reporting
- Publishing of data on sector and domestic vs non-resident ownership of domestic assets

Market development
- Existence and effectiveness of capital markets association
- Existence and strength of rules protecting minority shareholders
- Existence of sovereign rating (Fitch, Moody's, S&P)
- Number of corporate ratings issued (Fitch, Moody's, S&P)

Pillar 4: Capacity of local investors

Local investor asset concentration
- Value of pension assets per capita
- Pension and insurance fund assets, ratio to total market capitalisation of equities and bonds listed on exchanges

Pillar 5: Macroeconomic opportunity

GDP growth
- Composite five-year historical GDP average (2012-17) and five-year forecast (2018-23)

Living standards
- GDP per capita

Competitiveness
- Absolute export market share and growth in export market share (excluding oil) over past five years

Macroeconomic data standards
- Publication and frequency of GDP, inflation and interest rate data

Budget release
• Regular release of budget

MPC outcomes transparency
• Frequency and regular publishing of MPC decisions and meeting schedules

Debt profile
• External debt-to-GDP

Quality of banking sector assets
• Non-performing loans ratio

Pillar 6: Legality and enforceability of standard financial markets master agreements

Netting and collateral positions
• Enforced netting and collateral positions

Use of financial market master agreements
• Use of ISDA master agreements, GMRA, GMSLA or own non-standard agreements

Insolvency framework
• Strength of insolvency frameworks, World Bank score

Methodology

Pillars and indicators
The index scores each country based on six pillars: market depth; access to foreign exchange; market transparency, tax and regulatory environment; capacity of local investors; underlying macro opportunity; and the legality and enforceability of standard master financial agreements. Pillars are built from a set of key indicators listed on p.38-39.

Each individual indicator is weighted equally in each pillar, and each pillar is weighted equally in the overall index score.

The second edition of the index adds three additional countries (Angola, Cameroon and Senegal). The scope for direct comparison of countries' position in the index between 2017 and 2018 is therefore limited.

Data and survey
The data informing the scores for each pillar and their indicators stem from a mixture of quantitative and qualitative analysis. The quantitative data collected are of the latest year available. For full year statistics (i.e. GDP) this is 2017 data. For statistics covering the previous 12 months (i.e. securities market turnover) this is July 2017 to July 2018. In cases where the data refer to current conditions, such as for the Basel implementation stages, international accounting standards, and credit ratings, the data are as of mid-August 2018.

The survey element provides both quantitative and qualitative data relating to legal, regulatory and market conditions in each of the countries, such as information on tax environment, as well as responses based on country experiences.

The survey was conducted between June and August 2018, covering more than 50 institutions operating throughout Africa. Participants include chief executives, managing directors, managing partners or country experts across a range of global, regional and local institutions, including banks, securities exchanges, regulators, asset managers and investors.

Harmonisation and scoring
Raw data are harmonised on a scale of 10-100 to allow comparability between indicators.

Outliers in the raw data falling above or below two standard deviations of the mean are accounted for during the scoring. In the case of an outlier greater than the upper bound, its value is replaced by the next-highest data point in the sample. This means indicators can have more than one country scoring maximum points.

In the rare case of missing data, data points are modelled to smooth gaps and ensure the overall pillar score is not affected. The proxy value takes the average of the remaining harmonised scores for the country across all its indicators in the pillar, ensuring the final pillar score is not skewed by a missing value.

The scoring of each indicator and pillar works under the same process. Once indicators have a harmonised score, the average is taken across each indicator in a pillar to create the overall pillar score. Similarly pillar scores are averaged to create the country's composite score.

How to get full marks
As the index is a comparison of a country's financial market against the selected sample, a country can reach the maximum score of 100. In such a scenario, the country must achieve the maximum score of 100 in all six pillars.

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