Absa Africa Financial Markets Index 2019

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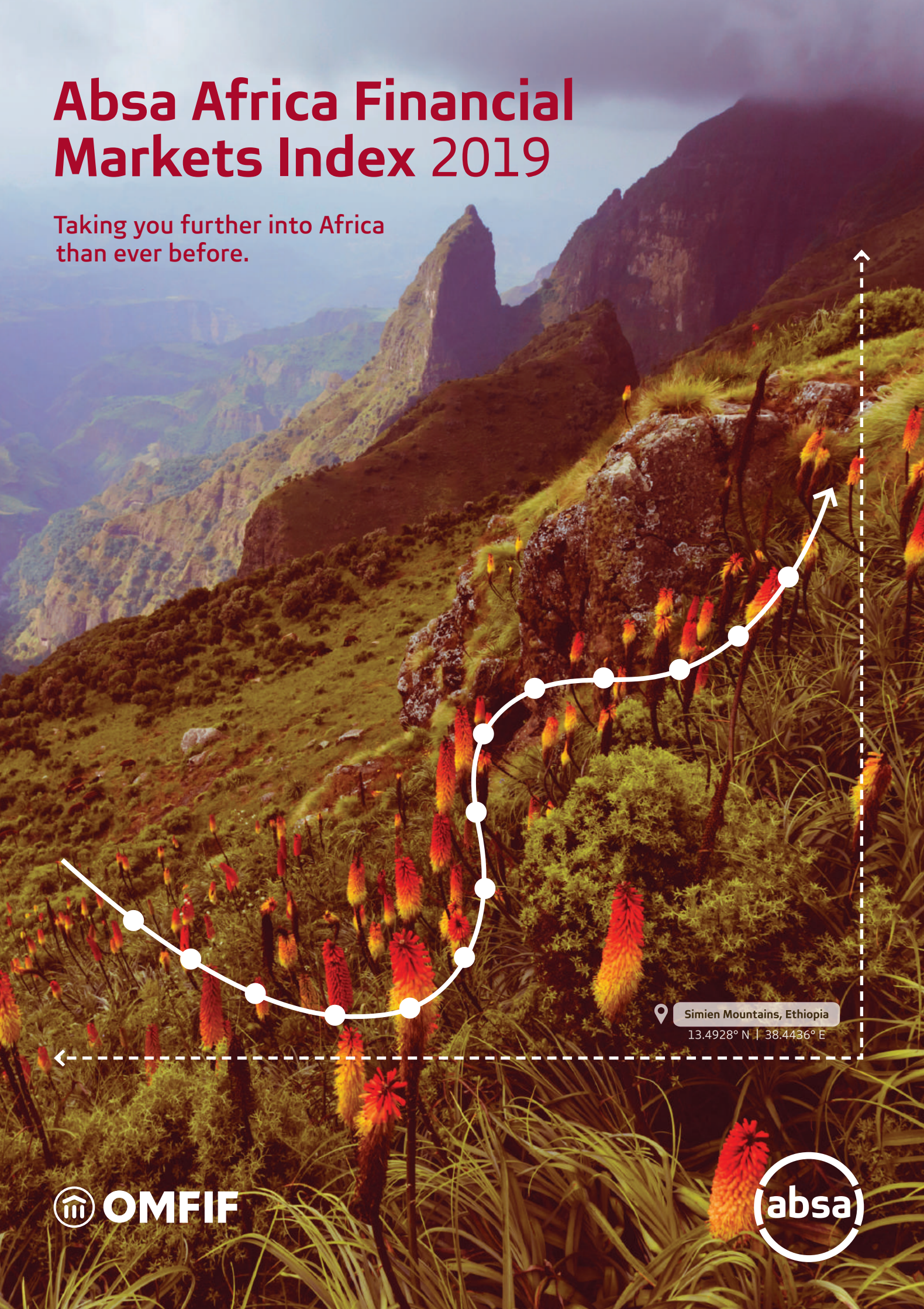

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The Absa Africa Financial Markets Index was produced by OMFIF in association with Absa Group Limited. The scores on p.7 and elsewhere record the total result (max=100) of assessments across Pillars 1-6. For methodology see individual Pillar assessments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

OMFIF conducted extensive quantitative research and data analysis. Qualitative survey data were collected and analysed by OMFIF with input from Absa.

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Benefiting the people behind the numbers

Peter Matlare
Deputy Chief Executive Officer, Absa Group

Christine Lagarde, as managing director of the International Monetary Fund, once said, 'We cannot just look at a country by looking at charts, graphs, and modelling the economy. Behind the numbers, there are people.' This sentiment is reflected in the Absa Africa Financial Markets Index.

This report is published against the backdrop of people's growing disillusionment across the African continent with their individual and collective socioeconomic and political prospects. Accelerated economic development, underpinned by strengthening economic resilience and building robust institutions, is key to realising the aspirations of our fellow Africans.

The deepening and widening of financial markets are crucial steps towards national economic self-sufficiency. To reach the next level of growth, Africa requires a collective commitment to ensuring the transnational cross-pollination of ideas. This index suggests we are making headway. The continent's challenges are clearly visible, and its countries are crafting actionable solutions.

The report assesses progress and potential across six key pillars: market depth, access to foreign exchange, market transparency, the capacity of local investors, macroeconomic opportunity, and the legality and enforceability of standard financial markets master agreements.

Most promisingly, it highlights positive developments in market infrastructure and the fostering of market growth. Foreign exchange liquidity is improving, while market transparency and financial inclusion have been prioritised. Many countries have set ambitious strategies for national economic and financial market transformation.

As a leading African banking group, Absa is committed to furthering the development and prosperity of the continent and its people. We trust that the insights embodied in the index will inspire active engagement among policy-makers and market participants, resulting in measurable actions that foster inclusive growth and sustainable development to benefit the people 'behind the numbers'.

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 third 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.

Nurturing the growth of African businesses

Ludger Schuknecht
Deputy Secretary General,
Organisation for Economic Co-operation and Development

Private sector development is key for growth on the African continent. A strong and dynamic private sector can unlock jobs and opportunities for better lives, and is therefore instrumental in attaining development objectives. Fortunately, the international community is paying increasing attention to the important role of the private sector as a motor of progress.

In 2017 in Hamburg, G20 countries agreed that it was time to grant the private sector a central place in their co-operation with Africa. The G20 Compact with Africa was established in partnership with international organisations and African countries to strive towards a more enabling environment for private investment. African members committed to implement reforms in their macro, business and financing frameworks to facilitate investment. G20 countries and international organisations committed to enhance and better coordinate their efforts, and encourage their businesses to step up their activities in the region. This is a novel approach and an opportunity to which 12 African countries subscribed, and much progress has already been made.

Nurturing the growth of African businesses requires an open and enabling investment environment as well as access to finance. It is encouraging, therefore, to see Compact and other African countries working on both these fronts, together with international partners and organisations. The third edition of the Absa Africa Financial Markets Index shows that, across the continent, countries are making remarkable steps to develop and enhance their capital markets.

By tracking progress on financial market developments, this OMFIF-Absa report is a valuable part of the monitoring and reporting of exciting progress in Africa. It helps us know where things are moving, and who is open for business. We in the international community look forward to further progress in the months and years ahead.

Financial markets can help more Africans

Jingdong Hua
Vice-President and Treasurer,
World Bank

Africa's economic successes have often been supported by financial market development, which in turn has been supported by improved economic management and better institutions. This year's Absa Africa Financial Markets Index highlights some important achievements on the continent, but also the large variation across countries and the major opportunities yet to be marshalled.

Although financial investments are becoming increasingly international, their currency denomination should become increasingly local to match projects' risk profiles. Because currency depreciations often follow economic shocks, foreign currency borrowers with local currency earnings are simultaneously burdened by economic hardship and increasing debt service obligations. Infrastructure projects, non-exporting firms and small or medium-sized firms all need local currency financing to manage risks. Emerging markets have gradually been able to develop both local investor bases and tap international investors for local currencies; Africa must continue this trend. Financial markets in countries' own currencies will help African businesses, infrastructure borrowers, homeowners and microentrepreneurs gain access to the finance they need.

The World Bank has a long history of supporting the development of local currency financial markets. We help governments design, finance and implement investment projects and hold billions in local currency-denominated loans. We share knowledge globally on economic and financial markets policies and regulations. The World Bank is committed to finding new and innovative local currency financing solutions, because African nations need more options to borrow in their own currencies.

Local currency market development relies on many fundamentals captured by this index. It is my hope that readers will explore the many opportunities we have to improve the local mobilisation of finance and to develop investable projects. We must all help Africa create local markets that combine these forces to develop well-functioning financial markets and enhance economic development to benefit all Africans.

Individual steps show collective progress

Despite disparities in individual standing, financial market developments in countries covered by the Absa Africa Financial Markets Index show a collective progression towards a more robust, investment-supporting environment. Key mergers, new regulations and innovative financial products have contributed to the expansion of financial markets across the region. Policies that incentivise market activity and attract new players, such as favourable tax regimes and internationally aligned contractual frameworks, have boosted country scores.

When the index was first launched in 2017, the average mark for 17 countries was 49.6 out of 100 and only three scored above it, indicating much room for growth. Since then, the index has been expanded to include three additional countries, and the average overall score across all 20 has climbed to 52.7. The Seychelles progressed the most since the first edition of the index. Its score climbed to 47 from 29, partly owing to its growing pool of local assets.

In this edition, nine countries perform above average, showing that progress is becoming more evenly distributed across the index: South Africa, Mauritius, Kenya, Namibia, Botswana, Nigeria, Tanzania, Zambia and Rwanda. In the face of changing global conditions and domestic challenges for each market, this improvement shows that the region is moving in the right direction.

The countries whose scores increased most since last year are Mauritius, Tanzania, Egypt, Namibia and Mozambique. Market depth improved in Mauritius following a substantial listing of bonds by the central bank. Enhanced export performance improved Egypt's macroeconomic environment. Some markets remain hampered by the allure of the international bond market, a cheaper way for their governments to raise money but a barrier to the deepening of local markets and developing reliable yield curves. The outlook for Ethiopia, one of the lowest scoring countries, has improved following plans to launch a stock exchange in 2020, which may list the shares of telecoms companies it is planning to privatise.

Rank 2019	Rank 2018		Score 2019	Score 2018	Comments
1	1	South Africa	**88**	93	Deep market liquidity anchored by strong domestic investors
2	4	Mauritius	**75**	62	Sizeable pool of investible pension assets with strong legal framework
3	3	Kenya	**65**	65	Sovereign bond listings enhance asset pool
4	6	Namibia	**65**	57	Wide range of financial products available but low market turnover
5	2	Botswana	**64**	65	Drop in pension assets reduces local investor capacity
6	5	Nigeria	**63**	61	Multiple exchange rate reporting weakens robust performance across pillars
7	15	Tanzania	**55**	43	Strong investment environment but markets still small and illiquid
8	8	Zambia	**55**	53	Improving regulatory and legal frameworks but weak capacity of local investors
9	11	Rwanda	**53**	49	High transparency and financial reporting standards
10	10	Uganda	**52**	50	Active foreign exchange market and high level of foreign reserves
11	16	Egypt	**51**	42	Strong macroeconomic outlook and high transparency
12	9	Morocco	**51**	50	High growth in export market share and strong insolvency regime
13	7	Ghana	**50**	55	Attractive tax environment but low wholesale foreign exchange market turnover
14	12	Seychelles	**47**	45	Small and illiquid equity market
15	18	Mozambique	**44**	36	Low securities turnover and high level of external debt
16	13	Ivory Coast	**41**	44	Fragmented bond market hinders yield curve development
17	19	Angola	**36**	34	Shallow markets but improving regulatory environment
18	14	Senegal	**35**	44	Fast-growing economy but small pool of local assets available for investment
19	17	Cameroon	**35**	41	Weak domestic investor capacity
20	20	Ethiopia	**27**	26	Rapid economic growth but still lacking financial markets infrastructure

Score across all pillars, max = 100.

South Africa retains top position, other countries catching up

The Absa Africa Financial Markets Index evaluates financial market development in 20 countries, and highlights economies with the 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 40 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.

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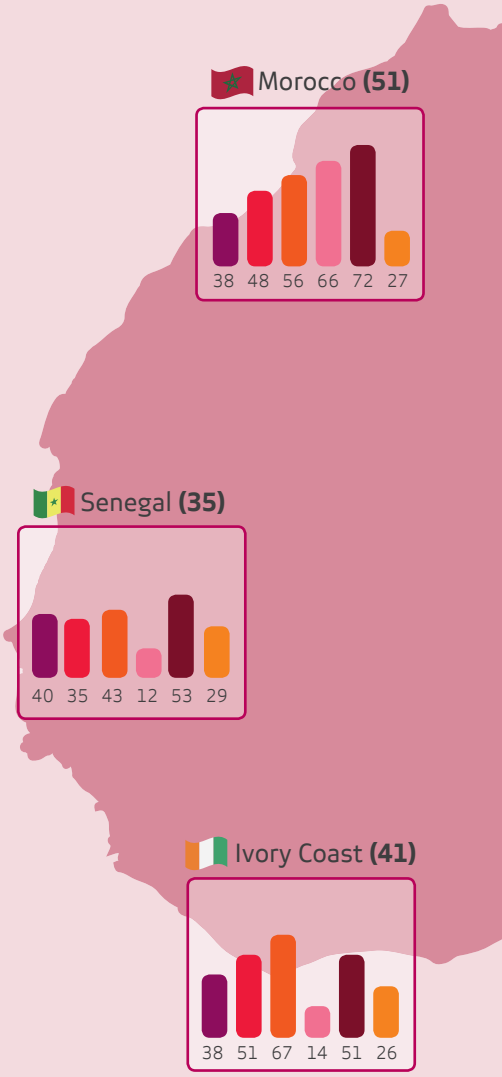


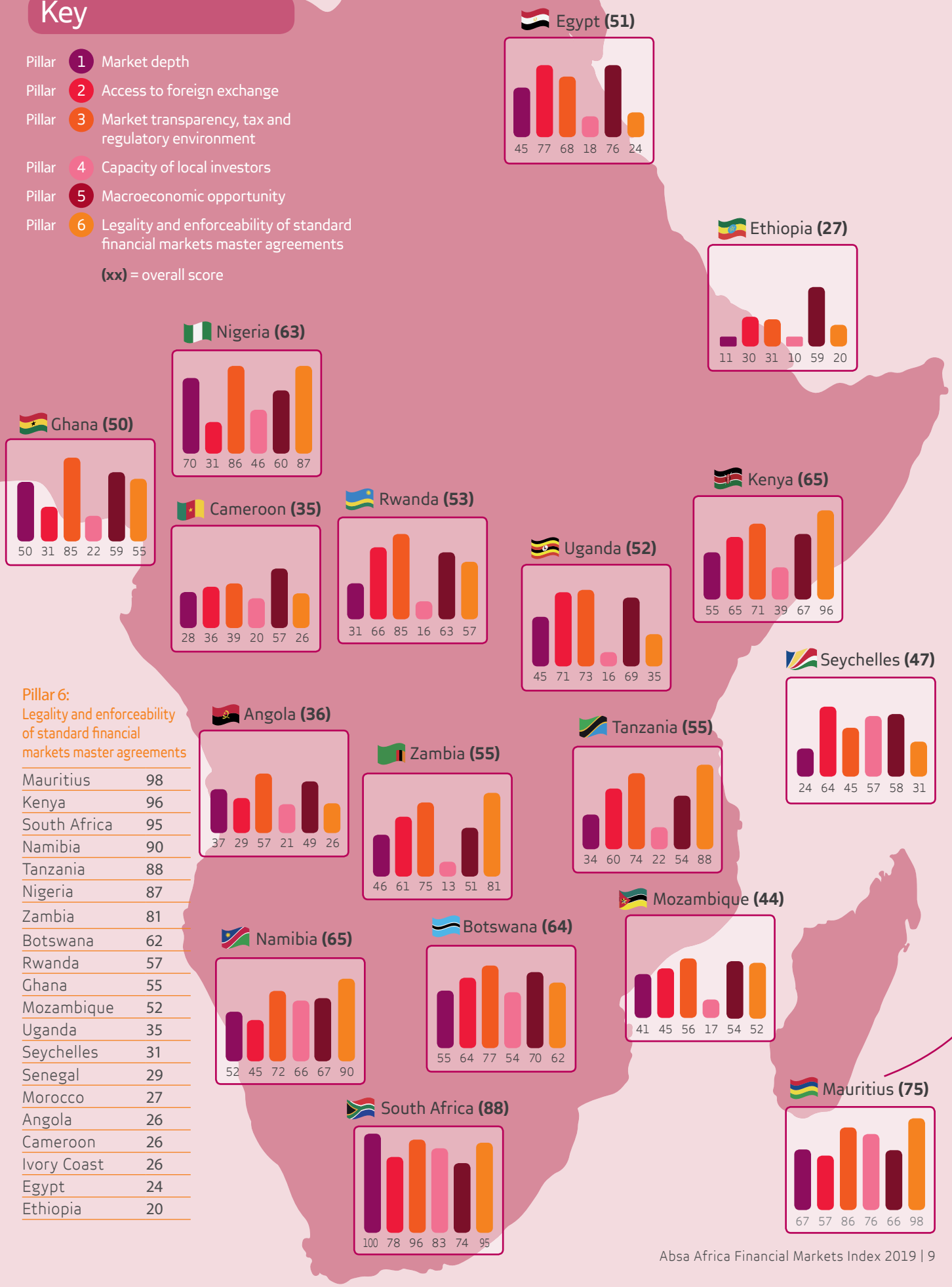
Overall pillar scores max = 100

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	
South Africa	100	South Africa	78	South Africa	96	South Africa	83	Egypt	76
Nigeria	70	Egypt	77	Mauritius	86	Mauritius	76	South Africa	74
Mauritius	67	Uganda	71	Nigeria	86	Morocco	66	Morocco	72
Botswana	55	Rwanda	66	Rwanda	85	Namibia	66	Botswana	70
Kenya	55	Kenya	65	Ghana	85	Seychelles	57	Uganda	69
Namibia	52	Botswana	64	Botswana	77	Botswana	54	Namibia	67
Ghana	50	Seychelles	64	Zambia	75	Nigeria	46	Kenya	67
Zambia	46	Zambia	61	Tanzania	74	Kenya	39	Mauritius	66
Egypt	45	Tanzania	60	Uganda	73	Ghana	22	Rwanda	63
Uganda	45	Mauritius	57	Namibia	72	Tanzania	22	Nigeria	60
Mozambique	41	Ivory Coast	51	Kenya	71	Angola	21	Ghana	59
Senegal	40	Morocco	48	Egypt	68	Cameroon	20	Ethiopia	59
Morocco	38	Namibia	45	Ivory Coast	67	Egypt	18	Seychelles	58
Ivory Coast	38	Mozambique	45	Angola	57	Mozambique	17	Cameroon	57
Angola	37	Cameroon	36	Mozambique	56	Uganda	16	Tanzania	54
Tanzania	34	Senegal	35	Morocco	56	Rwanda	16	Mozambique	54
Rwanda	31	Ghana	31	Seychelles	45	Ivory Coast	14	Senegal	53
Cameroon	28	Nigeria	31	Senegal	43	Zambia	13	Ivory Coast	51
Seychelles	24	Ethiopia	30	Cameroon	39	Senegal	12	Zambia	51
Ethiopia	11	Angola	29	Ethiopia	31	Ethiopia	10	Angola	49

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

(xx) = overall score



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

Mauritius	98
Kenya	96
South Africa	95
Namibia	90
Tanzania	88
Nigeria	87
Zambia	81
Botswana	62
Rwanda	57
Ghana	55
Mozambique	52
Uganda	35
Seychelles	31
Senegal	29
Morocco	27
Angola	26
Cameroon	26
Ivory Coast	26
Egypt	24
Ethiopia	20

The report finds that:

- South Africa tops the index largely due to its sizeable lead in 'market depth'. While it is likely to remain an outlier in this pillar, the creation of new bourses and key mergers between existing ones will improve the standing of other countries in coming years. This year, Botswana, Kenya and Namibia join the ranks of countries that score over 50 in Pillar 1, which also includes Nigeria, Mauritius and Ghana. Issuance of new debt with longer tenor has lengthened the yield curve in Ghana, Nigeria and Tanzania. The creation of new products, such as green and blue bonds, could enhance market activity and attractiveness to foreign investors in coming years. Assigning primary dealers will help create a secondary market in jurisdictions where none yet exist.

- Other countries are catching up in the rest of the index. Egypt has the highest score in 'macroeconomic opportunity' while Mauritius and Kenya claim the two top spots in 'legality and enforceability of standard financial markets master agreements'. Ethiopia, although lagging behind, has significant potential for improvement in the coming year. It has announced plans to establish a stock exchange in 2020. Local banks and other financial service firms are in the process of adopting international financial reporting standards.

- Countries perform best collectively in 'market transparency, tax and regulatory environment', with 13 out of 20 scoring above the average mark of 67. Favourable tax regimes in different jurisdictions incentivise market activity and the entry of new players. Survey respondents in Rwanda, Tanzania, Kenya, Ghana and South Africa gave positive feedback for their respective tax systems. Uganda, Cameroon and Senegal have earned international corporate credit ratings for the first time.

- 'Legality and enforceability of standard financial markets master agreements' improved significantly, with the average score growing to 55 from 47 last year. Amendments to insolvency laws and processes boost the scores of Kenya, Morocco and Rwanda. Ghana, Morocco and the Seychelles are considering enacting some form of netting legislation, which would earn them higher marks in coming years.

- 'Access to foreign exchange' is the only pillar where average scores fell. Aggregated reserves grew modestly to $244bn from $233bn last year, but countries like Zambia and Angola are running low, leaving them potentially vulnerable to foreign exchange risk. There is also high disparity in interbank foreign exchange turnover across countries. South Africa's turnover is 466% of GDP, but the index average without it is only 13%.

- Egypt's strong performance in 'macroeconomic opportunity' is driven by steady economic and export growth, along with a decline in non-performing loans. It does well in macro reporting and transparency, topping Pillar 5 as it completed the International Monetary Fund's reform programme earlier this year.

- The amount of pension assets varies greatly among countries in the index. Mauritius leads with

$4,331 per capita, followed closely by South Africa, Namibia, Botswana and the Seychelles. Meanwhile, 11 countries have less than $100 pension fund assets for every person. Expanding the coverage of pension schemes increases the amount of investible assets available, enhancing local investor capacity. Because of limited product availability, pension funds in some countries are constrained to investing in sovereign securities. Building up pension fund assets through innovative and inclusive schemes can help spur demand for a wider range of financial products and lead to greater market activity.

- There have been significant improvements for individual countries since the index was first established in 2017. Since then, countries have taken steps to align their local market infrastructure with global standards. Tracking these changes annually helps measure the gradual progress of Africa's financial markets and provide guidance on how countries can advance further.

Acknowledgements

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Highlights 2018-19

The Seychelles issued the world's first sovereign blue bond, an instrument developed to finance sustainable marine and fisheries projects.

South Africa's Financial Sector Conduct Authority published a draft conduct standard determining skills and training requirements for board members of pension funds.

The Johannesburg Stock Exchange launched a Nasdaq clearing platform for equity and currency derivatives markets.

Namibia issued the first green bond from a commercial bank in southern Africa.

Cameroon's Douala Stock Exchange merged with regional stock market Bourse des Valeurs Mobilières de l'Afrique Centrale.

400%:
Oversubscription of Nigeria's first 30-year government bond issued earlier this year.

Zambia is introducing a primary dealer system to boost the secondary market for government bonds.

Mauritius established a multi-commodity spot and derivatives trading platform and clearing house.

$1.5bn:
Pooled assets under management of Kenyan pension funds that formed the Kenya Pension Fund Consortium to invest in alternative assets.

Ivory Coast is developing an agricultural commodities exchange to be launched in 2020.

Mauritius launched an ebond trading and market surveillance system, a new electronic trading system for its government bonds.

Market developments and policy changes boost growth of financial markets across the continent

The Bank of Mozambique approved its first independent licensed broker, Amaramba Capital.

Rwanda's central bank shifted to targeting inflation between 2-8% through interest rates instead of managing money supply.

Tanzania created a Tax Ombudsman Office to handle disputes arising from the administration of tax laws.

Ethiopia announced plans to launch a stock exchange by 2020.

Botswana formed a Financial Stability Council to coordinate between the country's various financial authorities.

Morocco is developing plans for an agricultural commodities exchange, Bourse des Matières Premières Agricoles.

The Bank of Ghana released an Interbank Forex Market Conduct to regulate and improve trading practices.

The Dar es Salaam Stock Exchange has been made a full member of the World Federation of Exchanges.

10x: Increase in banks' minimum capital requirements as proposed by Egypt's new banking bill, raising it to $294m from $29.4m.

Uganda reduced withholding tax on 10-year government bonds to 10% from 20%.

Angola expects its first ever initial public offering this year, following the privatisation of multiple state-owned enterprises.

All local Ugandan banks signed onto a GMRA and the market is now able to trade horizontal repos.

Senegal began implementation of a hybrid Basel II and III banking regulation framework.

Morocco issued its first sovereign sukuk, Islamic bonds that are compliant with sharia principles.

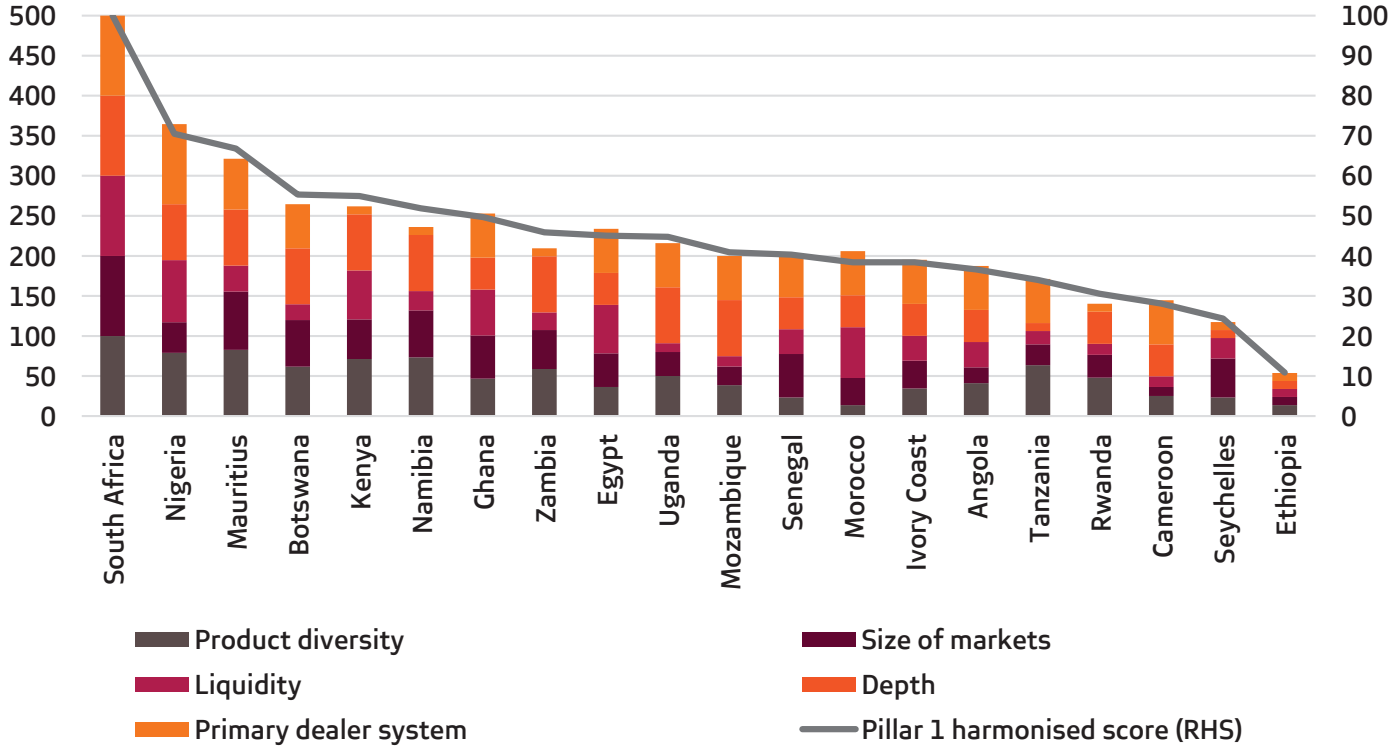
Pillar 1:
Market depth

Making headway on market infrastructure

Countries are making progress on developing active secondary markets and reliable yield curves, but still have some way to go. New markets were created, enhancing product diversity and market size.

Figure 1.1: Large disparities remain in market size and level of activity

Scores for Pillar 1 categories, max=500; harmonised score, max=100 (RHS)



Sources: National securities exchanges, national central banks, OMFIF analysis. Note: Category scores (LHS) provide the average of indicator scores within each category. The harmonised score (RHS) represents the average of all Pillar 1 indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

South Africa receives the highest Pillar 1 score again this year. Its stock market capitalisation, the largest in the index, is triple the size of its economy. Botswana has the second-largest market capitalisation at 204% of GDP, but finishes fifth in the pillar due to lower secondary market activity. Most of Botswana's listed companies are dual-listed mining firms that trade at low volumes on the local stock exchange. Nigeria, Africa's largest economy, has a small equity market at 8% of GDP, but maintains second place due to its high level of activity and broad range of available products.

Mauritius' score increases by 11 points, driven by the listing of Bank of Mauritius bonds with a value of $268m at end-June 2019, raising the total value of bonds listed on the exchange by 27% compared with the same time last year. Namibia's performance on the pillar also improved due to a 17% rise in the value of its listed bonds, with contributions from the public and private sector. Kenya earns points following a sharp climb in the value of listed sovereign bonds and a 20% rise in bond turnover in the 12 months to June 2019.

In contrast, Uganda's market liquidity continued to drop, with $11m in turnover, down from $25m. A local survey respondent said one of the market's largest brokers decided not to renew their licence in 2019 due to falling revenues. Turnover has been hit by uncertainty over Umeme, the country's main electricity firm and most-traded stock. Still, Uganda's overall performance in this pillar improves slightly, with the decline in liquidity offset by the higher value of listed bonds and equities.

Morocco's market capitalisation is 51% of the country's GDP, and its equities market is the fifth most active in the index, with turnover at 9% of market size. Its score, however, is constrained by the limited availability of financial products compared to other index nations.

Egypt has a fairly liquid stock market with turnover at 26% of market capitalisation. There are no equities listed on Angola's exchange, and both Cameroon and Mozambique have market capitalisations of less than 5% of GDP. Ethiopia is the only country in the index without a stock exchange, although the government plans to establish one in 2020.

Enhancing market depth

Survey respondents in several countries said the lack of a reliable benchmark yield curve against which to price various securities is hindering the development of domestic capital markets. Governments have not prioritised developing a credible local currency yield curve. This is due partly to easy access to Eurobond markets, where bonds come at cheaper nominal interest rates and in some cases give useful currency hedges. In the West African Economic and Monetary Union (UEMOA), governments can offer bonds through the central bank's auction system and regional securities exchange, preventing the formation of a yield curve and stunting secondary market growth.

In October 2019, Egypt's central bank introduced the Cairo Overnight Interbank Average benchmark to deepen its money, derivatives and capital markets. This will help price a broad array of products, enhancing market liquidity. Angola is tapping reissuances of government bonds to spur secondary market trading and boost the debt market's size.

Most index countries have a primary dealer system in place for government bonds, improving the efficiency of debt issuance and reducing operational risk associated with counterparties. However, the volume of 'horizontal repos' (short-term loans between commercial banks) is low in nearly all markets except South Africa, Nigeria and Mauritius, where the average daily turnover in 2018 was $4.5bn, $290m and $55m, respectively. Uganda's central bank has approved reforms to its primary dealer system to narrow the number of banks involved. It tried expanding primary dealership to all commercial banks in 2017, but found the secondary market had become fragmented.

The Central Bank of Nigeria disrupted debt markets by barring local banks from buying government bills at an open market auction in July 2019, to encourage banks to lend more to the private sector.

A lack of interest from international investors stymies capital market development in several countries. Some survey respondents said the low interest in their country was due to a lack of awareness, or a dearth of domestic investment opportunities. For others, like South Africa, international appetite has waned in the light of credit ratings downgrades and political

Figure 1.2: Product availability

	Equities	Corporate bonds	Government bonds	FX swaps	Currency futures	Climate-aligned bonds	Asset-backed securities	Exchange-traded funds	Options
Angola	✗	✓	✓	✗	✗	✗	✗	✗	✗
Botswana	✓	✓	✓	✓	✗	✗	✓	✓	✓
Cameroon	✓	✓	✓	✗	✓	✗	✗	✗	✗
Ivory Coast	✓	✓	✓	✗	✗	✗	✗	✗	✗
Egypt	✓	✓	✓	✗	✗	✗	✓	✓	✗
Ghana	✓	✓	✓	✓	✗	✗	✓	✓	✗
Kenya	✓	✓	✓	✓	✓	✓	✗	✓	✓
Mauritius	✓	✓	✓	✓	✗	✓	✗	✓	✗
Morocco	✓	✓	✓	✗	✗	✗	✗	✗	✗
Mozambique	✓	✓	✓	✗	✗	✓	✗	✗	✗
Namibia	✓	✓	✓	✓	✓	✓	✓	✓	✓
Nigeria	✓	✓	✓	✓	✓	✓	✗	✓	✓
Rwanda	✓	✓	✓	✗	✗	✗	✗	✗	✗
Senegal	✓	✓	✓	✗	✗	✗	✗	✗	✗
Seychelles	✓	✓	✓	✗	✗	✓	✗	✓	✗
South Africa	✓	✓	✓	✓	✓	✓	✓	✓	✓
Tanzania	✓	✓	✓	✓	✗	✗	✓	✗	✗
Uganda	✓	✓	✓	✓	✗	✗	✓	✓	✗
Zambia	✓	✓	✓	✓	✗	✗	✗	✓	✓

Ethiopia not included as does not have a securities exchange
Sources: National securities exchanges, national central banks, OMFIF analysis

uncertainty. Ghana is trying to reduce foreign investment in its government debt. The country's central bank and finance ministry are discussing a cap on the amount of debt that can be held by foreign investors, as a way to reduce external vulnerabilities.

Fostering market growth

It has become a more challenging environment for new listings in certain countries. Kenya's interest rate cap, introduced in 2016, has hampered credit creation, weakening companies' financial bottom line and hindering their expansion plans, negatively impacting their capital issuance. The value of bonds listed on the Nairobi exchange doubled to $17.5bn from $8.8bn over the year, due entirely to sovereign issues. One survey respondent said the country's large government bond issuance in recent years has crowded out investor demand for private sector securities.

Many countries plan to bolster their market capitalisation. Kenya's Capital Markets Authority wants to boost the country's venture capital and private equity markets to create a pipeline of smaller firms that can pursue initial public offerings. The Capital Markets Authority of Uganda is developing mandatory listings for firms in strategic sectors such as telecommunications, tier one banks and mining firms to increase the number of listed companies on its bourse. The Casablanca Stock Exchange launched a programme in 2016 to encourage listings of small and medium-sized enterprises and expects the first such IPOs to go ahead this year.

The Bourse Régionale des Valeurs Mobilières, the UEMOA stock exchange, introduced in 2017 its small-cap index to help provide smaller firms with capital before a listing on the main exchange, but still awaits its first listing. Egypt's market capitalisation was lifted by the privatisation of a number of state-owned enterprises.

The MERJ Exchange (formerly Trop-X) in the Seychelles demutualised in September and listed on its own market. It launched tokenised securities of its own stock – digital assets representing shares in a company and underpinned by blockchain technology, the first public offering of its kind.

Ghana is working on a 'capital market master plan' for the next decade of development, though few details are yet available. Legislation was introduced to permit the listing of real estate investment trusts on the exchange. Mauritius has created a new regulatory and tax framework to encourage development of Reits.

Merging and making markets

The past year has seen progress in initiatives to launch new markets or merge existing ones, which should improve efficiency and liquidity. Cameroon's Douala Stock Exchange merged with the Bourse des Valeurs Mobilières de l'Afrique Centrale to create a unified regional exchange in Central Africa. Cameroon's regulator has also joined forces with the regional regulator, a move that survey respondents expect will add depth to the financial market framework.

The West African Capital Markets Integration programme is an ongoing project that would closely align the exchanges of Ghana, Nigeria, Sierra Leone, Cape Verde and the BRVM. It would allow brokers from each country to trade directly on any of the others' exchanges. The regional regulator is also working to develop covered bonds, green and social bonds, and Reits.

Ethiopia plans to develop a secondary market in government bonds, which should create the basis for a broader securities exchange. Respondents expect Ethiopia's privatisation of Ethio Telecom will aid the formulation of a stock market.

The Stock Exchange of Mauritius began trading in commercial paper after the central bank finalised regulations for issuance and trading. There are further plans to create a green bond market. Mauritius established a new commodities and derivatives exchange to enhance its position as a wealth and asset management destination. Similarly, Ghana's commodity exchange has started operations, trading agricultural products.

'An efficient and liquid bond market provides some scope for effective transmission mechanism for monetary policy.'

Maxwell Opoku-Afari, first deputy governor, Bank of Ghana, June 2019

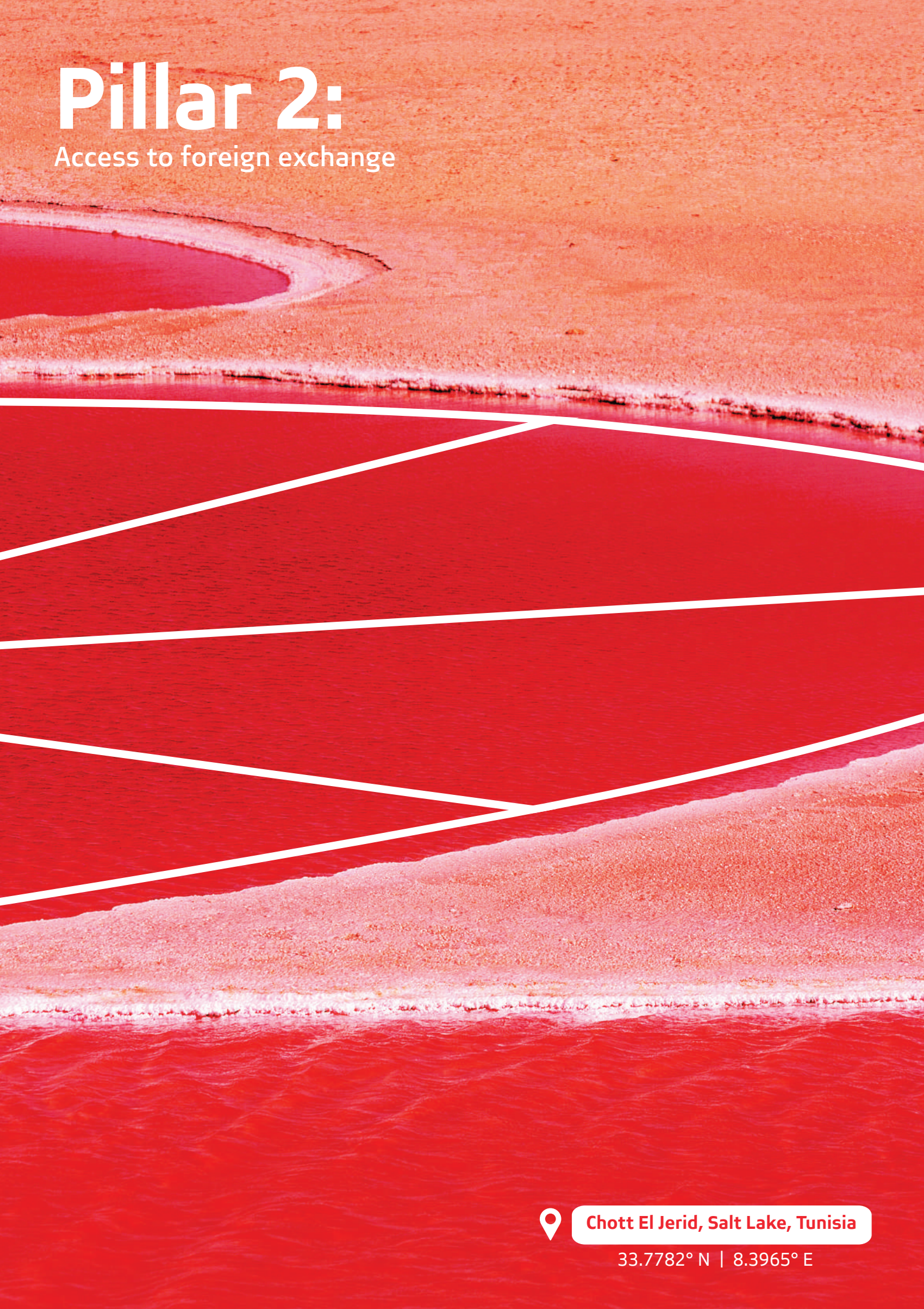
Figure 1.3: Market size and liquidity

	Market capitalisation, % of GDP	Total turnover of equities, % of market capitalisation	Total sovereign and corporate bonds outstanding, listed on exchanges, $bn	Total turnover in bond market, % bonds outstanding
South Africa	292	33	342	190.9
Botswana	204	0	13	1.4
Mauritius	72	4	3	1.3
Morocco	51	9	15	0.7
Rwanda	35	0	4	0.2
Senegal	33	4	2	5.1
Kenya	25	6	35	17.5
Uganda	22	0	0	2.1
Seychelles	21	3	0	0.2
Ivory Coast	19	4	2	5.1
Namibia	18	2	3	3.1
Zambia	18	1	9	5.5
Egypt	18	26	10	43.1
Ghana	17	0	78	14.8
Tanzania	14	1	5	4.1
Nigeria	9	6	66	58.3
Mozambique	4	0	3	1.0
Cameroon	1	0	4	0.3
Ethiopia	0	0	0	0.0
Angola	0	0	37	7.5

Sources: National stock exchanges, national central banks, World Federation of Exchanges, Thomson Reuters, OMFIF analysis

Pillar 2:

Access to foreign exchange



Chott El Jerid, Salt Lake, Tunisia

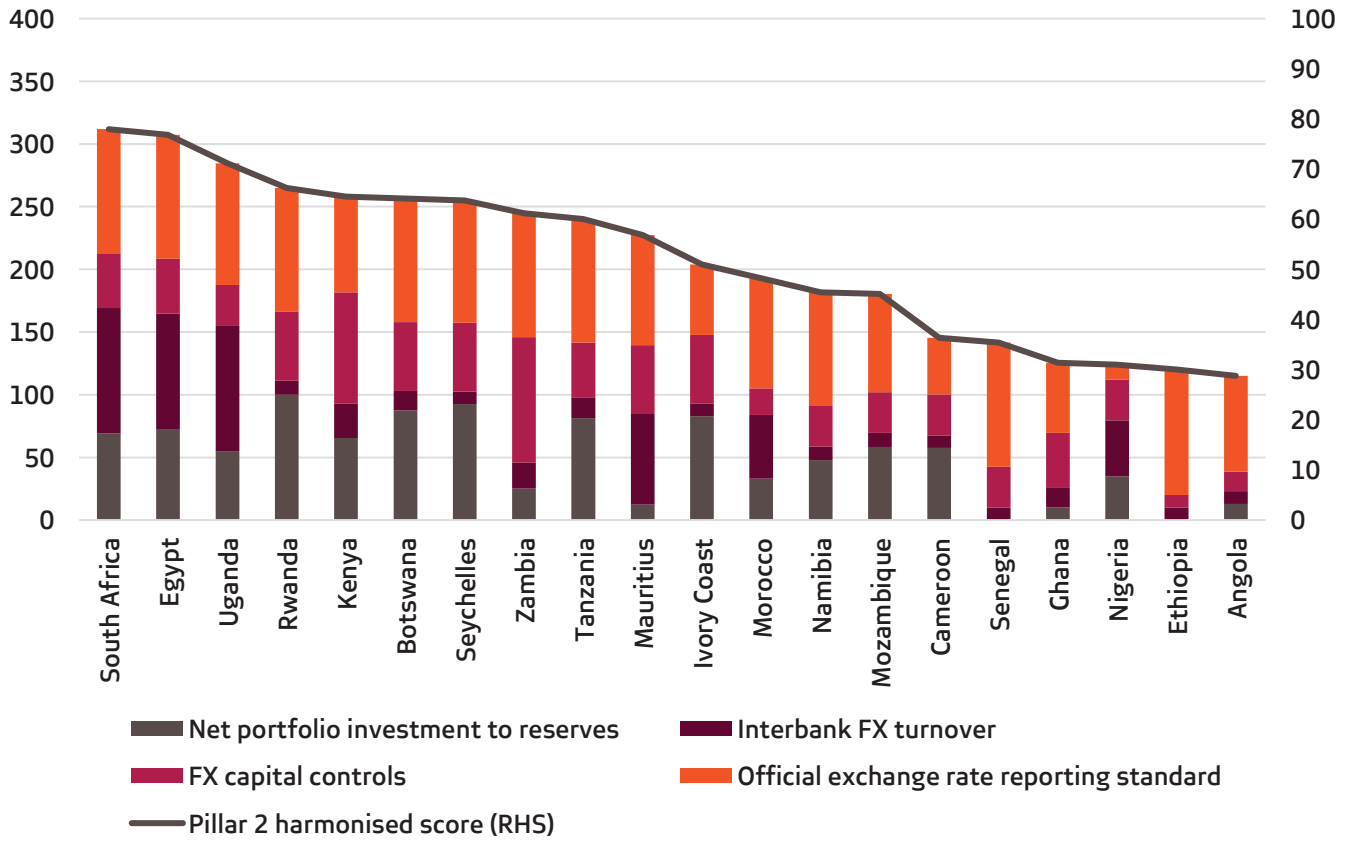
33.7782° N | 8.3965° E

Rebuilding and reforming

Foreign exchange liquidity is improving in key index economies, while oil exporters appear to be recovering from past difficulties and strengthening foreign reserves.

Figure 2.1: South Africa, Egypt and Uganda buoyed by foreign exchange liquidity

Scores for Pillar 2 indicators, max=400; harmonised score, max=100 (RHS)



Sources: International Monetary Fund, national central banks, OMFIF analysis. Note: The harmonised score (RHS) represents the average of all Pillar 2 indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Pillar 2 examines factors that impact markets' accessibility to international investors. These include the existence and severity of capital controls, exchange rate reporting standards and the level of foreign exchange liquidity. This pillar also addresses the need to manage volatility resulting from openness. This is measured by central banks' ability to meet demand for currency, by looking at the ratio of net portfolio flows to reserves.

South Africa reclaims the top spot in this pillar after having been overtaken by Kenya in the previous edition of this index. High interbank foreign exchange turnover, regular exchange rate reporting and a favourable reserve level relative to net portfolio flows all contribute to South Africa's high position. Kenya, meanwhile, drops in ranking after the International Monetary Fund reclassified its exchange rate regime to 'other managed arrangement' from 'floating', a move the central bank contests.

Boosting foreign exchange liquidity

Ghana scores low in this pillar overall, though its interbank foreign exchange market has deepened in recent years. Monthly average turnover in the interbank foreign exchange market doubled to around $200m in 2018. The Bank of Ghana deals heavily in the interbank market and is responsible for almost 60% of total activity. However, the index score deliberately excludes central bank transactions to reflect market activity only.

In 2016, Ghana loosened surrender and repatriation requirements for exporters, which partly explains the growth in its interbank foreign exchange market. The move has allowed more foreign currency to flow through the commercial banking system rather than being facilitated only by the central bank. The result has been a steady increase in monthly interbank foreign exchange turnover. The BoG published the Ghana Interbank Forex Market Conduct, a set of guidelines for market participants, to support further development.

South Africa has the most active interbank foreign exchange market, with annual turnover reaching $1.7tn in 2018, considerably higher than other index countries. Egypt and Mauritius follow, each with foreign exchange turnover greater than $10bn. Nigeria's turnover rose by 38% to $7.8bn from $5.6bn the year before. On the other hand, Ivory Coast, Senegal, Ethiopia, the Seychelles, Angola, Cameroon and Rwanda have negligible or no interbank foreign exchange turnover.

Even relative to its economy, South Africa's interbank foreign exchange activity is still highest, with turnover equivalent to 466% of GDP. Mauritius is second at 98%, followed by Uganda at 72%. Excluding South Africa, the index average is 13% of GDP.

The FX Global Code, established in 2017 through the efforts of central banks worldwide and the Bank for International Settlements, sets best practice principles for the foreign exchange market. Market participants in South Africa, Kenya and Botswana are adopting the code, according to survey responses. Only a few banks in Mauritius have adopted the code. More are expected to follow suit, which would improve the country's standing in coming years.

Reserves running low

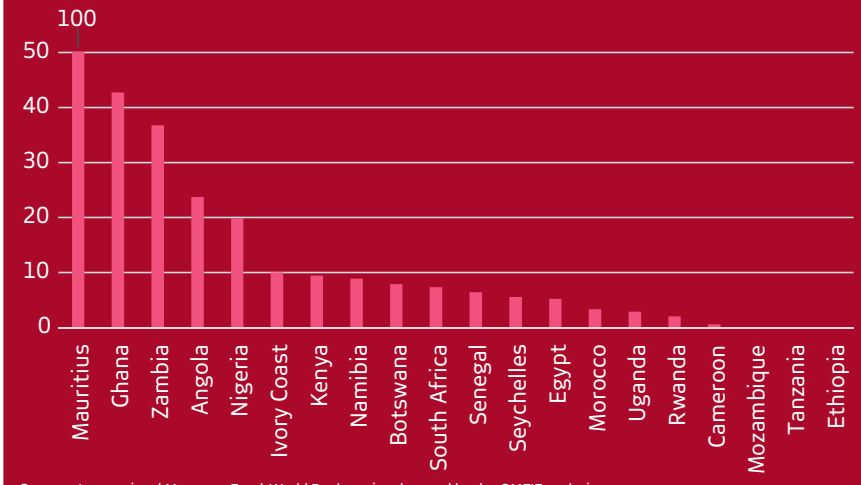
Zambia suffers the largest drop in its score for portfolio reserves. These fell to $1.6bn at the end of 2018 from a peak of just under $4bn in 2015. The 2018 figure is far below the generally accepted adequacy benchmark of three months' imports cover. Reserves fell slightly further over the first half of 2019. Zambia still pays interest on external debt, its mining production has declined, and international investors have less appetite for Zambian assets.

Following the sharp fall in oil prices in 2014, Angola ran significant current account deficits. Its stock of reserves has since halved. It achieved a current account surplus in 2018 for the first time in five years, but its reserves relative to its net portfolio investment remain low, weighing on its pillar score. In contrast, Nigeria, the continent's other major oil exporter, has kept a tighter control over deficits and has been running a current account surplus since 2016. It has held successful Eurobond issuances and built up its reserves back to more than $40bn.

Uganda performs strongly in this pillar, with almost the same score as top-ranked South Africa. It has a high level of foreign reserves relative to net portfolio investment flows and enough reserves to cover more than four months of imports.

Figure 2.2: Foreign exchange exposure uneven across countries

Net portfolio investment to reserves, %



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

Mauritius has high net portfolio investment, but is less vulnerable to foreign exchange fluctuations. The significant inward flow is due to its position as a favourable domicile for funds, often comprised of international money invested globally.

The combined reserves of index countries have climbed 9% over the last five years to $244bn. Nominally, the holders of the largest reserves are South Africa, Nigeria and Egypt, with 52% of the total.

Mixed year for floating rates

Few major changes in exchange rate regimes can be observed across index countries each year. Nine have freely floating regimes, while the rest are a mix of intermediate or fixed regimes.

The IMF is urging Angola to move towards a freer exchange rate as part of its bail-out after the country transitioned to a band system in early 2018. The kwanza has gradually depreciated and is now around half of its previously fixed value against the dollar. Angola's central bank stopped direct sales of foreign currency late last year. These will be handled by authorised commercial banks. According to local analysts, the policy has improved foreign exchange liquidity and increased the volume of foreign exchange. The kwanza's depreciation and rebound in oil prices last year helped Angola reduce its twin deficits. A rebuilding of its foreign reserves and possible reclassification of its exchange rate regime to 'flexible' from 'intermediate' could raise its Pillar 2 score in coming years.

Nigeria has moved towards unifying its various exchange rates and allowed its foreign exchange fixing rate (the rate at which it sells dollars to certain local companies) to depreciate. This has brought it closer to the Nigerian autonomous foreign exchange rate fixing rate used by foreign bond and stock investors. Last year it signed a currency swap agreement with China, its second largest trade partner, to increase trade and ease pressure on the naira-dollar rate by reducing Nigerian importers' reliance on dollar transactions.

'In 2016, Ghana loosened surrender and repatriation requirements for exporters, which partly explains the growth in its interbank foreign exchange market. The move has allowed more foreign currency to flow through the commercial banking system rather than being facilitated only by the central bank.'

Some countries are moving away from freer regimes. Early last year the IMF reclassified Kenya's exchange rate regime to 'other managed arrangement' from 'floating'. In its October 2018 Article IV economic health check, the Fund noted that the shilling was overvalued by around 18%. It was one of the best performing African currencies over 2018 and has been stable against the dollar, which climbed against most African currencies during the second half of the year. The Central Bank of Kenya disagreed with the IMF's assessment, arguing it only intervenes in foreign exchange markets to counter volatility, and that the lender exaggerated the shilling's overvaluation.

The reclassification pulls down Kenya's rank but its score is still among the highest in the pillar, as other indicators remain healthy. It has a large stock of foreign reserves, worth four months of imports and 10 times its 2018 figure for net portfolio investment.

Fig 2.3: IMF classification of exchange rate regimes

Floating

The exchange rate is market-determined. The central bank rarely, if at all, intervenes to manage the exchange rate.

Ghana	South Africa
Mauritius	Tanzania
Mozambique	Uganda
Nigeria	Zambia
Seychelles	

Intermediate

The exchange rate floats within a pre-determined range, or the central bank may intervene occasionally in a managed float arrangement. May also be referred to as a soft or crawling peg.

Angola	Kenya
Egypt	Morocco
Ethiopia	Rwanda

Fixed

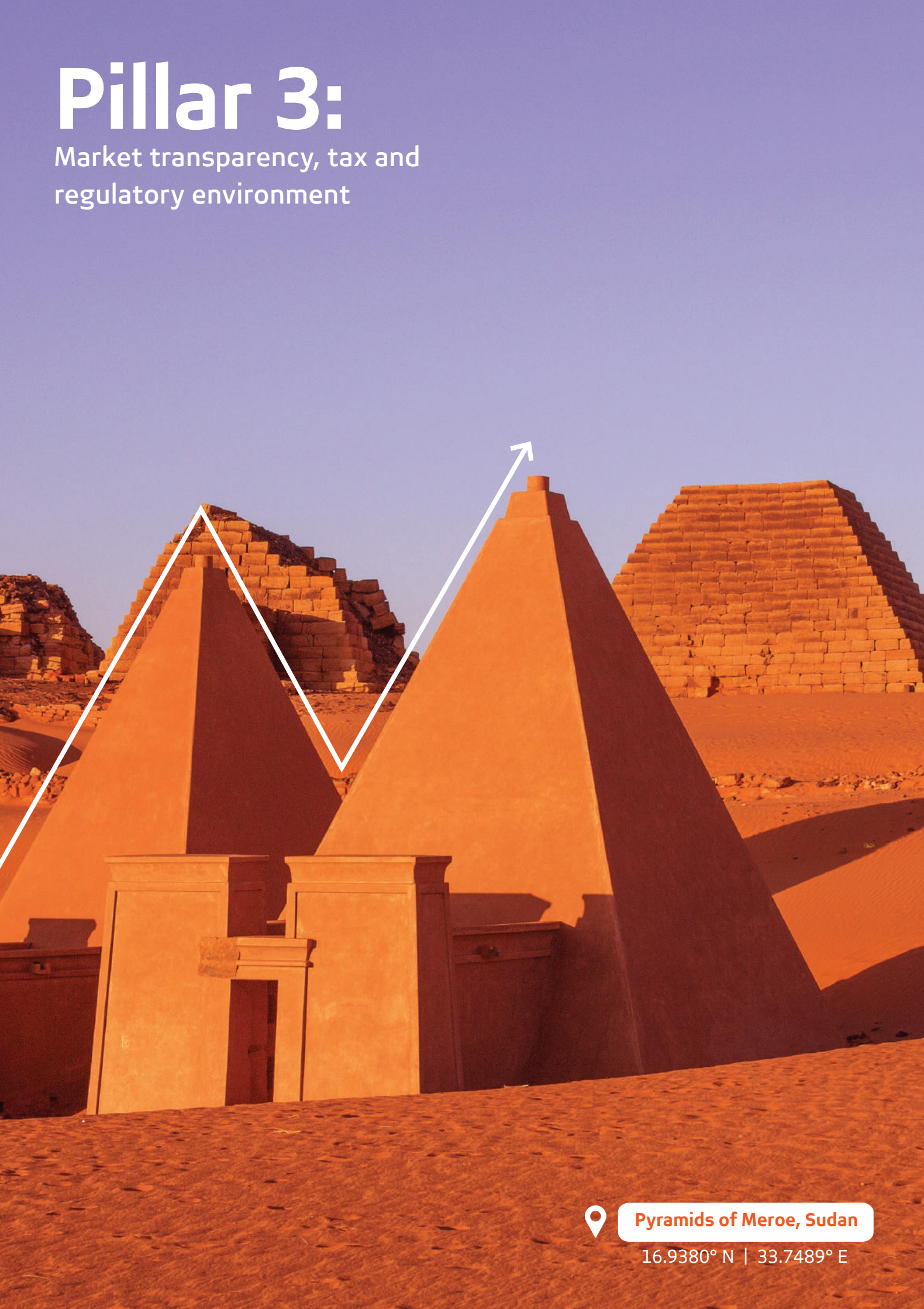
The exchange rate is tied to another country's currency or a composite of other currencies. May also be referred to as a hard peg. The central bank intervenes to maintain the exchange rate.

Botswana	Namibia
Cameroon	Senegal
Ivory Coast	

Sources: International Monetary Fund, OMFIF analysis.
Note: Kenya formally disagrees with the IMF's definition of its currency regime.

Pillar 3:

Market transparency, tax and regulatory environment



Pyramids of Meroe, Sudan

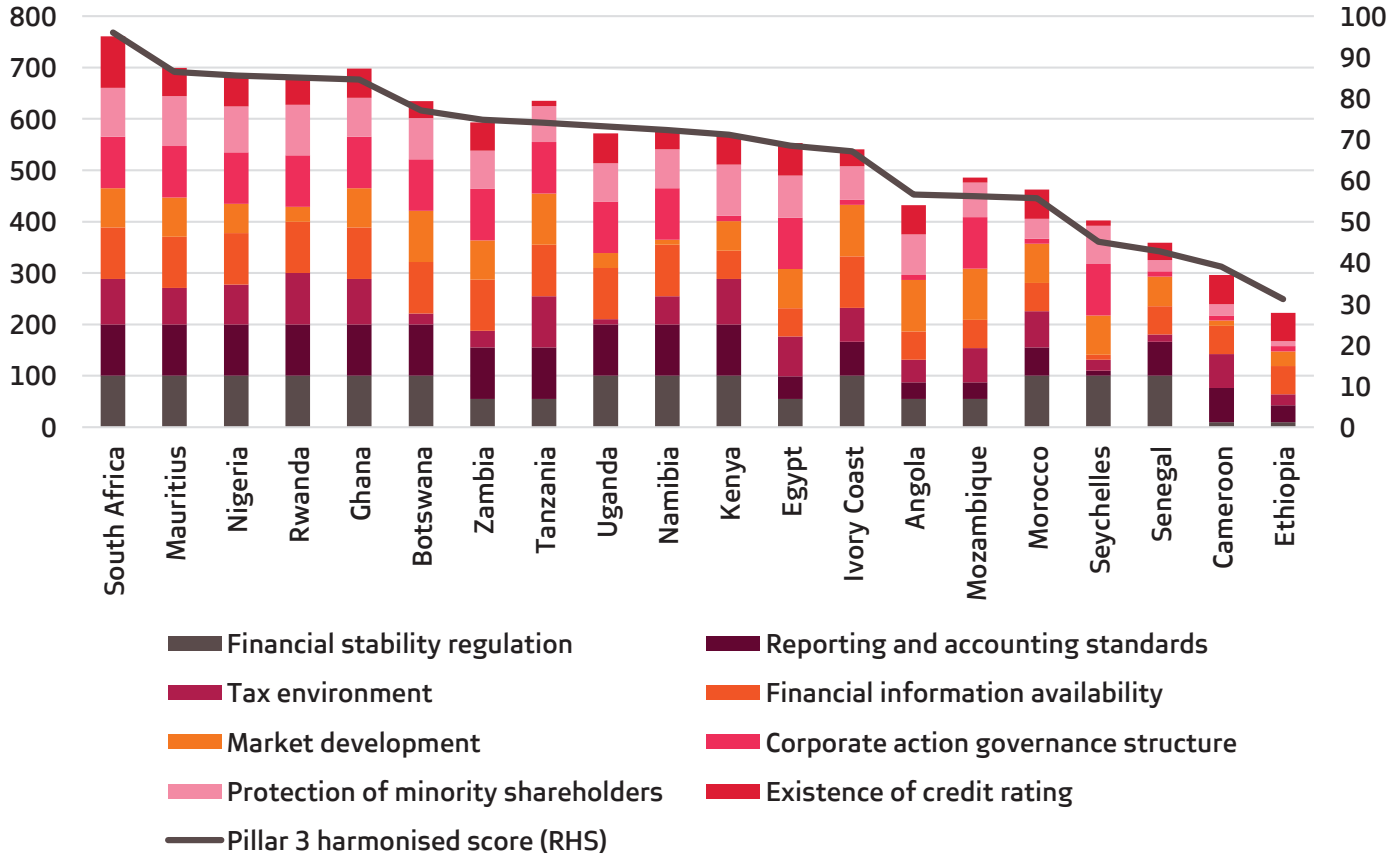
16.9380° N | 33.7489° E

Mixed progress on international standards enforcement

Many countries are moving towards supportive tax systems. However, in several jurisdictions, transparent financial reporting is hindered by a lack of accounting and audit capacity, attitudes to transparency and enforcement problems.

Figure 3.1: South Africa leads on transparency and tax environment

Scores for Pillar 3 categories, max=800; harmonised score, max=100 (RHS)



Source: Bank for International Settlements, International Financial Reporting Standards, Deloitte International Accounting Standard Plus, World Bank Doing Business, Standard & Poor's, Moody's, Fitch, OMFIF analysis. Note: Category scores (LHS) provide the average of indicator scores within each category. The harmonised score (RHS) represents the average of all Pillar 3 indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

This pillar assesses countries' regulatory and tax environments for financial markets. These factors play a fundamental role in offering investors incentives to invest in financial products. They provide transparency, which is vital for fostering investor confidence.

Ghana scores highly, receiving a near-perfect score for its tax regime. Financial market participants view its tax system as broadly favourable to financial market development. Two respondents praised its straightforward tax code, as well as exemptions on a variety of capital market taxes such as capital gains earned on listed stocks and interest on government bonds to non-residents. There are also exemptions on interest paid to resident individuals by the government, local financial institutions, unit trust schemes and mutual funds. In addition, there are tax holidays or exemptions for venture capital companies, rural banks and real estate investment trusts.

Kenya's tax code is generally supportive, according to one local tax professional. However, in an effort to raise revenue, the government has introduced prohibitive taxes, such as an increased levy on mobile cash transactions. Responses were positive for Tanzania and Rwanda, where low taxes on capital gains and interest income boost scores for their tax environment.

Tax systems in Angola and Botswana are less friendly. Respondents said their systems were generally unsupportive of financial market growth. One financial institution executive in Botswana said that planned improvements to the tax regime were not high on the government's agenda, and there was insufficient public consultation on changes that have been made. Ugandan respondents were also downbeat, saying the country has the highest tax rates on dividends in the region with no exemptions or incentives to encourage financial market development. A central banker from one of the low-scoring countries suggested that corporation tax discounts for listed companies would promote further development.

Mauritius, Nigeria and South Africa score highest for tax overall. Nigeria has 14 ratified tax treaties and six in the pipeline. 'Nigeria's tax system has performed considerably well in encouraging and facilitating financial market development,' said a senior member of a major accountancy firm. Mauritius earned similar praise, although in fostering a tax system that encourages financial market development, it must avoid being seen as a tax haven by international authorities. In 2018, it introduced some levies on banks and financial institutions to comply with the Organisation for Economic Co-operation and Development's base erosion and profit-sharing initiatives. As a result, the OECD concluded that Mauritius does not have a 'harmful tax regime' in terms of unfair tax competition, confirming its position as a compliant jurisdiction.

Figure 3.2: Most countries comply with global accounting standards

International Financial Reporting Standards required

	IFRS Standards are required for domestic public companies	IFRS Standards are required or permitted for listings by foreign companies	The IFRS for SMEs Standard is required or permitted
Botswana	✓	✓	✓
Ghana	✓	✓	✓
Kenya	✓	✓	✓
Mauritius	✓	✓	✓
Namibia	✓	✓	✓
Nigeria	✓	✓	✓
Rwanda	✓	✓	✓
South Africa	✓	✓	✓
Tanzania	✓	✓	✓
Uganda	✓	✓	✓
Zambia	✓	✓	✓
Cameroon	✓	✓	×
Ivory Coast	✓	✓	×
Senegal	✓	✓	×
Angola	✓	×	×
Morocco	✓	×	×
Mozambique	✓	×	×
Egypt	×	✓	×
Ethiopia	×	×	×
Seychelles	×	×	×

Source: International Financial Reporting Standards, OMFIF analysis. Countries are ordered by number of tick marks, then alphabetically.

Financial market transparency

Adoption of the latest financial reporting and accounting standards helps improve transparency, which can increase domestic and international investor confidence. International financial reporting standards have been widely adopted in 17 of the 20 index countries. Of the remaining three, Ethiopia is planning a full roll-out for public companies by 2020, which would boost its performance in this pillar. Ethiopian banks, insurance companies and public enterprises are in the process of adopting IFRS 9, transitioning from Generally Accepted Accounting Principles. No domestic companies use IFRS in Egypt, while in the Seychelles only the central bank has adopted these standards.

There are common complaints across index countries with regard to financial reporting. Those that have adopted IFRS still find market reporting hindered by factors such as a lack of regulatory enforcement or insufficient accountancy and audit capacity. 'Financial reports are not

standardised among the players in capital markets,' said one central bank executive in a country with full IFRS adoption. Rules on financial reporting exist in Angola, Ghana, Mozambique, Namibia and Tanzania, but adoption deadlines were missed and enforcement remains weak in these countries.

In Kenya, a senior member of a financial institution said that reporting standards had been improved thanks to a better relationship with the central bank, which raised awareness of compliance requirements. A respondent in Rwanda praised its strong regulatory framework for reporting. It scores highly in the pillar, finishing fourth overall, with strong marks for its tax framework and minority investor protection.

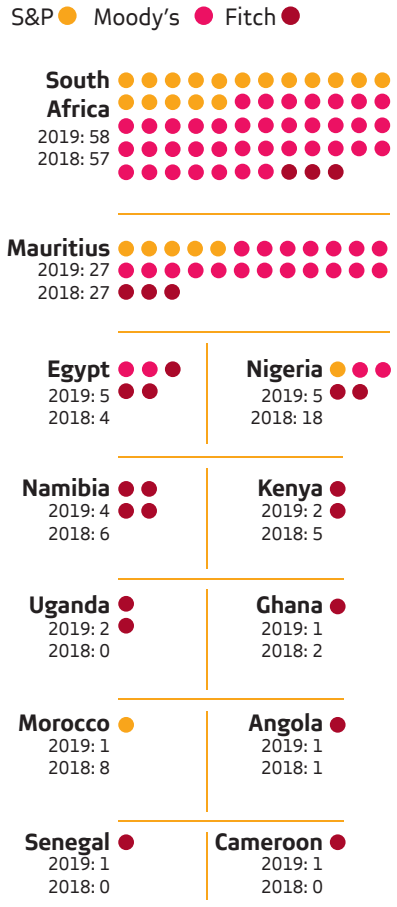
One tax executive from a large accounting firm in Namibia said, 'There remains a shortage of suitably qualified and experienced financial services expertise in the country. This is mitigated by in-house training (both in audit and in business) and by leveraging off international networks.' Shortages of accountancy and audit expertise, either in companies or in external auditors, were reported in Botswana, Ghana, Ethiopia, Nigeria and Zambia. Another respondent in Nigeria said there was a mindset that viewed transparent financial reporting as unnecessary exposure.

In contrast, Mauritius scores highly for its level of financial transparency. 'Listed issuers realise that their performance as a listed company is not only linked to the growth in specific metrics over time, but also on how they communicate these metrics,' said one respondent from the country.

International credit ratings also aid transparency. South Africa and Mauritius have the most corporate credit ratings from the three main ratings agencies with 57 and 27 respectively. The rest of the index countries are far behind. Egypt has the third-highest number with five, up from four last year. It moves five places up the pillar. Along with the extra credit rating, the country's score is lifted by a strengthening in its protections for minority investors. New rules introduced in 2018 stipulate that those with at least a 10% share of a company are guaranteed a seat on its board.

Figure 3.3: Uganda, Cameroon and Senegal earn corporate ratings

Number of corporate credit ratings from international ratings agencies



Source: Standard and Poor's, Moody's, Fitch, OMFIF analysis
Note: Botswana, Ivory Coast, Ethiopia, Mozambique, Rwanda, Seychelles, Tanzania and Zambia have zero ratings.

> 'It is essential that supervisors and regulators are well aware of the underlying concepts of IFRS 9. They need to be equipped with the right tools to conduct supervision of financial institutions in the most effective way. It is only then that they will be able to gain adequate insights into the implications of IFRS 9 on credit risk models and blend the IFRS 9 requirements with existing methods and models used for risk and regulatory purpose.'
>
> **Yandraduth Googoolye, governor, Bank of Mauritius, August 2019**

While the number of international ratings in Nigeria fell to five, its local credit ratings industry provides at least 25 corporate ratings. It also receives a high number of ratings from South African agency GCR Ratings, which has strong coverage in South Africa and Kenya.

Banking standards

Senegal's score improves after starting its five-year transition to a combination of Basel II and III banking regulations. It takes the number of countries implementing Basel III (at least partially) to 13, up from 12 last year and seven two years ago. Ethiopia and Cameroon follow Basel I and neither have expressed any interest in moving on to Basel II or III.

Implementing the most recent Basel rules signals financial development and stability to international investors. If banks are expanding internationally, it can reassure host country regulators and market participants that they are governed well at home. If a country's banking system is relatively insulated, such as Ethiopia's, it is less incentivised to adopt the latest rules.

As part of its banking sector clean-up, the Bank of Ghana revoked the licenses of 23 insolvent savings and loans companies and finance houses, which followed the closure of numerous small finance firms.

Pillar 4:
Capacity of local investors

Jebha, Morocco

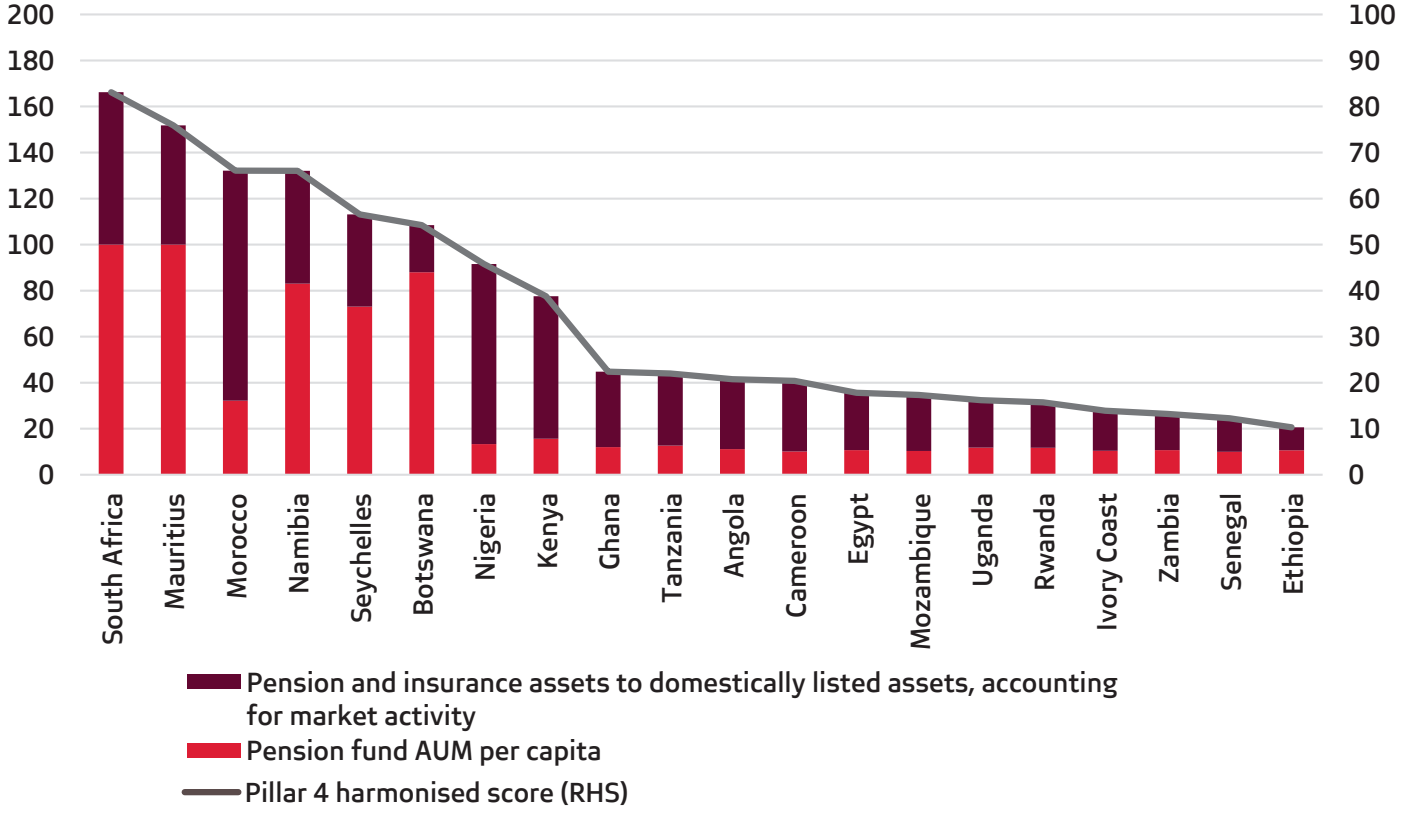
35.2035° N | 4.6644° W

Unlocking savings to lift capital market development

Financial inclusion strategies complement the build-up of pension assets, allowing savings to be invested in a wider variety of products.

Figure 4.1: Countries with large pension AUM per capita have high domestic investment potential

Scores for Pillar 4 indicators, max=200; harmonised score, max=100 (RHS)



Sources: African Development Bank, Organisation for Economic Co-operation and Development, national stock exchanges, Thomson Reuters, national central banks, national pension regulators. Note: The harmonised score (RHS) represents the average of both Pillar 4 indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39.

Pension funds and other institutional investors play a vital role in capital market development. Not only do they become sizeable investors as economies mature, their long investment horizon allows them to move away from government securities and cash towards investments such as listed equities, infrastructure financing, corporate bonds and private equity. Policies that support financial inclusion and encourage long-term savings help build up countries' pool of pension assets, increasing the capacity of domestic investors and stimulating demand for a wider range of financial products.

Pillar 4 also considers the size of pension funds relative to their local stock market capitalisation (for both bonds and equities), to indicate how much potential there is for institutional investors to propel capital market growth. At the same time, the pillar considers market liquidity in terms of turnover, as larger institutional investors faced with a restricted local market may adopt buy-and-hold strategies or invest in mostly international assets.

South Africa is top of the pillar. It has the second-highest pension fund AUM per capita. Its capital markets are deep and liquid, giving local pension funds plenty of investment options. Its pension funds are also large relative to the capitalisation of assets listed on the Johannesburg market, which means they contribute to its liquidity and development, as well as benefitting from it.

Mauritius is second. It moves up from last year due to the inclusion of the country's National Pension Fund and National Savings Fund, state-owned pension funds with sizeable investment portfolios. Many index countries lag on the size of their per capita pension assets; it is below $100 in 11 of them.

The Seychelles and Morocco also score highly. Morocco has a large ratio of pension assets to listed securities at 52%, but falls short on market liquidity.

Investment strategy

Ethiopia's pension assets climbed 29% to $3.3bn by end-2018. The increase is entirely accounted for by larger holdings of Ethiopian Treasury bills, which the main pension funds are required to hold. One survey respondent said the requirement to invest most of their assets in government securities was an impediment to investment in private assets. Ethiopia has been growing actively its two major pension funds by requiring more people to contribute. While regulation can hinder institutional investment, an Ivory Coast analyst said institutional investors face capacity limitations in managing the risk associated with newer asset classes.

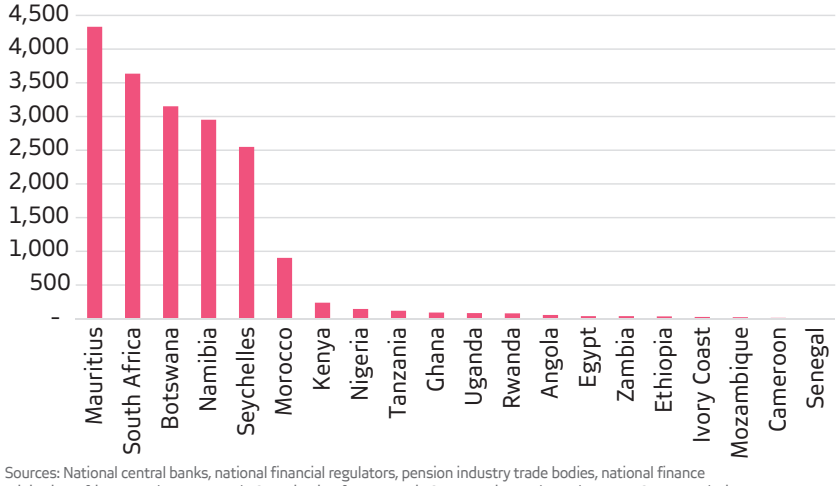
Kenya's pension assets rose by 17% from the previous year to $10.5bn. However, one respondent said 'the fragmentation of those assets in many small pension fund schemes, the broken relationship between pension fund trustees and managers, and limited capacity and motives to invest in securities other than government debt and real estate' hampered pension funds' contribution to capital market development. Government securities account for 39% of Kenya's pension assets, followed by real estate at 20%. Large allocations to government securities are common across index countries.

In Uganda, where pension assets have also risen, government securities account for 75% of assets and quoted equities 14%. Where local equity markets are small, pension funds tend to hold significant amounts of sovereign bonds.

Some pension funds have higher allocations to equities. Namibia has 56% of its pension fund assets in equities and only 22% in fixed income. However, the outlook for investment in equities and market liquidity is downbeat. 'Thin market trading and local asset requirements limit access to and volumes of assets that may be invested in,' said one respondent in the country. Namibian pension funds are required to invest 45% of their investment portfolio in local assets, a proportion that has climbed steadily over the last two years from 35%. Local assets are thought to be illiquid; most trading on the Namibian exchange is in dual-listed mining companies with operations in the country but which are not considered local. With pension funds' investments restricted to a less liquid market, Namibia's pillar score may drop in future. However, in the longer term the policy may encourage more local listings.

Figure 4.2: Mauritius leads a small group of pension high achievers

Pension fund AUM per capita, $



Sources: National central banks, national financial regulators, pension industry trade bodies, national finance ministries, African Development Bank, Organisation for Economic Co-operation and Development, OMFIF analysis

Pension funds in other countries have been encouraged to consider investments in infrastructure projects. An amendment to Nigeria's Pension Reform Act gave legal basis for pension fund administrators to invest in projects through infrastructure funds, bonds and sukuk. More than $44m of Nigeria's pension assets was invested in infrastructure in 2018. While representing less than 5% of total pension assets under management, the investment demonstrates how pension funds can contribute to broader national development goals.

Building up savings

Most countries have a financial inclusion initiative run by their central bank or finance ministry, which can help unlock savings. Nigeria last year revised its National Financial Inclusion Strategy and aims to have 70% of its adult population included in the formal financial services sector by 2020, up from 58.4% in 2016. Rwanda's national strategy for financial inclusion is expected by one survey respondent to win cabinet approval by end-2019.

Economic growth is increasing the potential capital that can be accessed through greater financial inclusion. 'Kenya's growing, emerging middle class presents significant potential as retail investors that could be tapped with appropriately tailored investment products,' said one survey respondent. Additional M-Akiba infrastructure bonds were issued in the first half of 2019. Kenyan retail investors can access these government-issued bonds through their mobile phones with a minimum investment equivalent to $30. Botswana is planning a similar policy, according to one policy-maker.

'Financial inclusion is being largely driven by mobile money platforms rather than banks,' said one central bank official. One capital market participant in Cameroon, which has the lowest pension fund AUM per capita in the index, said, 'Most financial institutions are launching digital services or products. And people are quickly getting on board.' The Mauritius stock exchange last year created a mobile application enabling retail investors to invest in listed securities.

Banks are playing a role in some countries. Ethiopia requires banks to expand their branches into rural areas as part of the country's financial inclusion strategy, along with targets for automated teller machines and point of sale terminals per capita.

Respondents said regulatory clarifications have been helpful. In Tanzania, the microfinance bill passed late last year formalises rules around micro-savings, small loans to households and small businesses, and micro-insurance. The Bank of Botswana earlier this year implemented electronic payment services regulations – rules on the licensing and oversight of electronic payments services providers. Some respondents said addressing concerns around cybercrime and data protection would be important.

Many respondents said financial education for citizens and public authorities was one of the best things that could be done to improve financial inclusion. The Central Bank of Kenya and Kenya Bankers Association are championing financial education through various seminars, a respondent said. Authorities in Botswana and Mozambique are using TV and radio programmes to share knowledge widely.

'While there has been great leaps in the development of capital markets in Africa, there remains a gap in the intermediation role of African capital markets as domestic pools of funds from pension and insurance companies continue to see major growth. Therefore, more needs to be done to improve financial infrastructure and make Africa's capital markets more attractive, in areas such as cross-border listings, settlements, and payments for transactions.'

Denny Kalyalya, governor, Bank of Zambia, September 2018

Figure 4.3: Namibia can raise investment in domestic companies

Pension fund assets, % of listed securities

Note: Ethiopia has no securities exchange.

Sources: National central banks, national financial regulators, pension industry trade bodies, national finance ministries, African Development Bank, Organisation for Economic Co-operation and Development, national securities exchanges, OMFIF analysis

Pillar 5:

Macroeconomic opportunity

The White Desert, Egypt

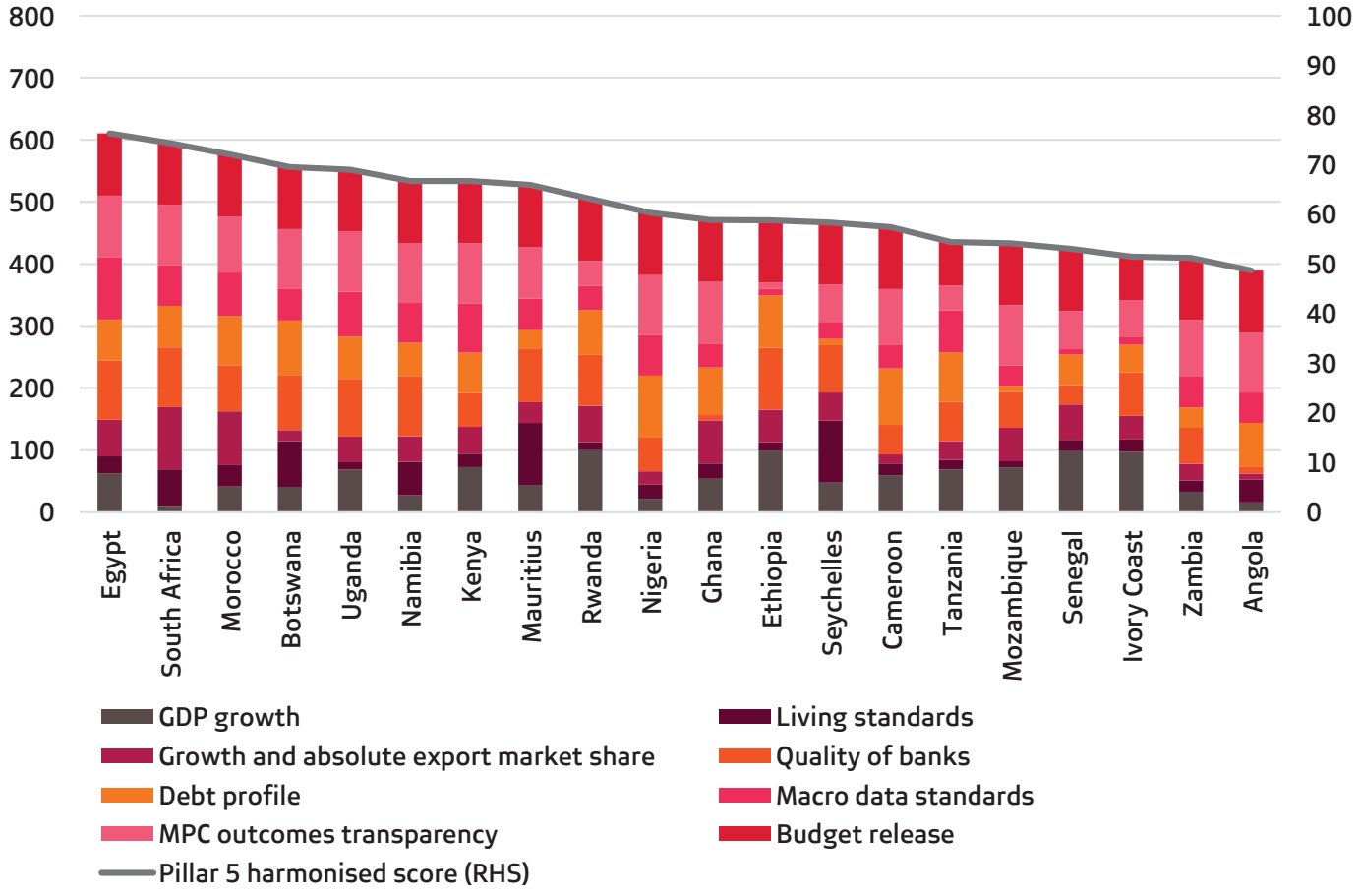
27.3637° N | 28.1219° E

Ambitious strategies for national transformation

While index countries' average rate of growth remains largely unchanged from last year, the ratio of non-performing loans to GDP is falling in several major economies.

Figure 5.1: Growth and export strength lift Egypt to top spot

Scores for Pillar 5 indicators, max=800; harmonised score, max=100 (RHS)



Source: International Monetary Fund, World Bank, national central banks, national finance ministries, African Development Bank, OMFIF analysis. Note: The harmonised score (RHS) represents the average of all Pillar 5 indicators and is used to compile the total scores for Pillars 1-6. More information on p.38-39

Pillar 5 evaluates economic performance, financial risks and financial transparency, as demonstrated by availability of data, open monetary policy communication and the timely release of state budgets.

Egypt has the highest overall Pillar 5 score this year, overtaking South Africa. While Egypt's GDP per capita remains fairly low compared with other countries, the country ranks highly on both economic and export growth. This year, Egypt completed the final review of its three-year $12bn International Monetary Fund programme, with its credit rating upgraded by ratings agencies after several years of high and stable growth rates. South Africa has much higher GDP per capita than Egypt, but the sluggish growth it registered in 2018 has continued in 2019, worsened by power outages caused by problems plaguing its state-run electric utility.

Rwanda rises six places, the largest jump in the pillar, after its economy grew 8.6% in 2018 and share of regional exports expanded. Preliminary agreement has been reached with the IMF on policies that could form the basis of a new reform programme focusing on achieving the country's 'National Strategy for Transformation 2017-24', a plan to accelerate urbanisation and financial market development. The IMF programme, which would not involve financing, looks at broadening the tax base, improving access to financial services, and supporting the National Bank of Rwanda's new forward-looking monetary policy framework. Under that structure, the central bank will assign the short-term interbank rate as an operational target and adjust this based on its inflation forecast, rather than targeting the level of reserves balances and broader monetary aggregates.

Senegal scores well in terms of growth. Like Rwanda, it has maintained high growth rates while the government undertakes the 'Emerging Senegal' plan, a long-term reform agenda aiming to make the country a middle-income economy by 2035.

Oil-dependent economies like Angola and Nigeria continue to struggle with low oil prices, with the IMF approving a $3.7bn bail-out for the former at the end of last year. Angola is pursuing a 'National Development Plan 2018-22', which includes unifying its exchange rate system and investing in infrastructure and non-oil sectors. However, falls in oil revenue have hindered its ability to spend substantially on public investment.

The average rate of economic growth across index countries was 4.3% in 2018, mostly unchanged from 2017's 4.4%.

Financial risks down as NPL ratios drop

Bank balance sheets broadly improved in 2018, with non-performing loans ratios shrinking in most countries. However, the rising dollar in 2018 impacted negatively on external financing for some countries.

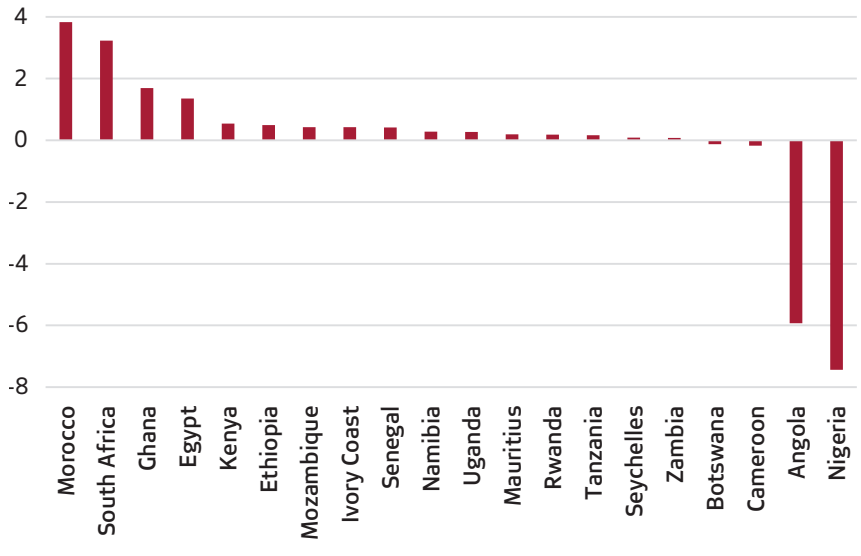
Egypt, Mauritius, Nigeria, Rwanda, Tanzania and Uganda all registered a decline in NPL ratios, boosting their Pillar 5 scores. Egypt's dropped to 3.9% from 5.5%, giving it one of the lowest shares of bad credit across the continent. CDC Group, the UK's development finance institution, this year gained approval to invest £200m of tier-two capital in Egypt's banks. Late last year Moody's upgraded Egypt's banking system outlook to positive from stable. The country has joined several others in ramping up capital requirements in line with international standards, which is expected to facilitate market consolidation.

Bank mergers and acquisitions, propelled mostly by the need to increase capital buffers, have been seen across African economies such as Ghana, Kenya and Angola. The Bank of Ghana last year merged five commercial banks that did not meet the minimum capital requirements set in 2017, creating Consolidated Bank Ghana. Some banking M&A has been market-led, such as in Kenya, where a scramble for balance sheet size and market share is spurring consolidation.

NPL ratios are expected to fall further in Mauritius, with a large share of state-owned MauBank's bad loans

Figure 5.2: Morocco leads export gains as oil-focused exporters lose ground

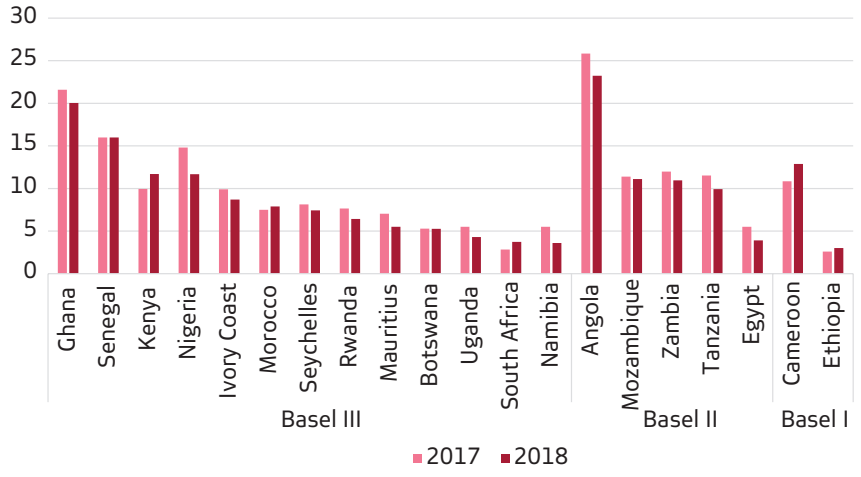
Percentage point change in export market share, 2013 vs 2018



Source: International Monetary Fund, OMFIF analysis

Figure 5.3: Credit quality broadly improved, but treatment of non-performing loans differ by Basel stage

NPLs, % of gross loans



Source: International Monetary Fund, national central banks, OMFIF analysis. Note: Mauritius, Kenya, Seychelles and Ghana are implementing aspects of Basel II/III. Morocco implemented Basel III capital adequacy in July 2015. Uganda still uses the Basel I capital adequacy ratio. Rwanda has adopted the Basel III liquidity coverage ratio.

'Bank mergers and acquisitions, propelled mostly by the need to increase capital buffers, have been seen across African economies such as Ghana, Kenya and Angola.'

moving to a special purpose vehicle and banks accelerating write-offs. In Nigeria the sale of NPLs to asset management companies has aided the country's ratio, but the IMF has warned that some restructured loans, which could account for 30% of loans in some institutions, may be masking further asset quality deterioration, especially those linked to the oil sector. Varying levels of compliance with Basel regimes hinder the comparability of reported NPL levels. For example, Ethiopia has the lowest NPL ratio in the index, but this is based on the more forgiving Basel I definitions.

External debt profiles worsened slightly. Seven index countries have external debt greater than 55% of GDP, the level beyond which the IMF considers there to be a strong risk of debt distress. China's Belt and Road initiative exacerbates concerns about foreign debt, with Mozambique, Kenya, Nigeria, Ethiopia and Angola among index countries that have received financing for infrastructure projects.

Mozambique has the highest external debt ratio at 145.8% of GDP, which includes both public and private debt. However, that has fallen from a peak of 158% in 2016. Mozambique came to an agreement with creditors earlier this year on the restructuring of its 2023 Eurobond, but a June ruling by the country's constitutional court that prior debt issuance tied to the Eurobond was illegal has cast uncertainty over the agreement.

Egypt's score worsens on its external debt as it climbed to 47.1% of GDP from 40.4%. It launched a pan-Asian roadshow for its bonds last year in a bid to lift demand for dollar-denominated Eurobonds before some sizeable issuances on the Luxembourg exchange.

Zambia leads financial transparency improvement

Zambia and Ivory Coast improve their scores on Pillar 5's budget-related items, with more accessible budget reporting accompanied by spending breakdowns.

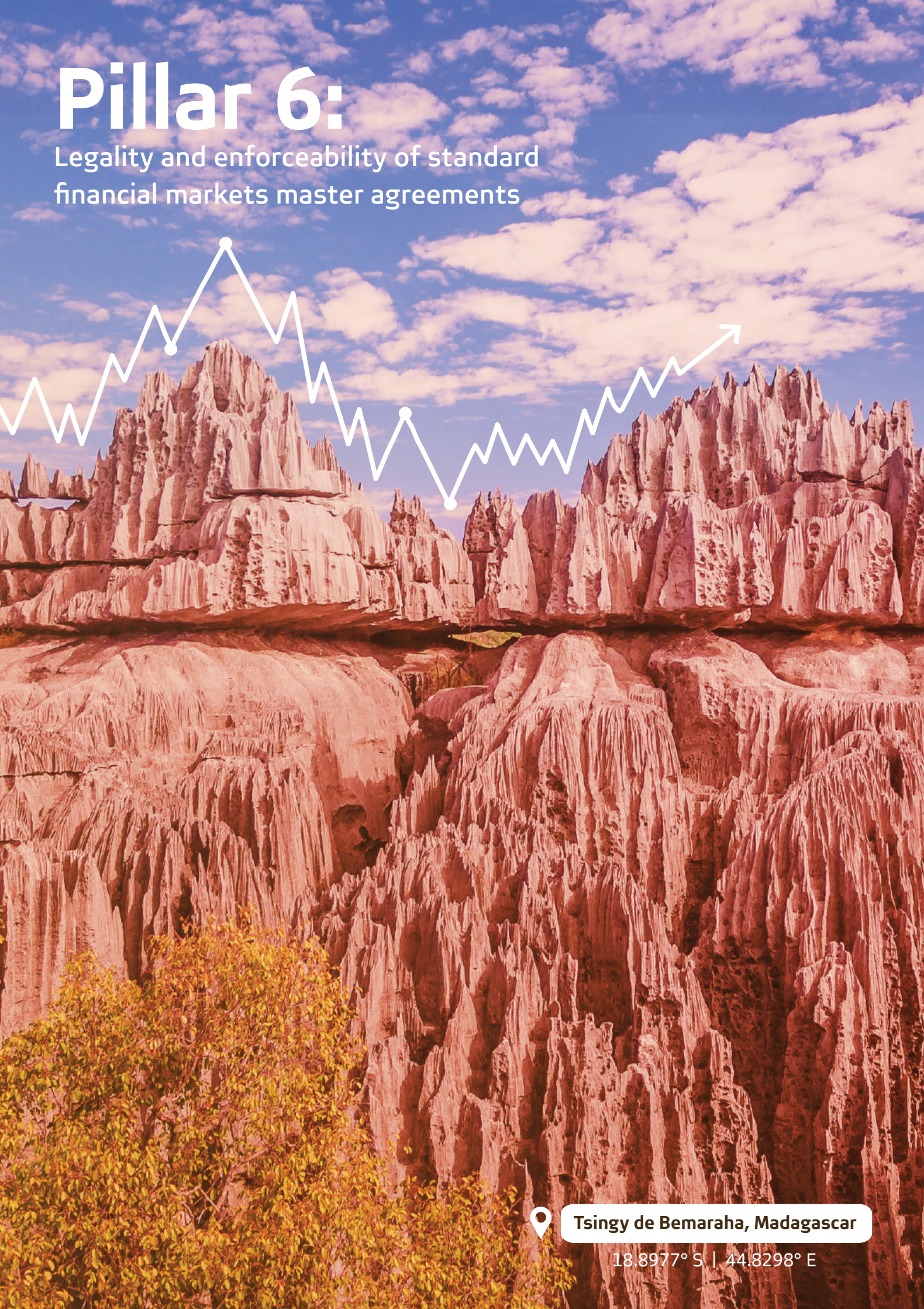
The Bank of Botswana now publishes the dates of future monetary policy committee meetings clearly on its website. Morocco's central bank circulates a full year-ahead calendar of monetary policy announcements and its monetary and survey data releases. The quality of central bank reporting tends to be high across the index, with most countries publishing detailed minutes or reports explaining policy decisions.

Tanzania this year repealed an amendment to its 2015 Statistics Act that made it a criminal offence to publish figures not approved by the National Bureau of Statistics. The law again allows groups and individuals to collect and distribute relevant information.

Despite undoing the amendment, Tanzania scores lower this year on both its budget release and data standards, and in April the country blocked the publication of its IMF Article IV report, a macroeconomic health check. Press leaks suggest the report was critical of a more difficult business environment, with the IMF forecasting lower growth over the next five years, weighing on Tanzania's Pillar 5 score.

Pillar 6:

Legality and enforceability of standard financial markets master agreements



Tsingy de Bemaraha, Madagascar

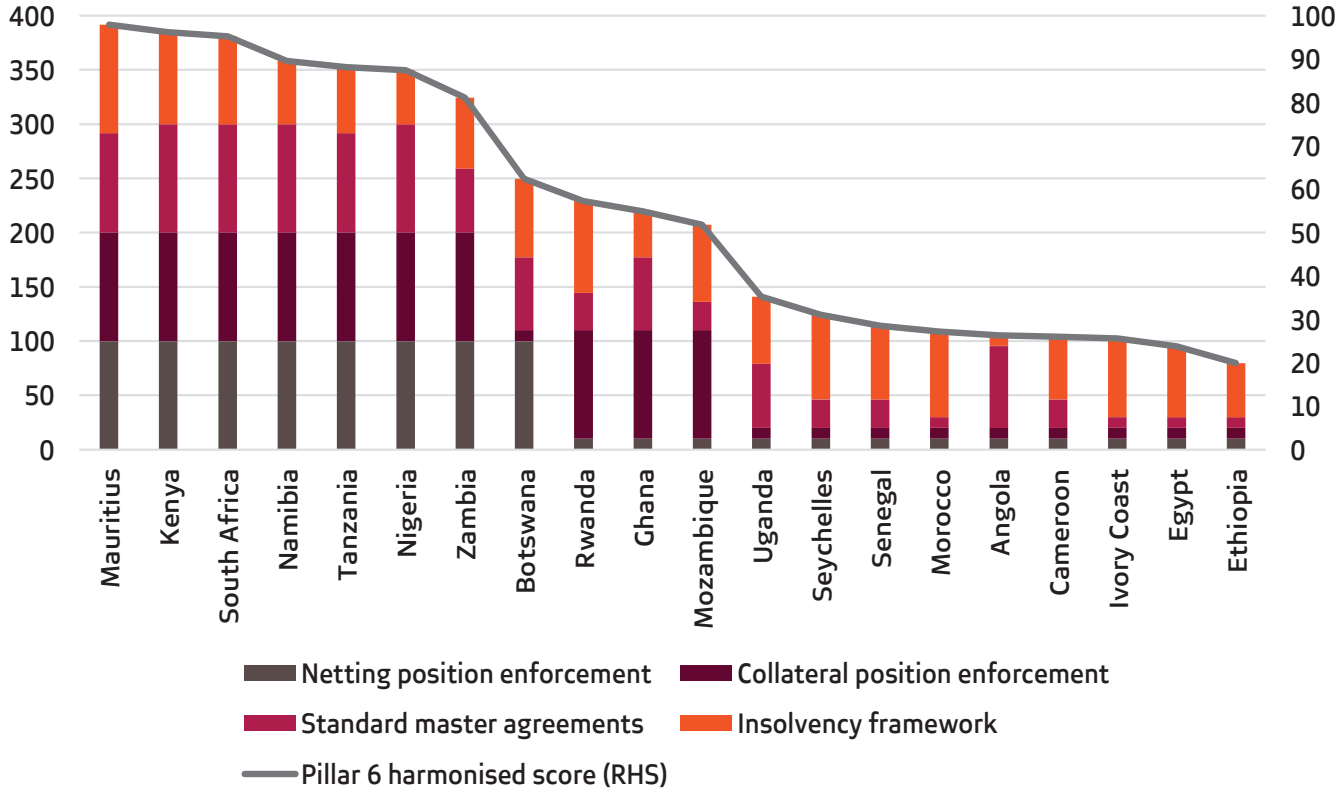
18.8977° S | 44.8298° E

Mitigating risks through legal and contractual certainty

Strong legal frameworks, clear rules on property rights and the recognition of internationally accepted legal standards build an attractive investment environment.

Figure 6.1: Mauritius and Kenya overtake South Africa with improving insolvency regimes

Scores for Pillar 6 indicators, max=400; harmonised score, max=100 (RHS)



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

Financial market growth requires adequate legal frameworks that mitigate uncertainty for market participants, especially those entering new jurisdictions. Adherence to global contractual standards and the establishment of strong insolvency processes contribute to the overall health and attractiveness of a financial system.

Pillar 6 measures how well countries have adopted internationally accepted legal standards based on their recognition of master agreements, the enforcement of netting and collateral positions, and the adequacy of insolvency regimes.

Mauritius takes the top spot this year for having a slightly stronger insolvency regime than runners-up Kenya and South Africa, as measured by their scores in the World Bank's 'Doing Business 2019' report. Netting and collateral positions are enforced in these countries, and all three master agreements considered in this pillar are widely recognised.

Standard master agreements

The use of standard master agreements in financial transactions in developing markets helps build trust by demonstrating their readiness to adopt internationally recognised procedures. The master agreement of the International Swaps and Derivatives Association is the most widely used contractual framework for over-the-counter trading globally. All but four index countries have some experience with it. Rwanda earns points for adoption of this master agreement, with the central bank reporting that it has used it for cross-currency swaps with a multilateral development bank.

The Global Master Repurchase Agreement governs repurchase agreements, often used in cross-border transactions as well as domestic repo markets. Nine index countries are yet to use the GMRA, while others are either already using it regularly or in some limited way.

The Global Master Securities Lending Agreement provides a contractual framework for securities lending arrangements. Only six index countries have used the GMSLA, indicating a reliance on domestic legal arrangements in the countries yet to adopt it. Kenya's index performance improved, reflecting its adoption of the GMSLA.

Enforcement of netting and collateral positions

Master agreements set out standards for the netting of contractual obligations. Enforcing these agreements' netting provisions reduces credit risk in a local derivatives market, as well as overall risk in a financial system. Similarly, collateral arrangements provide protection in default scenarios.

In some jurisdictions, netting legislation as proposed by ISDA has either been adopted or incorporated in existing banking laws, increasing the likelihood that netting positions will be enforced. South Africa and Mauritius, for example, have laws with provisions that cover netting. Countries like Ghana, Morocco and the Seychelles are considering enacting netting legislation.

Figure 6.2: More countries adopting global contractual standards

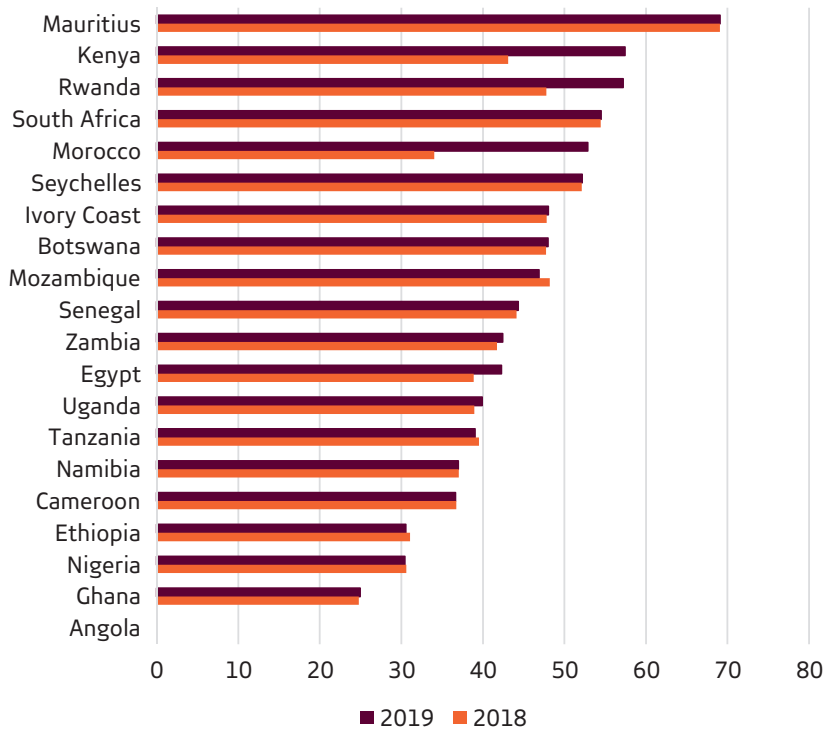
Use of key financial master agreements

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

Sources: Africa Financial Markets Index survey, OMFIF analysis

Figure 6.3: Kenya, Rwanda and Morocco improve insolvency procedures

Score for resolving insolvency, 0-100



Sources: World Bank Doing Business, OMFIF Analysis

Insolvency processes

Adequate insolvency procedures improve investor confidence, mitigate risks and encourage business growth. Scores from the World Bank's 'Doing Business' report consider the quality of insolvency laws, the efficiency of bankruptcy and reorganisation processes, the time and cost of resolution, and the recovery rate for claimants.

Kenya scores well for its insolvency law that encourages rehabilitation through administration of companies facing financial difficulty. Enacted in 2015, the law has since been amended to give more flexibility for the continuation of a business while undergoing insolvency procedures. Another revision being considered prioritises the repayment of loans incurred while a troubled firm is under administration, which aims to encourage lending to insolvent companies as they recover.

Morocco shows the biggest improvement from the previous year, giving debtors access to new financing while under insolvency proceedings. Rwanda's score also rises in the light of a new insolvency law passed in 2018, as well as further training for insolvency practitioners, members of the judiciary and banking professionals.

The refinement of insolvency frameworks, along with adoption of standard international master agreements, will help business environments thrive. Policy-makers must invest in the legal and contractual frameworks that will enable market players to transact more comfortably on a wider scale.

'Adequate insolvency procedures improve investor confidence, mitigate risks and encourage business growth.'

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 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 over past five years

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

Budget release
- Regular release of budget

Monetary policy committee 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
- Recovery rate and strength of insolvency framework

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 financial markets master 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.

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 2018 data. For statistics covering the previous 12 months (i.e. securities market turnover) this is July 2018-July 2019. 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 2019.

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 from June-August 2019, covering more than 40 individuals from 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.

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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