June 2019
Vol 13 Issue 6

Africa Monitor

East & Central Africa

SSA: Horn Of Africa To Benefit From Improving Diplomatic Relations And Increasing Investment

Key View

- At Fitch Solutions, we believe that the economic and political outlook for nations in the Horn of Africa region (which comprises Djibouti, Eritrea, Ethiopia and Somalia) will improve in the coming years.
- Domestic political shifts will likely boost diplomatic relations between these states, as

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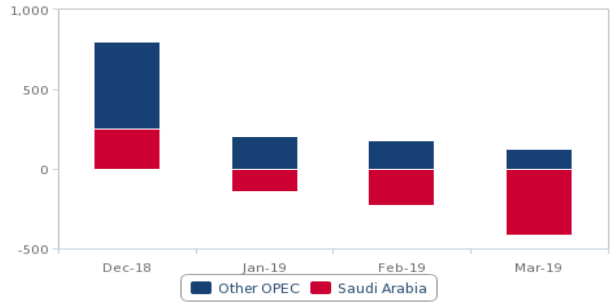
Tanzania: Growth Will Remain Robust But Decelerate 9

We believe that Tanzania's economy will continue to grow at a brisk pace, but see a slowdown across our short-term outlook. Fixed investment, largely driven by the government, will continue to be the main driver of economic expansion, with the project pipeline remaining packed.

Oil Outlook

Saudi Arabia Leading The Way
OPEC Production Cuts Versus November 2018 Reference Level ('000 b/d)



Source: OPEC, Fitch Solutions

Oil closed above USD70.0 per barrel (/bbl) in April for the first time since early December 2018, bringing its year-to-date gains to nearly 34%. Renewed concerns over supply disruption emerged in Libya as the Libya National Army moved to occupy Tripoli. Better numbers from China's leading indicators and no further escalation in trade tensions with the US have provided additional upside. However, the International Monetary Fund's downward revision of the global outlook has tempered gains. Overcompliance at 135% of OPEC+ production cut targets in March and continued impact on supply from sanctions in Iran and Venezuela have supported price appreciation. We at Fitch Solutions expect the overall demand growth to remain positive within emerging markets, excluding China. The US will boost overall demand as China and the eurozone will continue to drag on consumption. The supply-side constraint has tightened markets while outweighing concerns about the health of the global economy. We hold to our current forecast for Brent at an annual average of USD73.0/bbl for 2019 *(see 'Brent: Strong Fundamentals To Drive H2 Gains', April 2).*

ISSN: 1754-226X

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EAST & CENTRAL AFRICA RISK INDEX

Our Country Risk Index scores countries on a 0-100 scale, evaluating short-term and long-term political stability, short-term economic outlook, long-term economic potential and operational barriers to doing business. For a detailed methodology, visit fitchsolutions.com or contact us using the details on page 1.

RISK INDEX TABLE

	Short Term		Long Term		Operational	Country
	Political	Economic	Political	Economic	Risk	Risk
Tanzania	63.8	45.6	60.5	51.0	36.5	48.9
Uganda	59.6	47.5	53.9	51.5	35.3	47.4
Kenya	52.9	48.8	58.9	52.3	41.9	49.4
Congo (DRC)	23.8	44.0	30.1	39.2	24.6	31.0
Ethiopia	47.9	41.5	41.7	46.5	34.5	41.2
Sudan	30.4	25.8	30.4	35.8	26.8	29.3
Regional Average	**46.4**	**42.2**	**45.9**	**46.1**	**33.3**	**41.2**
Global Average	**63.1**	**52.8**	**62.0**	**54.2**	**49.8**	**55.1**

Note: Scores out of 100; higher scores = lower risks. Source: Fitch Solutions

SSA – ECONOMIC OUTLOOK

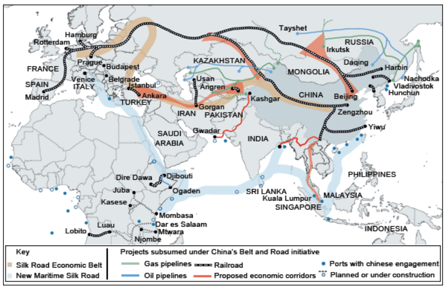
...continued from front page

will the region's increasing geopolitical importance.

- The potential for greater regional integration could also improve the business environment, offering further upside potential to growth.
- Increasing interest from foreign investors, particularly those from the Gulf and China, will offer economic tailwinds.
- Significant threats to the region, however, still remain. Potential entanglement in geopolitical disputes, domestic instability and Islamist militant groups pose major political risks going forward.

Belt And Road Inclusion Highlights Region's Strategic Importance

Map of Belt & Road

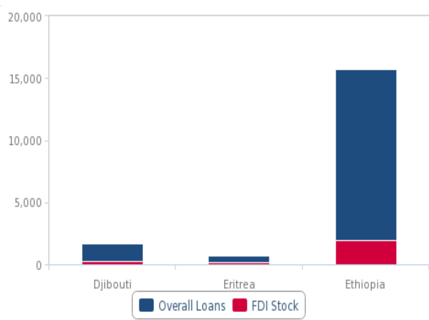


Source: Mercator Institute for China Studies, Fitch Solutions

Improvements to diplomatic relations between Horn of Africa states will offer opportunities in the coming years. The appointment of Abiy Ahmed as Prime Minister of Ethiopia in April 2018 precipitated several improvements in terms of foreign relations between Horn of Africa nations. For example, in June 2018, not long after he assumed office, Abiy announced that the Ethiopian and Eritrean governments had negotiated a peace deal, ending a stalemate that had been in place since 2002. In November 2018, US sanctions against Eritrea were lifted, signalling a gradual end to the country's previous international isolation (*see 'Quick View: Lifting Of Eritrea Sanctions Will Boost Horn Of Africa', November 15 2018*). This followed Eritrea's agreement to normalise its ties with Somalia in July and Djibouti in September. As a result of these developments, we expect greater economic cooperation between regional peers that will translate into greater interest in tangible investments from foreign governments and investors.

China To Remain Key Financing And Investment Partner

China – Overall Loans (2000-2017) & FDI (2017 Stock) To Horn Of Africa Nations, USDmn



Source: China Africa Research Initiative, National Bureau Of Statistics China, Fitch Solutions

Opportunities for economic cooperation will most likely come in the form of infrastructure investment, which is likely to boost the region's operating environment over the longer term while presenting opportunities for greater foreign direct investment. Since Ethiopia and Eritrea signed their peace agreement, joint infrastructure projects have been proposed. For example, the Italian government announced in January 2019 that it would fund a feasibility study for a 736km railway connecting Addis Ababa with the port of Massawa in Eritrea. Such a railway would improve access to landlocked Ethiopia, which has been dependent on Djibouti for port usage since the Eritrean-Ethiopian War began in 1998. We also note that access to Eritrea's other port at Assab would be ideal for exporting Ethiopia's potash resources from the Danakil depression. The Addis Ababa-Djibouti Railway was inaugurated in early 2018, connecting Ethiopia's capital with the Port of Doraleh and boosting freight transport capacity. These projects are likely to offer significant gains to regional connectivity, boosting trade. Operating environments in the region face significant constraints; our Operational Risk team notes that all Horn of Africa nations rank within the bottom quartile in the Crime and Security Risk and Logistics Risk (with the exception of Ethiopia) sub-components of our proprietary Operational Risk index. This suggests that while political risks in the region remain high, and until significant investment is poured into the region's infrastructure, the costs of operating supply chains will remain elevated for businesses.

In turn, increasing levels of foreign direct investment into the region will be a driver of growth, cementing its increasing strategic importance, while supporting opportunities for connectivity to improve. The advantageous geopolitical location of the region – located near the intersection of Africa, Asia and Europe and bordering the Red Sea – will attract significant foreign capital inflows over the coming years. The promise of the region is further underscored by the fact that it is a key target in China's 'Belt and Road Initiative' (BRI), whereby China has provided over USD15bn of investment and loans to Ethiopia since 2000, particularly into road, power and rail projects. While China is likely to continue to play a large role in the region's economic development, the region's strengthening ties with the Gulf will also be of increasing importance over the coming years. In the latter, for example, the UAE announced plans in August 2018 to build an oil pipeline connecting Eritrea and Ethiopia. The Emirati government invested USD1bn into the National Bank of Ethiopia in order to support the currency, and Abu Dhabi property firm **Eagle Hills** launched a major residential construction project in Addis Ababa in November 2018. As such, the region will benefit from a diversification in its sources of investment over the coming years.

Djibouti and Eritrea in particular will be target destinations for major global powers to develop a greater military presence, given their advantageous location in the Gulf of Aden. China, France, Japan, Saudi Arabia, the UK and the US all currently have military bases in Djibouti, while in Eritrea the UAE has a base, and Russia plans to open a logistics base there. Turkey also opened a military base in Somalia in 2017. These developments reflect growing recognition of the region's geostrategic importance, and we therefore expect demand for land in these territories to grow as major global powers jostle for greater military influence.

While we note significant growth opportunities for the region, we stress that Horn of Africa nations face multiple challenges, such as becoming a focus for geopolitical squabbles, persistent domestic political instability and weak operating environments. Although increasing geopolitical prominence will offer economic tailwinds to the region, land is increasingly likely to become hotly contested as major global powers jostle for strategic advantage. In Djibouti, a legal battle over one of its main ports has been ongoing since early 2018. The government seized ownership of the Doraleh Container Terminal from Emirati firm **DP World**, the port's operator since 2006, after the government sold 23.5% of its two-thirds stake in the terminal to **China Merchants Port Holdings**. This raised suspicion that Djibouti aimed to hand over ownership of the port to China (*see 'Djibouti's DP World Dispute Highlights Wider Risks', February 15*), which will likely raise tensions with the Emirati government. Eritrea is also likely to walk a tightrope over its foreign relations, given that it currently holds a Chinese military base but is also attracting interest from the US and Russia. Moreover, in April 2018, Somalia's federal foreign minister criticised DP World for entering into a port development contract with the Somaliland government, saying that the agreement 'bypassed the legitimate authority' of Somalia and nullified the agreement for control of the port of Berbera. The UAE, which has been a key investor in Somalia, planned on building a military base there and continues to be involved in the Saudi-led coalition fighting Houthi rebels in Yemen. The cancellation of the project will likely lead to a deterioration in relations with the UAE, particularly after Somali President Abdullahi Mohamed refused to cut ties with Qatar and remain neutral on the conflict between the two countries – this further exemplifies the risks that Horn of Africa nations face when accepting investment from opposing military powers.

In Ethiopia, the largest economy in the region, land disputes and ethnic tensions will slow the country's growth potential. Since 2015, the majority Oromo and Amhara populations have protested economic marginalisation and the political dominance of the Tigrayan ethnic group. These were sparked by plans to extend the boundaries of Addis Ababa, which would have entailed the eviction of Oromo residents and farmers, leading many Oromo to protest. While Abiy, an ethnic Oromo, has taken steps towards improving democratisation in the country, disputes over land, resources and representation between ethnic groups represent a structural political challenge (*see 'Social Fragmentation Will Keep Political Landscape Tense', April 13 2018*).

In Somalia, the Al-Shabaab insurgency will be the focus of the central government's concerns for the foreseeable future. Major terrorist attacks and widespread criminal activity mean that Somalia will remain one of the most high-risk operating environments in the world. We also note that disagreements between the federal authorities and heads of the autonomous regions of Somaliland and Puntland – which have both declared independence but are not internationally recognised – could also stunt the passing of policy. As such, while we expect a brighter economic outlook for the region, political risks will be a major impediment to improvements in the operating environment.

KENYA – ECONOMIC OUTLOOK

KES: Short-Term Range-Trading, Longer-Term Downward Pressures

Key View

- We at Fitch Solutions expect the Kenyan shilling to remain relatively stable in the coming months, but we see greater downward pressure beyond our short-term outlook.
- Expectations for slower monetary normalisation in developed markets, as well as moderate tightening by the Central Bank of Kenya (CBK), will likely see the shilling trade within range over the coming months.
- Downward pressures will likely become more pronounced in the latter half of our currency forecast period, driven by declining remittances, high import spending and rising foreign debt servicing costs.
- Risks to the shilling are largely weighted to the downside given potential for political and fiscal headwinds.
- We expect the shilling's average exchange rate to fall gradually against the US dollar, by 2.5% in 2019 and 3.4% in 2020.

Gradual Sell-Off To Resume

Kenya – Exchange Rate, KES/USD (Daily)

Source: Bloomberg, Fitch Solutions

Short-Term Outlook (three-to-six months)

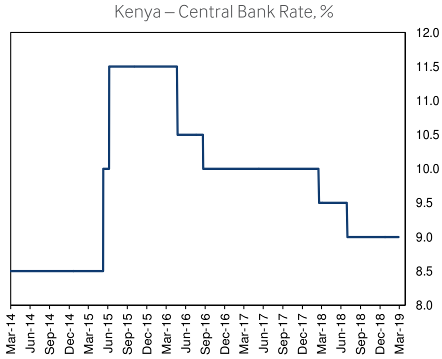
The Kenyan shilling will likely trade broadly within range over the coming months, given declining pressures from global market sentiment. Our Global team now forecasts only one Federal Funds Rate hike until the end of 2020. Slower monetary policy normalisation in developed markets has seen pressure on emerging market assets ease. This will also reduce pressure on the shilling. Moreover, we forecast the CBK to enact 50 basis points (bps) worth of rate hikes by the end of 2019 in response to higher food inflation, likely in order to shore up real interest rates. These factors will temper the pace of depreciation in the coming quarters.

Long-Term Outlook (six-to-24 months)

Over a longer-term trajectory, however, we expect a number of factors will lead to greater downward pressures on the Kenyan shilling. As such, we expect the shilling to fall to a rate of around KES114.0/USD by the end of 2020 from the current spot rate of KES100.7/USD. Depreciation will be driven by a deterioration in the external accounts. Lower exports – as a result of weaker tea production, lower remittances, and an increase in interest payments on debt – will weigh on the current account. These factors suggest that downward pressures on the shilling will grow in the coming months. This will be compounded by a slowdown in growth to 5.2% and 5.5% in 2019 and 2020 respectively, from an estimated 5.8% in 2018, which will likely weaken investor perceptions.

Moderate Tightening Ahead

Kenya – Central Bank Rate, %



Source: CBK, Fitch Solutions

However, we believe that depreciation will be somewhat offset by the fact that the CBK will be able to guard against a more significant sell-off. As of December 2018, the CBK had 5.3 months' worth of import cover, above the IMF's recommended benchmark of 4.0 months.

This suggests that policymakers will be able to engage in sporadic FX intervention in order to avoid the shilling falling more rapidly against the dollar and thus boosting imported price pressures for Kenyan consumers.

Risks To Outlook

We maintain our view that risks to the Kenyan shilling are weighted to the downside. The relatively high valuation of the shilling in real effective exchange rate terms suggests that any weakening in investor sentiment towards the country could lead to faster depreciation of the nominal exchange rate. For example, if investors begin to anticipate a faster trajectory of monetary tightening by the US Federal Reserve or other major developed market central banks than we currently anticipate, this would likely see sentiment turn towards risk assets such as the Kenyan shilling, and its value against the dollar could fall more quickly.

Otherwise, notable domestic risks to the shilling could come from political risks given a likely weakening of policy formation or potential unrest as a result of social and ethnic tensions, or a greater deterioration in the fiscal accounts that we currently forecast given concerns about the country's relatively high debt load.

KENYA – DATA & FORECASTS

	2015	2016	2017	2018	2019f	2020f	2021f
Population, mn	47.24	48.46	49.70	50.95	52.21	53.49	54.78
Nominal GDP, USDbn	63.7	70.5	82.0	88.0	93.5	99.9	107.6
GDP per capita, USD	1,348	1,455	1,650	1,728	1,789	1,867	1,964
Real GDP growth, % y-o-y	5.7	5.8	4.9	5.8	5.2	5.5	5.3
Consumer price inflation, % y-o-y, ave	6.6	6.3	8.0	4.7	6.0	6.2	6.5
Consumer price inflation, % y-o-y, eop	8.0	6.4	4.5	5.5	6.5	6.5	6.5
Central bank policy rate, % eop	11.50	10.00	10.00	9.00	9.50	10.00	9.00
Exchange rate KES/USD, ave	98.28	101.52	99.28	101.40	106.25	111.50	116.00
Exchange rate KES/USD, eop	102.30	102.51	103.30	103.50	109.00	114.00	118.00
Budget balance, KESbn	-478.2	-514.8	-711.0	-638.7	-559.2	-564.4	-608.8
Budget balance, % of GDP	-8.2	-7.7	-9.3	-7.5	-5.9	-5.4	-5.2
Goods and services exports, USDbn	10.6	9.9	10.4	11.5	12.5	14.0	15.8
Goods and services imports, USDbn	17.7	16.1	19.1	20.6	22.5	25.0	27.4
Current account balance, USDbn	-5.1	-4.1	-3.1	-5.0	-5.4	-5.9	-5.7
Current account balance, % of GDP	-8.0	-5.8	-3.8	-5.6	-5.8	-5.9	-5.3
Foreign reserves ex gold, USDbn	7.5	7.6	7.1	6.8	7.4	8.2	9.0
Import cover, months	5.1	5.6	4.5	3.9	4.0	3.9	3.9
Total external debt stock, USDbn	19.8	22.3	26.4	29.3	31.7	34.2	36.7
Total external debt stock, % of GDP	31.0	31.7	32.2	33.3	33.9	34.2	34.1
Crude, NGPL & other liquids prod, '000b/d	0.0	0.0	0.0	0.7	1.8	1.8	1.9
Total net oil exports (crude & products), '000b/d	-98.7	-104.8	-110.7	-117.2	-123.5	-130.8	-138.6
Dry natural gas production, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dry natural gas consumption, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0

f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

CONGO (DRC) – ECONOMIC OUTLOOK

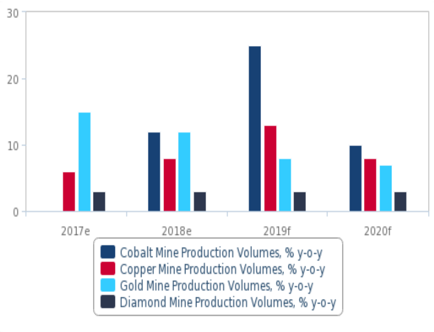
External Accounts To Improve Due To Higher Mining Exports

Key View

- The Congolese current account deficit is set to narrow over our forecast period as the large mining sector ramps up metals exports.
- Import demand will be relatively subdued in the short term, due to unrest and displacement affecting consumer demand.
- Over our 10-year forecast period, however, we anticipate that the current account will remain in deficit because we expect that some major infrastructure projects are likely to take place over that time, increasing demand for capital goods imports.
- In line with these factors, we expect the current account deficit to narrow from an estimated 1.4% of GDP in 2018 to 1.2% in 2019, before averaging 0.7% between 2020 and 2028.
- Financial account inflows are likely to be sufficient to fund the current account deficits.

Rising Mining Production To Boost Exports

DRC – Production Of Mining Sector



e/f = Fitch Solutions estimate/forecast. Source: National sources, Fitch Solutions

Direct investment inflows will tick upwards over our forecast period as some infrastructure projects are undertaken – notably the Inga 3 dam – while we expect that inflows of grants are likely to increase somewhat over the coming quarters.

An increase in mining production will drive an expansion in the volume of metals exports, supporting a narrowing of the Democratic Republic of the Congo (DRC)'s current account deficit over several years. Metals produced by mining – particularly copper, cobalt and rare earths – accounted for 64.5% of the DRC's goods exports in 2017. Following several mines being brought back online with expanded capacity in 2017 and 2018, metals exports have risen sharply. Exports of copper and cobalt ores rose by 58.8% and 77.4% respectively in 2017 – the most recent available data – while the exports of rare earth metals rose by 172.7%. Cobalt in particular, will support the DRC's external position because it is by far the largest exporter of this vital industrial metal worldwide. Given our Mining team's forecast of significant expansion in mining output of copper, cobalt, gold and diamonds in 2019, we expect that export growth will be sustained, driving a narrowing of current account deficit over a multi-year time horizon.

Meanwhile, ongoing disruption caused by political instability and ethnic conflict is likely to subdue import demand in 2019. Over 4 million Congolese are displaced – out of a population of approximately 84 million – meaning that demand for consumer goods will be relatively weak, as many people will not be able to secure a sustainable income, reducing consumer purchasing power.

While we expect current account deficits to narrow from their current level over our forecast period, we expect that overall current account deficits will persist due to a gradual uptick in import demand for capital goods. Although instability and the presence of Ebola in the eastern part of the DRC will act as partial constraints on new investment, we note that some plans for infrastructure projects have been made. Development plans in the DRC include:

- The Inga 3 hydropower project in the east – planned since 2013 but with construction slated to begin by early 2019.
- The development of a deep sea port at Banana.
- A bridge over the river Congo linking Kinshasa with its twin city of Brazzaville in the Republic of Congo.

These projects are plagued with operating problems and uncertain timelines but we expect that there will be some progress in some or all of them over our forecast period, likely seeing demand for capital goods imports rise, thereby keeping the current account in deficit. Financial account inflows should be sufficient to fund the DRC's current account deficit. As outlined above, we expect that there will be a gradual uptick in direct investment into the DRC over our forecast period, likely funding the relatively moderate current account deficits. Moreover, given that Felix Tshisekedi rather than Emmanuel Shadary – who is under numerous sanctions – has been made president of the DRC following elections in 2018, we expect that grants will gradually start flowing into the DRC once again. These factors should ensure that financial account inflows are sufficient to fund the current account deficit.

CONGO (DRC) – DATA & FORECASTS

	2015	2016	2017	2018	2019f	2020f	2021f
Population, mn	76.20	78.74	81.34	84.00	86.73	89.51	92.34
Nominal GDP, USDbn	38.1	42.1	39.8	44.4	45.1	48.8	53.1
GDP per capita, USD	500	535	489	528	519	544	574
Real GDP growth, % y-o-y	6.9	2.4	3.3	2.6	4.5	4.4	4.7
Consumer price inflation, % y-o-y, ave	1.4	14.9	40.9	27.6	19.0	9.5	7.9
Consumer price inflation, % y-o-y, eop	1.6	31.1	46.8	31.2	6.2	5.2	4.3
Central bank policy rate, % eop	2.00	7.00	20.00	14.00	14.00	10.00	5.00
Exchange rate CDF/USD, ave	921.38	966.95	1,458.92	1,686.88	1,962.07	2,074.05	2,172.75
Exchange rate CDF/USD, eop	925.00	1,165.00	1,595.00	2,092.93	2,223.61	2,339.31	2,440.74
Budget balance, CDFbn	-278.6	-482.3	56.5	-707.2	-1,216.7	-855.5	-858.5
Budget balance, % of GDP	-0.8	-1.2	0.1	-0.9	-1.4	-0.8	-0.7
Current account balance, USDbn	-1.5	-1.3	-0.7	-0.6	-0.5	-0.3	-0.6
Current account balance, % of GDP	-3.9	-3.2	-1.7	-1.4	-1.2	-0.7	-1.0
Foreign reserves ex gold, USDbn	1.2	0.7	0.5	0.6	0.9	0.9	1.0
Import cover, months	1.2	0.7	0.5	0.5	0.7	0.7	0.7
Total external debt stock, USDbn	5.4	5.1	5.1	7.3	7.2	7.2	7.3
Total external debt stock, % of GDP	14.1	12.0	12.9	16.4	15.9	14.8	13.8
Crude, NGPL & other liquids prod, '000b/d	19.6	19.2	18.8	18.4	18.1	17.7	17.4
Total net oil exports (crude & products), '000b/d	-1.6	-2.6	-3.9	-5.2	-6.7	-8.3	-10.0
Dry natural gas production, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dry natural gas consumption, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0

f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

SUDAN – POLITICAL OUTLOOK

Q&A: What's Next For Sudan After Bashir's Removal From Office?

On April 11, former President Omar al-Bashir was removed from office by Sudanese security forces and arrested. This development came after almost four months of protests across the country, in which wide sections of Sudanese society participated. After his removal, government news sources reported that former Defence Minister and Vice President General Awad Ibn Auf would head the Supreme Security Committee, a body comprising members of the army, police, paramilitary and intelligence services, and that this would lead a two-year transitional government. Ibn Auf also announced a three-month state of emergency, suspension of the constitution and a one-month curfew between 10pm and 4am. As a result of these developments, we have revised down Sudan's Short-Term Political Risk Index score to 22.1 out of 100, from 30.4 previously.

Will The Change Of Regime Lead To Increased Stability?

It is likely that Bashir's removal from office will lead to a period of continuing instability and uncertainty. The Sudanese Professionals Association (SPA), a coalition of trade unions which played a leading role in the protests, vowed to continue demonstrating on the basis that they would only accept a civilian government. Protests continued the evening after Bashir stepped down despite the imposition of the curfew. Activists are also likely to be dissatisfied with the two-year mandate of the Supreme Security Committee, meaning that they are likely to continue demonstrating in the short term. While the committee sought to reassure protesters by promising a civilian government after two years at most, doubts are likely to remain. In the coming months, the military will likely crack down on protesters which are perceived to be a threat, which may serve to entrench dissent. In the longer term, a split within the military between the regular armed forces and the paramilitary Rapid Support Forces (RSF) – which is part of the National Intelligence and Security Services (NISS) – is likely to present further challenges. The Sudanese Armed Forces and the RSF reportedly disagreed on how to deal with protests occurring outside the country's armed headquarters before Bashir's removal (*see 'Quick View: Weakening Military Support Increases Possibility Of Bashir Exit In Sudan', April 9*). With both factions of the military having a role in the Supreme Security Committee, we see potential for further divisions in the future, which will have a negative impact on stability.

What Will This Mean For The Country's Insurgent Territories?

Sudan's three insurgent territories – Darfur, Blue Nile and South Kordofan – are likely to see increased unrest in the coming months. Activists in Darfur took part in the country-wide protests from January, and we see potential for an uptick in violence in the region. The RSF largely comprises former members of the Janjaweed (the militia which is accused of carrying out the genocide against Darfuris which began in 2003), and their greater role in running the country during the transitional period will likely be opposed by Darfuris. We also note that Darfuri activists may seek to take advantage of recent instability to demand greater autonomy after previous calls were suppressed under Bashir's government in recent years (*see 'Darfur Referendum Outcome Will Continue To Undermine Peace Prospects', July 13 2016*). In Blue Nile and South Kordofan, we also expect greater calls from pro-secessionist activists. These states border South Sudan, where civil conflict has been ongoing since South Sudan's independence from Sudan in 2011. Blue Nile and Kordofan were not included in the 2011 referendum on South Sudanese independence, despite the fact that a majority of their populations reportedly wished for the territory to be part of South Sudan.

What Impact Will Bashir's Exit Have On The Country's Foreign Relations?

Sudan's allies in the Gulf – chiefly the UAE and Saudi Arabia – are likely to have interests in maintaining stability in the country. In the early weeks of the protests, the respective governments variously pledged military and financial assistance to Bashir's regime. We believe that Saudi Arabia and the UAE are likely to roll over their support to the new regime, given that they have large agricultural and mining investments in Sudan, strengthening their impetus to cool unrest in the country's resource-rich and fertile areas.

The relationship between Sudan and the US will likely remain at risk in the coming quarters. Relations had significantly improved in recent years, with the US removing sanctions that had significantly limited the extent to which Western entities could trade with and invest in Sudan. The removed US sanctions were placed on Sudan in 2007 under George Bush in response to violence in Darfur, and should fighting between pro-government and Darfuri forces erupt once again, it is possible that sanctions will be reinstated, although this is currently not our core view. Moreover, we note that late in 2018, the government had been in negotiations with the US to be removed from the State Sponsors of Terrorism list. Removal from the list is one of the objectives the Sudanese government has to achieve in order to receive debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. Should the unrest make way for greater activity by Arab nationalist militias in Darfur and Islamist militants across the country, the country's improving relations with the US could be under threat.

How Will This Affect Sudan's Economic Situation?

We expect greater instability to lead to slower progress on fiscal consolidation in the coming quarters. In order to quell popular unrest and appease the population (given that the protests originally erupted in response to quickly rising inflation), the Supreme Security Committee may seek to slow implementation of the fiscal austerity that originally led to the protests. This could be through increasing public sector wages or rolling back the subsidy cuts which led to a huge increase in bread prices. Moreover, progress on regaining access to multilateral loans will slow. As previously mentioned, the government may struggle with being removed from the US State Sponsors of Terrorism list, which is one of the prerequisites for access to debt relief under the HIPC initiative. Even after that, the government would have to be granted debt relief from the lenders holding at least 80% of the country's debt. Creditors largely comprise a mix of Paris Club and non-Paris club lenders, as well as a minority owned by international financial institutions. The government has been in arrears to multilateral financial institutions since the 1980s, effectively shutting it out from accessing much foreign lending. As such, progress on the debt relief process will likely slow as a result of the regime change.

Political instability will also bode poorly for Sudan's external accounts. Investors are likely to remain wary, leading to the outflow of foreign capital from the country. This will likely lead to the Sudanese pound's value falling against the US dollar on the parallel market. At the end of March, the Central Bank of Sudan (CBoS) suspended the work of the Market Makers Committee (MMC), a board of business owners and other stakeholders which was set up in October to decide the direction of the currency, suggesting that the CBoS will likely sell its dwindling dollar reserves to prop up the Sudanese pound in the coming months. Lastly, if unrest proves to be widespread, this could interfere with production and transportation in the agricultural, gold mining and petroleum sectors, which are significant foreign exchange earners for the country – further threatening Sudan's external accounts.

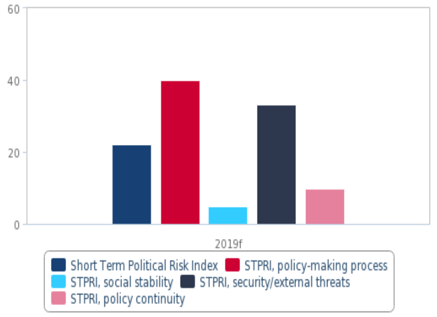
What Does This Mean For South Sudan?

We see an increase in political and economic risk for Sudan's southern neighbour South Sudan, which seceded from Sudan in 2011. South Sudan, which has been embroiled in a civil war since late-2013, is currently in the pre-transitional period of implementing a peace deal. Bashir was one of the guarantors of the peace deal, and enjoyed a relatively good relationship with Riek Machar (South Sudan's First Vice President and rebel leader). As such, Sudan's ability to influence the peace process has likely weakened, and South Sudanese President Salva Kiir Mayardit may see fewer reasons to work with Machar given that the benefits of better foreign relations may have eroded.

Moreover, a significant economic threat to South Sudan would be disruption of the Greater Nile Oil Pipeline, which runs through Sudan and which the former completely depends on in order to export its oil. Oil is the principal driver of economic activity, fiscal revenues and FX earnings, meaning that, despite a likely recovery in production in the coming months), the inability to export it could significantly dampen the outlook for South Sudan's economy. Our core view is for South Sudanese growth to recover in the coming quarters, but disruption to the pipeline could represent a significant risk.

Military-Assisted Transition Will Not Presage Greater Stability

Sudan – Short-Term Political Risk Index & Components



Note: Scores out of 100; higher score = lower risk. Source: Fitch Solutions

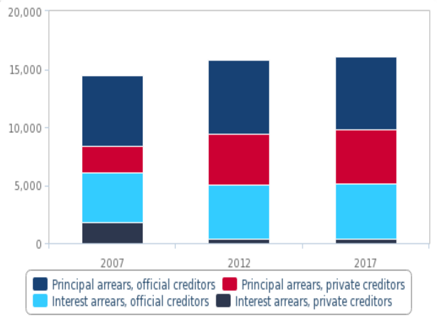
Insurgent Territories Could See Increased Instability

Sudan – Map Of Sudan

Source: d-maps, Fitch Solutions

Long-standing Arrears Unlikely To Be Resolved In The Short Term

Sudan – Arrears On External Debt, USDmn



Source: World Bank, Fitch Solutions

SUDAN – DATA & FORECASTS

	2015	2016	2017	2018	2019f	2020f	2021f
Population, mn	38.65	39.58	40.53	41.51	42.51	43.54	44.59
Nominal GDP, USDbn	80.3	84.8	118.9	46.2	37.3	46.4	52.6
GDP per capita, USD	2,077	2,142	2,932	1,112	878	1,066	1,178
Real GDP growth, % y-o-y	4.9	3.0	4.3	-2.2	0.7	4.8	4.7
Consumer price inflation, % y-o-y, ave	17.3	30.5	34.9	62.0	45.0	17.0	17.0
Consumer price inflation, % y-o-y, eop	12.6	17.6	52.4	70.0	34.0	17.0	17.0
Exchange rate SDG/USD, ave	5.97	6.16	6.65	27.00	47.50	46.50	50.00
Exchange rate SDG/USD, eop	6.45	7.01	7.01	47.00	45.00	48.00	52.00
Budget balance, SDGbn	-9.2	-10.5	-11.1	-33.6	-38.1	-42.9	-47.7
Budget balance, % of GDP	-1.9	-1.9	-1.4	-2.7	-2.2	-2.0	-1.8
Goods and services exports, USDbn	4.9	4.6	5.6	5.8	6.4	6.8	7.4
Goods and services imports, USDbn	10.0	9.0	8.2	6.6	6.9	7.9	9.0
Current account balance, USDbn	-5.3	-4.3	-3.3	-1.1	-0.9	-1.6	-2.4
Current account balance, % of GDP	-6.6	-5.1	-2.8	-2.4	-2.4	-3.4	-4.5
Foreign reserves ex gold, USDbn	0.2	0.2	0.2	0.2	0.2	0.2	0.3
Import cover, months	0.2	0.3	0.3	0.4	0.4	0.4	0.3
Total external debt stock, USDbn	21.4	21.1	21.8	16.7	16.8	18.1	19.8
Total external debt stock, % of GDP	26.7	24.9	18.3	36.1	45.0	39.0	37.7
Crude, NGPL & other liquids prod, '000b/d	108.2	105.2	102.2	98.1	107.9	110.1	109.0
Total net oil exports (crude & products), '000b/d	-2.6	-7.9	-9.7	-11.4	-0.4	0.7	-2.6
Dry natural gas production, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dry natural gas consumption, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0

f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

TANZANIA – ECONOMIC OUTLOOK

Growth Will Remain Robust But Decelerate

Key View

- At Fitch Solutions, we believe that Tanzania's economy will continue to grow at a brisk pace, but see a slowdown across our short-term outlook.
- Fixed investment, largely driven by the government, will continue to be the main driver of economic expansion, with the project pipeline remaining packed.
- While consumer demand will remain robust, it will be tempered as a result of rising inflation.
- Slower exports, however, will pose a challenge. A deteriorating investment environment will see growth decelerate in the longer term, with weakening donor relations posing further downside risks.
- We forecast real GDP growth of 6.5% and 6.2% in 2019 and 2020 respectively, down from an estimated 6.7% in 2018. We also note that the authorities have rebased and revised the country's GDP figures, with the country's real GDP having been estimated to be 3.8% larger than previously thought.

Fixed investment driven by construction projects will remain the engine of growth in Tanzania over our short-term outlook. Our Infrastructure team has a bullish view on the construction sector as projects such as the Dar es Salaam-Morogoro standard gauge railway, the Malindi-Bagamoyo highway, and the addition of new berths at Dar es Salaam port are set to progress. These are under the auspices of the government's National Five Year Development Plan, which aims to boost growth through boosting the operating environment. Simultaneously, we expect government consumption to remain elevated given that such projects will likely require significant administration and labour costs.

Private consumption will remain strong in the coming quarters, but expand at a weaker pace owing to rising inflation. Largely owing to upward supply-side pressures on food and fuel prices, we expect consumer price inflation to rise to averages of 5.4% and 5.5% in 2019 and 2020 respectively, up from 3.7% in 2018. This will exert mild pressure on consumers' spending power. Moreover, we expect normalising weather conditions to lead to slower growth in earnings for farmers. Given that the majority of working Tanzanians are employed informally in the agricultural sector, this will lead to private consumption slowing overall.

Challenges to the main exporting businesses will dampen growth. The government's decision to buy the entire stock of cashews (the country's most lucrative export crop) from domestic farmers at an elevated price, and sell them on to importers at a further inflated price, will mean that it will likely have trouble finding buyers, which will constrain export volumes. Moreover, a continued tax dispute with the country's largest mining operator, **Acacia Mining**, will mean that prospects for mining production growth remain dim (*see 'Sub-Saharan Africa Mining Overview', January 16*). That said, we note that talks between the government and the firm are ongoing, offering upside risk.

We hold our view that, in the longer term, an increasingly unattractive business environment will lead to a slowdown in economic growth. In 2017 and 2018, a number of strict regulatory measures were passed which significantly increased government intervention and taxation in the mining and extractive sector. One law gave the government the power to force the renegotiation of contracts with firms in those sectors. In February, the government announced that it was reviewing 11 existing contracts and their fiscal regimes. This will likely dent investor sentiment, likely leaving firms reticent to pursue foreign direct investment into Tanzania. We note that in recent quarters, increasingly authoritarian policies have seen some deterioration in relations with Western donors and multilateral financial institutions, particularly the World Bank. This poses the threat that Tanzania could face challenges securing funding for infrastructure projects. As such, risks to long-term growth are heavily weighted to the downside.

TANZANIA – DATA & FORECASTS

	2015	2016	2017	2018	2019f	2020f	2021f
Population, mn	53.88	55.57	57.31	59.09	60.91	62.77	64.67
Nominal GDP, USDbn	46.3	49.6	53.2	57.5	62.6	68.2	75.4
GDP per capita, USD	859	891	928	1,003	1,060	1,119	1,201
Real GDP growth, % y-o-y	6.2	6.9	6.8	6.7	6.5	6.2	6.2
Consumer price inflation, % y-o-y, ave	5.6	5.2	5.3	3.5	5.4	5.5	5.5
Consumer price inflation, % y-o-y, eop	6.8	5.0	4.0	3.3	5.5	5.5	5.5
Central bank policy rate, % eop	16.00	16.00	9.00	7.00	7.00	7.00	7.00
Exchange rate TZS/USD, ave	2,037.04	2,186.15	2,232.64	2,277.50	2,356.20	2,437.80	2,486.56
Exchange rate TZS/USD, eop	2,149.33	2,181.00	2,234.63	2,298.73	2,413.67	2,461.94	2,511.18
Budget balance, TZSbn	-2,621.8	-3,357.2	-1,925.0	-3,360.4	-4,603.0	-5,698.6	-6,139.8
Budget balance, % of GDP	-2.8	-3.1	-1.6	-2.6	-3.1	-3.4	-3.3
Goods and services exports, USDbn	8.8	9.3	8.7	8.4	8.9	9.3	9.8
Goods and services imports, USDbn	7.2	6.2	5.5	6.0	6.6	7.3	7.7
Current account balance, USDbn	-3.7	-2.2	-1.6	-2.7	-3.5	-4.0	-4.3
Current account balance, % of GDP	-7.9	-4.3	-3.1	-4.7	-5.6	-5.9	-5.6
Foreign reserves ex gold, USDbn	4.1	4.3	5.9	5.5	5.6	5.8	6.1
Import cover, months	3.9	4.9	7.4	6.4	6.1	5.9	5.8
Total external debt stock, USDbn	15.5	16.2	18.2	20.1	22.3	25.5	29.3
Total external debt stock, % of GDP	33.4	32.7	34.3	35.0	35.7	37.4	38.9
Crude, NGPL & other liquids prod, '000b/d	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total net oil exports (crude & products), '000b/d	-56.2	-56.7	-56.2	-60.1	-64.4	-68.9	-73.7
Dry natural gas production, bcm	1.1	1.3	1.4	1.3	1.5	1.7	1.8
Dry natural gas consumption, bcm	1.1	1.3	1.4	1.3	1.5	1.7	1.8

f = Fitch Solutions forecast. Source: National sources, Fitch Solutions

UGANDA – INDUSTRY OUTLOOK

Loan Growth To Decelerate In 2019

Key View

- Credit growth in Uganda will remain relatively robust over the coming quarters due to a backdrop of continued strong economic growth.
- Extensive government borrowing, rising inflation and moderate monetary tightening will however temper loan growth compared to 2018.
- We forecast client loan growth of 8.6% over 2019 after growth of 10.6% in 2018.
- We note, however, a risk that more aggressive monetary tightening to a benchmark interest rate above our end-2019 forecast of 11.00% could see lending undershoot our projections.

A positive macroeconomic backdrop will continue to support credit growth over the coming quarters. Credit to the private sector grew by 10.9% y-o-y in December 2018, down from 12.1% in November, but up from 6.2% a year earlier. Loan growth in recent quarters has been supported by the Bank of Uganda (BoU)'s accommodative monetary policy stance following previous stimulus, with policymakers having cut the central bank rate by 800 basis points (bps) between April 2016 and February 2018 to 9.00% before a 100bps hike in October 2018.

Favourable weather conditions have also kept inflation subdued, averaging 2.6% over 2018 compared to 5.7% in 2017.

Moreover, data from the Uganda Bureau Of Statistics (UBOS) showed that real GDP growth in Q318 accelerated to 6.8% y-o-y from 5.2% in the previous quarter with upticks in a wide range of sectors, and figures from the BoU show that 2018 ended with key industries recording increased loan growth compared to the previous year. We forecast continued growth in the agricultural sector alongside the government's public investment agenda to underpin real GDP growth of 5.8% in 2019 (*see 'Uganda's Growth Continues To Outperform The Rest Of Sub-Saharan Africa', January 30*). This will see Uganda's asset quality strengthen further, with the ratio of non-performing loans (NPLs) to total loans having already fallen to 4.7% as of Q318 compared to the 16-year high of 10.5% in Q416 following drought conditions, keeping banks more willing to lend than in previous years.

Government borrowing will further contribute to asset growth for banks, though will continue posing headwinds to private borrowers' access to loans. Private sector credit growth in 2018 was higher than 2017 and 2016, but remained below the average of 15.8% seen since January 2010. This has in part been due to the government's extensive borrowing from domestic banks to finance its Second National Development Plan (NDPII). The banking sector's bond portfolio grew by 7.1% y-o-y as of December 2018, following growth of 10.8% over 2017 and 25.8% over 2016, amid the government's revenue generation remaining systemically weak (*see 'Development Agenda Will See Ugandan Fiscal Deficit Widen', January 29*). With government securities being lower risk and more attractive to banks, we believe public borrowing has had the effect of crowding out potential private borrowers and contributed to lending rates remaining high, a trend that we expect to continue over the short term. Despite the BoU's benchmark interest rate currently standing at 10.00% compared to 17.00% prior to monetary stimulus beginning in April 2016, the weighted average commercial lending rate has proven more static and remains significantly higher at 20.2% as of December 2018 compared to 24.3% in April 2016.

Our core view is for moderately rising inflation and monetary tightening to further temper credit growth, however, risks of more aggressive tightening could see lending undershoot our forecasts. With favourable weather conditions following previous droughts having kept inflation muted in recent months, we expect a gradual normalisation of weather and harvests over the coming quarters to see inflation rise from an average of 2.6% in 2018 to 5.1% over 2019. In turn, our core expectation is for the BoU to raise its policy rate cautiously by 100bps to 11.00% by the end of 2019, aiming to keep inflation contained while not reversing the recovery of credit growth (*see 'Subdued Inflation And Strong Growth Limit Impetus For Monetary Tightening In Uganda', January 16*). Rising inflation will see demand for credit weaken, while an environment of tighter monetary policy will lead banks to restrict loan issuance, with our forecast for year-on-year loan growth to weaken from 10.6% over 2018 to 8.6% over 2019.

However, downside risks to this forecast stem from potential for inflation to exceed our projections. This could occur due to a return of adverse weather once more reducing food supplies or a sharper-than-anticipated depreciation of the shilling (*see 'Ugandan Shilling To Weaken Further In 2019', January 21*). Such a scenario would likely see the BoU hike beyond 100bps to contain price growth and defend the currency, but this would also weigh on private consumption and investment by making credit harder to access. This would exacerbate the crowding out effects of government borrowing, which shows little sign of waning over the coming year, leading growth of credit and real GDP to fall short of our forecasts.

Banking Sector Risk Components

Asset Quality

The ratio of NPLs to gross loans improved to 4.7% as of September 2018 from 10.5% in December 2016, which followed a notable deterioration in asset quality. We expect this ratio to remain relatively low, preventing lending rates from rising too sharply as central bank policy gradually tightens. This will help maintain debt affordability for private sector borrowers, given that most loans have floating interest rates.

FX Exposure

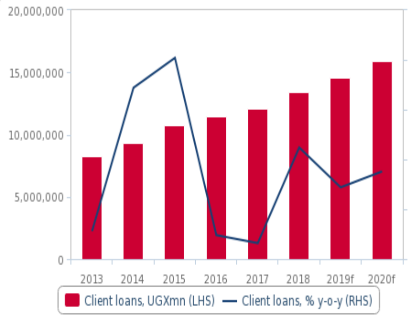
FX exposure in the banking sector remains relatively contained. According to the Bank of Uganda, foreign currency loans as a percentage of total outstanding loans decreased to 37.9% in December 2018 from 41.6% in December 2017. Even so, concern about the prospect of rising non-performing foreign currency loans is likely to increase provisioning and in turn weigh on profitability. In addition, businesses and consumers, squeezed by costlier imports following currency depreciation, may face greater difficulty in repaying their debts.

Funding Structure

The loan-to-deposit ratio has remained mostly stable in recent months, standing at 73.3% in December 2018 compared to an average of 71.7% over the past year, with slightly over half of those deposits transferable. This is an adequate amount in order to cover withdrawals, although if public confidence in the sector were to be swiftly eroded, risks to liquidity could escalate.

Credit Growth Moderating Over The Short Term

Uganda – Client Loans



f = Fitch Solutions forecast. Source: BoU, Fitch Solutions

Capital Adequacy

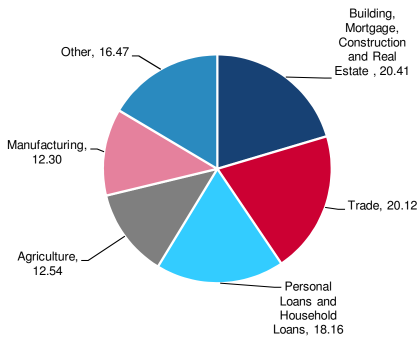
The sector is now much better able to withstand credit shocks due to the BoU's implementation of a number of prudential measures in recent years, meaning that banks continue to be well capitalised. Average Tier 1 capital ratios are at 19.8% and average total regulatory capital ratios are at 21.6% as of September 2018, well above the respective requirements for most banks of 12.5% and 14.5% respectively. Even so, the depth of Uganda's capital markets, despite improvements in recent years, remains low by international standards, and despite an improving trend, financial inclusion is weak.

Sovereign Support Capacity

The government's fiscal deficit is set to widen in the coming years owing to higher infrastructure spending. Tax collection remains weak and due to the large informal sector, expansion from its low base will occur only gradually. As spending ramps up, we see debt servicing costs rising, which will impede the government's ability to bail out suffering financial institutions. However, given that the regulatory framework has improved in recent years and authorities are attentive to potential failures – such as that of Crane Bank, which suffered from a disproportionately large NPL book – we see wide-scale bank failures as unlikely.

Broad-Based Credit Growth To Continue In 2019

Uganda – Sector Composition Of 2018 Private Sector Credit, %



Source: Bank of Uganda, Fitch Solutions

Regulatory Body Assessment

The Ugandan banking authorities continue to strengthen financial sector supervision to ensure financial stability and soundness. These efforts have been stepped up in recent years following the 2011-2012 collapse in credit growth and the failure of Crane Bank in October 2016. Since then, the authorities have taken a more proactive and prudent approach to banking sector regulation by introducing more regular stress testing and supervision, as well as further strengthening the monetary policy framework and improving market guidance.

UGANDA – DATA & FORECASTS

	2015	2016	2017	2018	2019f	2020f	2021f
Population, mn	40.14	41.49	42.86	44.27	45.71	47.19	48.70
Nominal GDP, USDbn	26.5	25.0	27.6	29.3	31.4	34.1	36.9
GDP per capita, USD	730	664	711	730	757	794	832
Real GDP growth, % y-o-y	5.7	2.6	5.0	6.1	5.8	5.9	6.1
Consumer price inflation, % y-o-y, ave	5.5	5.5	5.7	2.6	5.1	6.1	4.9
Consumer price inflation, % y-o-y, eop	8.5	5.7	3.3	2.2	7.5	4.8	5.0
Central bank policy rate, % eop	17.00	12.00	9.50	10.00	11.00	10.00	9.00
Exchange rate UGX/USD, ave	3,068.50	3,484.25	3,619.88	3,675.90	3,791.77	3,912.50	3,999.38
Exchange rate UGX/USD, eop	3,372.00	3,596.50	3,643.25	3,708.54	3,875.00	3,950.00	4,048.75
Budget balance, UGXbn	-1,931.3	-2,451.7	-3,016.3	-3,318.0	-4,713.4	-6,075.7	-8,090.3
Budget balance, % of GDP	-2.4	-2.9	-3.2	-3.2	-4.2	-4.6	-5.8
Goods and services exports, USDbn	4.7	4.8	5.1	5.7	6.2	6.8	7.6
Goods and services imports, USDbn	7.3	6.5	7.2	8.1	9.0	9.9	10.9
Current account balance, USDbn	-1.7	-0.8	-1.3	-1.6	-1.9	-2.2	-2.4
Current account balance, % of GDP	-6.3	-3.4	-4.6	-5.5	-6.0	-6.3	-6.5
Foreign reserves ex gold, USDbn	2.9	3.1	3.3	3.5	3.7	4.0	4.3
Import cover, months	4.8	5.7	5.4	5.2	5.0	4.9	4.8
Total external debt stock, USDbn	9.6	9.5	11.2	12.2	13.5	15.2	17.6
Total external debt stock, % of GDP	36.1	38.1	40.5	41.6	42.8	44.5	47.8
Crude, NGPL & other liquids prod, '000b/d	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total net oil exports (crude & products), '000b/d	-26.0	-26.8	-28.5	-30.2	-32.0	-33.6	-35.3
Dry natural gas production, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dry natural gas consumption, bcm	0.0	0.0	0.0	0.0	0.0	0.0	0.0

f = Fitch Solutions forecast. Source: National sources, Fitch Solutions