Fundamentals

21 March 2022

Economic insights I Strategy I Market analysis I Africa

Geopolitics boiling pot brews volatility; fundamentals reign supreme

Economist, West Africa:
Mosope Arubayi +234 706 2774 539
mosope.arubayi@ic.africa

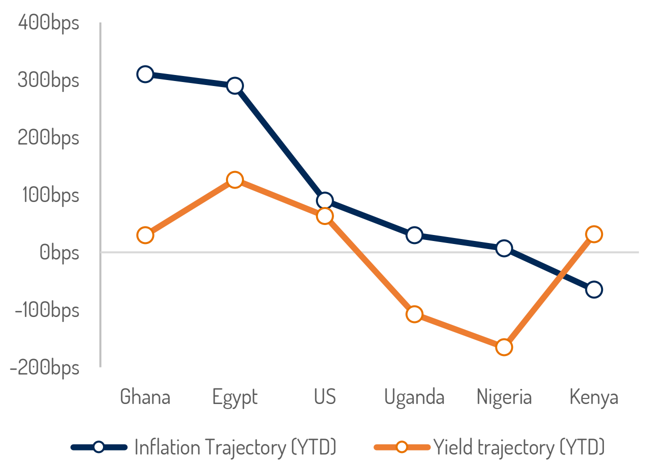
IN BRIEF

- War and conflict have rarely been absent from Europe, but the Russian-Ukrainian crisis is proving to be far-reaching - with its economic collateral damage extending beyond Europe.
- Sharp increases in commodity prices have exacerbated the vulnerabilities of many countries, especially African sovereigns that have high oil and grain intensities.
- As commodity prices surge, we see West and North African countries as most vulnerable to consumer price pressures, while regressive subsidies in Nigeria, Egypt, and Kenya constitute a drag on fiscals.
- However, a possible diversification of Europe's energy reliance on Russia portends a long-term growth opportunity for Africa's natural gas bright spots - including Nigeria, Senegal, and Tanzania.
- Among our coverage countries, Kenya appears to be the most vulnerable to the crisis due to its relatively higher dependence on its imports of oil and wheat, as well as its unsustainable fuel subsidy.
- The overall implications of the crisis on African countries will be soaring inflation, weaker fiscal and external health, and a possible dent in earlier growth prospects as the region's central banks respond to inflation running wild.
- Central Banks in Egypt, Morocco, and Ghana are likely to be more responsive in stabilizing consumer prices in the near term

A sense of confusion, uncertainty, and even fear has been the overriding message from the financial markets since Europe was once again plunged into armed conflict. Tipping a longstanding diplomatic crisis into a military conflict, Russia's invasion of Ukraine has left investors on the backfoot and sent shockwaves through pretty much every asset class across the globe. No one expected to see cruise missiles fired into Europe in 2022, in a hostile attack.

If that is not enough, the US Federal Reserve Bank's (US Fed) hawkish tone kept investors on the edge. Equities were already under pressure from the surge in treasuries at the start of 2022 as the Fed and other central banks signaled a more aggressive pace of monetary policy tightening. Record high rates of inflation have already prompted traders to price in multiple interest rate rises in Europe and the US this year, as well as a largely reactive knee-jerk tightening cycle in emerging markets.

YTD inflation trajectory vs yield trajectory



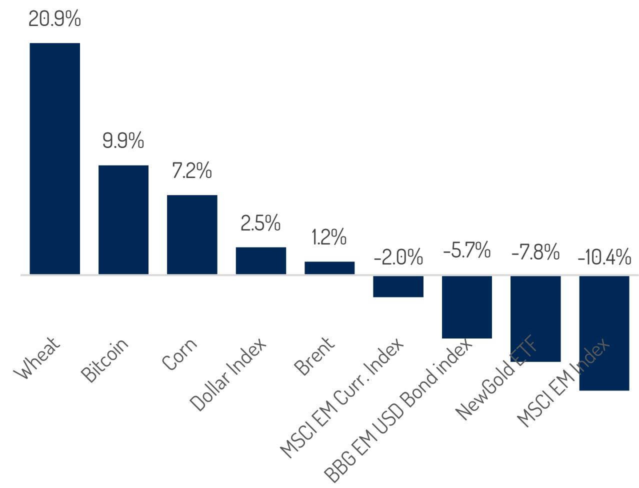
Source: Bloomberg

For Africa that has no strategic interest in the Ukrainian crisis, the fallout will be mostly economic – with elements of political instability. Although some African countries may benefit from a shift in global markets away from Russia due to the crisis, the short-term potential impacts on economic livelihoods are worrying and could trigger an uprising from the continent's poorest inhabitants.

Russia's invasion of Ukraine is likely to hurt Africa's fragile economies through tighter fiscal constraints, and higher commodity costs. The most pronounced consequence will be the surge in prices, particularly of oil and wheat, as these will have implications for inflation, current-account, and budget balances across the continent.

Besides hydrocarbons and grains, the prevalence of the crisis bodes well for the region's biggest metal exporters, including South Africa, Ghana, Zambia, and the Democratic Republic of Congo.

Performance of selected assets since the crisis



Source: Bloomberg
Note: Data collated as at 16 Mar 2022

Unfortunately, Kenya is particularly vulnerable to the crisis due to its relatively higher dependence on imports of oil and wheat, as well as its unsustainable fuel subsidy. With a general election due in five months, a further cut back in its fuel subsidy scheme is unlikely and would quicken the deterioration of its twin deficits in the near term – portending near-term risks for the Kenyan shilling and the performance of the Nairobi stock exchange (NSE).

The above notwithstanding, based on historic data, the impact of Russian aggression on Africa's domestic bourses have generally been short-lived – lasting between one to six months, post-crisis.

Sweet and sour consequences from the energy price shock

While net oil exporters – like Nigeria, Ghana and Angola – could record large current account improvements on account of the upward pressure on oil prices, net oil-importers like South Africa, and Kenya are likely to record negative terms of trade shocks, as demand for crude oil is price inelastic in the short-run. The crisis, however, presents long-term growth opportunities for some of the continent's natural gas bright spots – including Nigeria, Senegal, and Tanzania – as Europe looks to reduce its dependence on Russian energy.

Countries with regressive fuel subsidies run the risk of further fiscal stress, especially those with general polls in the offing. With elections due in a few months, Nigeria and Kenya are delaying the implementation of energy reforms, while the reforms committed to by Zambia in its negotiation with the International Monetary Fund (IMF) will become less popular in the face of rising oil costs. South Africa is also vulnerable to the oil price shock amid the going trend where oil and gas majors are shutting down refineries, rather than investing in their renovation, which has left the country in import mode.

Wheat squeeze complicates food price and polity dynamics

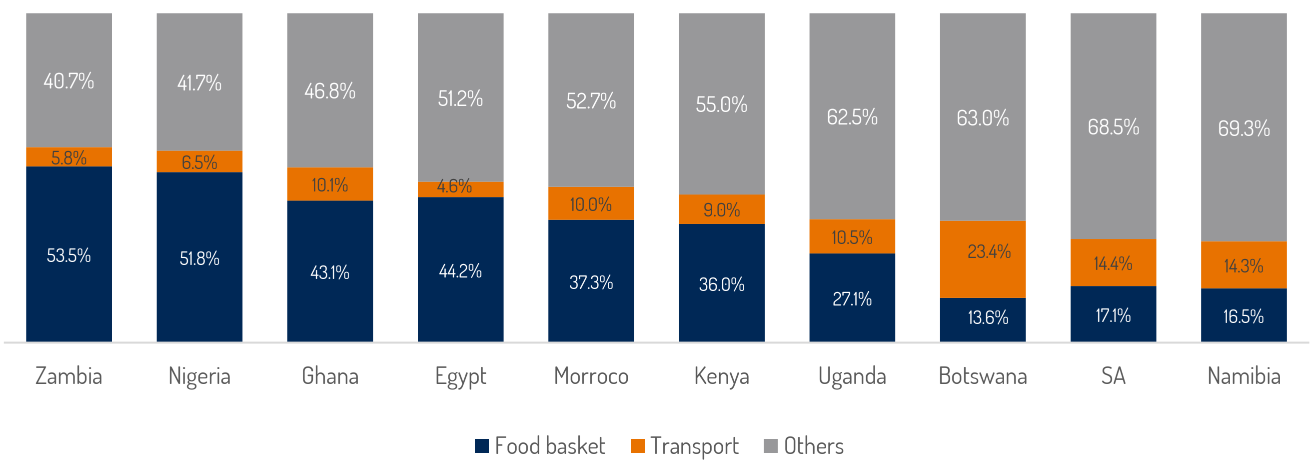
As oil and food markets have become highly interconnected, African countries – especially Sahel and Sahara countries - are on course to face steeper food price pressures in the near term. Disruption to Russian and Ukrainian wheat export is also fueling the pressure as they both account for nearly 30% of the world's wheat supplies. Already, the Food and Agriculture Organization's (FAO) Food Price Index (FPI) jumped 21% y/y in February 2022 – just five days into the conflict.

The last wheat price spike, in 2007, led to food riots in at least 14 of Africa's 54 countries including Egypt and Tunisia in the North, Burkina Faso, Cote d'Ivoire, and Senegal in the West, and Madagascar and Mozambique in the South.

The countries most vulnerable to this year's bread crunch are predominantly in North and West Africa, which spend a higher fraction of their income on food.

With a food and non-alcoholic beverage (FNAB) weighting of 51.8% and 43.1% in their respective consumer price indices, Nigeria and Ghana are exposed to higher price shocks from the surge in wheat prices relative to their Southern Africa counterparts. Ghana's exposure is worsened by the depreciating cedi, which will amplify the impact of the rising dollar prices of commodities

Cross section of CPI for selected African countries



Source: Bloomberg

Up North - as Africa's largest consumer - Egypt's exposure to the wheat squeeze stems from its generous state bread subsidies. The country sourced 86% of its wheat supplies from Russia and Ukraine in 2020 and with its wheat stock at its lowest in nearly a decade, Egypt is significantly exposed to the bread crunch.

Kenya and Ethiopia are also exposed to import concentration risk, with most of their wheat imports sourced from the conflicting countries. Rising food prices in Kenya in recent weeks have generated growing anger on social media while it would most certainly exacerbate already high levels of food insecurity generated by Ethiopia's civil war.

Impact of Russian aggression on African financial markets short-lived

A prolonged conflict could see African stocks plummet further, trading at relatively cheap valuations relative to their earnings and long-term growth potential. However, this presents an opportunity to buy the dip as the impact of Russia's aggression on African bourses tends to be short-lived. Russia is not new to being a catalyst for market turbulence, and its impact on Africa's domestic bourses last between one to six months – except in 2008 when its invasion of Georgia coincided with the global financial crisis (GFC).

Performance of major African indices during and post Russian invasions

	During conflict	1-month post-conflict	3-month post-conflict	6-month post-conflict	1-year post-conflict
Russian Financial Crisis					
MSCI EM Index	-15.2%	22.4%	29.1%	42.8%	65.1%
Nigerian stocks	-1.7%	-0.6%	-1.9%	-5.4%	-13.7%
South African stocks	-19.5%	19.4%	18.9%	32.3%	57.4%
Egyptian stocks	2.3%	-5.3%	-1.9%	16.8%	22.1%
Moroccan stocks	-1.4%	-2.5%	-4.7%	-8.1%	-7.3%
2008: Russian Invades Georgia					
MSCI EM Index	-4.8%	-20.0%	-47.9%	-46.2%	-14.0%
MSCI FM Index	-4.0%	-15.7%	-45.4%	-61.0%	-45.0%
Botswana stocks	0.9%	13.0%	5.9%	-12.7%	-12.0%
Nigerian stocks	-6.9%	1.7%	-18.8%	-50.5%	-50.3%
South African stocks	0.5%	-10.1%	-30.1%	-25.6%	-9.5%
WAEMU stocks	0.0%	-8.5%	-26.9%	-30.4%	-43.8%
Zambian stocks	-4.2%	-1.1%	-12.7%	-36.5%	-25.8%
Egyptian stocks	-7.3%	-14.2%	-48.9%	-57.1%	-23.6%
Kenyan stocks	0.8%	-14.1%	-23.6%	-40.2%	-29.6%
Moroccan stocks	-1.4%	-9.9%	-17.0%	-23.7%	-20.6%
Tanzania equities	-0.1%	-0.1%	14.6%	14.7%	13.1%
Ugandan stocks	-1.5%	-8.7%	-18.8%	-34.7%	-20.6%
2014: Russian Invades Crimea					
MSCI EM Index	-0.8%	7.3%	10.6%	11.9%	-0.3%
MSCI FM Index	-1.0%	7.3%	12.7%	15.6%	-2.4%
Botswana stocks	-3.3%	0.5%	1.7%	5.2%	8.2%
Ghanaian stocks	-1.4%	-3.8%	-1.7%	-6.7%	-8.8%
Nigerian stocks	-2.4%	2.9%	8.6%	7.6%	-21.0%
South African stocks	-0.7%	3.0%	8.7%	9.7%	11.4%
WAEMU stocks	-1.0%	-0.7%	-3.4%	3.8%	9.4%
Zambian stocks	4.9%	9.4%	7.2%	10.3%	9.2%
Egyptian stocks	3.4%	-3.4%	2.9%	15.7%	16.8%
Kenyan stocks	4.3%	1.7%	4.1%	12.4%	20.1%
Moroccan stocks	3.8%	-0.2%	-2.9%	2.4%	8.7%
Rwandan stocks	2.2%	0.5%	0.3%	-2.5%	-5.6%
Tanzanian stocks	3.0%	1.3%	9.7%	29.6%	33.1%
Ugandan stocks	9.6%	-0.2%	9.8%	20.3%	34.3%
2022: Russian Invades Ukraine					
MSCI EM Index	-10.4%				
MSCI FM Index	-6.6%				
Botswana stocks	0.5%				
Ghanaian stocks	1.6%				
Nigerian stocks	0.3%				
South African stocks	-2.0%				
WAEMU stocks	0.8%				
Zambian stocks	3.6%				
Egyptian stocks	-5.3%				
Kenyan stocks	-2.6%				

Conclusion

The Russia-Ukraine crisis brings a mixed bag of consequences for Africa's national economies, vis a vis the shock to commodity prices. Inflation is one key conduit through which the geopolitical tension would be acutely felt, along with weaker current account and fiscal balances, and a squeeze on economic growth. Economies with higher food weights in their CPI baskets, higher fuel intensities, and pre-existing inflation levels are more likely to experience sustained inflationary effects from the commodity price shock. However, countries with more independent central banks and higher governance scores are better positioned to contain the impact of these shocks.

For instance, Zambia, Nigeria, Ghana, Egypt, Morocco, and Kenya - where transport and food make up a large share of their consumer price indices -, are likely to be the most affected by these surging prices. The strongest pick-up in inflation is likely to be seen in countries that are facing currency depreciation pressure, like Ghana. But the central banks in Egypt, Morocco, and Ghana are likely to be more responsive in stabilizing consumer prices. The Bank of Ghana and the South African Reserve Bank have already embarked on policy rate normalization last year ahead of the US Fed. This buys them flexibility when it comes to managing inflationary pressures, reducing the likelihood of knee-jerk tightening.

As the boom in commodity prices is lifting consumer price pressures along with it, global policymakers are likely to extend tightening cycles. This will have a souring impact on most risk assets – including African currencies and equities, while cryptocurrencies are poised to reap the benefits of sanctions imposed on Russia's financial system.

For more information contact your IC representative

Business development & client relations

Derrick Mensah
Head, Business Development
+233 24 415 5765
derrick.mensah@ic.africa

Dora Youri
Head, Wealth Management
+233 23 355 5366
dora.youri@ic.africa

Kelvin Quartey
Analyst, Business Development
+233 57 604 2802
kelvin.quartey@ic.africa

Corporate Access

Joanita Hotor
Corporate access
+233 50 137 6100
Joanita.hotor@ic.africa

Investing

Isaac Adomako Boamah
Chief Investment Officer
+233 24 337 3118
isaac.boamah@ic.africa

Derrick Mensah
Portfolio Manager, Equities
+233 24 415 5765
derrick.mensah@ic.africa

Obed Odenteh
Portfolio Manager, Fixed Income
+233 54 707 3464
obed.odenteh@ic.africa

Timothy Schandorf
Portfolio Manager, Credit & Alternative assets
+233 24 292 2154
Timothy.schandorf@ic.africa

Bernard Tetteh
Analyst, Equities
+233 24 864 7114
bernard.tetteh@ic.africa

Herbert Dankyi
Analyst, Rates
+233 55 710 6971
herbert.dankyi@ic.africa

Operations

Nana Amoa Ofori
Chief Operating Officer
+233 24 220 6265
nanaamoa.ofori@ic.africa

Emmanuel Amoah
Fund Administrator
+233 20 847 2245
emmanuel.amoah@ic.africa

Kelly Addai
Fund Accountant
+233 20 812 0994
kelly.addai@ic.africa

Trading

Randy Ackah-Mensah
Head, Global Markets
+233 24 332 6661
randy.amensah@ic.africa

Allen Anang
Trader, Equities
+233 54 084 8441
allen.anang@ic.africa

Isaac Avedzidah
Trader, Fixed income
+233 24 507 782
isaac.avedzidah@ic.africa

Terms of use - disclaimer - disclosure