

Africa – is this leopard changing its spots?

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Following the most dramatic global contraction since the great depression, unprecedented monetary and fiscal easing has been a necessary response in the world's quest to restore economic growth. However, with the balance of probabilities shifting towards hikes rather than further cuts, fixed income fund managers will shortly be facing a dilemma. Yields are historically low and the prospects for capital losses loom ever larger as the effects of the massive global stimulus feeds through into inflation.

Africa however, presents an interesting low correlation alternative. The continent continues to be habitually dismissed and therefore, remains under-researched – providing the potential for strategic alpha generation. This prompted me to take a one man, two week, six country tour of the plateau continent, kindly organised by Standard Chartered, to discover if the ongoing scepticism of investors continues to be justified.

Ahead of my trip I had reason to be optimistic. Growth rates, though off their highs, were still strong, yields remained attractive and due to poor harvests last year and the high component of basic food in the inflation basket, the monetary easing cycle evident elsewhere in the world was not yet in place. In addition, banks were well capitalised and highly profitable and the overall levels of both private and public indebtedness were low both by Africa's own historical standards, and in comparison to the majority of the world.

This was my fifth visit to Africa, yet the level of research required to fully understand one of the world's greatest enigmas is extensive. Standard Chartered had organised an excellent schedule for me in Zambia, Kenya, Tanzania, Uganda, Ghana and Nigeria.

I'd experienced African airport security before. At Nairobi, my suitcase had been "checked" approximately six times before I had even checked in. I therefore, decided to travel light – one suit and a small rucksack containing the bare essentials. Chief of which were six brand new shirts still in their packets and an empty exercise book curious for notes. I hoped this approach would mean that I escaped the worst excesses of the over-zealous airport security, and despite the onerous travel schedule, the logistics went without hiccup (a sure sign of improvement). In fact, my biggest problem occurred at London Heathrow where an over officious counter assistant delayed me boarding the plane to Entebbe without a Ugandan visa (which I continually told him I could obtain on arrival).

My first stop was Zambia and I must admit to a little nervous apprehension as the average life expectancy has fallen to 37 (my 36th birthday is due in November). However, these melodramatic concerns aside, I arrived in Lusaka with the air buzzing with the news that ex-president Frederick Chiluba had been acquitted of embezzling \$500,000 during his 10 year term of presidency. This instant reminder of the West's perception of corruption in Africa was re-enforced as my taxi driver told me in no uncertain terms that the man was guilty, and as I got talking to the locals, that certainly appeared to be the opinion on the street. On further research however, there are positive structural and cultural changes taking place across Africa that discourage embezzlement from continuing to be a "privilege" afforded to the powerful few. This has led to a small but gradual decline in the abuse of public funds in recent years. For example, a president's immunity from prosecution was lifted in 2003 by Chiluba's successor, Levy Mwanawasa – a small yet positive step at the national level.

Looking at the wider continent, international aid, which accounted for \$38bn of inflows last year to close the gap between what can be raised by private capital and remittances, is now better co-ordinated and monitored following the Paris declaration of 2005. There is a strong physical presence of the IFI's in Africa's capital cities and these changes are increasing Africa's ability to raise funding in the international markets. Last year Africa was able to attract \$43bn in private capital and many senior officials paint a scenario of an Africa independent of foreign aid in the not too distant future.

There are changes at the political level too. Dictatorships are largely a thing of the past. The majority of governments have slim majorities. This ensures that the opposition parties have a louder voice and this can now be heard more freely through the media. It is true that there have been several recent failed attempts to silence the minority, but the communications tidal wave makes it increasingly difficult and public debate is now expected and common ahead of policy change.

Visiting the Kenyan central bank was certainly an experience even before I'd had the pleasure of meeting Jackson Kitili, the director of monetary operations and debt management office. Two AK47's were over-exuberantly pointed through my car window by what appeared to be 14 year olds in army combats as I arrived at the gates. I discovered that my visit had happened to coincide with a large delivery of Kenyan Shilling in what is still largely a cash based and informal economy - it appears you can't take any chances in Nairobi with a jeep load of cash.

Upon entering the central bank, the contrasts were alarming. Though the walls of the central bank offices are literally crumbling to the floor - the car park resembles a luxury showroom. This aside, I discovered that in both word and deed, the Kenyan central bank is extremely open to foreign investment and has maintained a fully liberalised capital account throughout the global crisis. A refreshing approach in direct contrast to a couple of Kenya's neighbours. Some still view foreign investment suspiciously and have adopted unconventional and what will ultimately be unsuccessful measures to control currency volatility. These differences in attitude are important when judging the merits of an investment into Africa. I tried my best to argue that liberalising the capital accounts would bring down borrowing costs significantly over the longer term, but in markets still driven in the short-term by cash flow, FX volatility is not a price many are currently prepared to pay.

Generally meetings with all the African central banks were open and candid. One criticism however, is that they continue to work on "price stability lite" basis – balancing the twin objectives of inflation and growth. Given that African countries are still by and large cash economies with a huge informal sector, open market operations rather than interest rates continue to be the preferred tool of choice. Central bank policy is not perfect, but they have made huge strides in a very short space of time.

Liquidity in the secondary government bond markets remains an issue in many cases – primary dealerships have been established to try and facilitate this, but "buy and hold" investing by the key participants in these markets remains the mentality for now (pension fund legislation may change this). Auction calendars are not planned or communicated and most African nations remain wary of developing a benchmark curve by tapping existing issues for fear of creating periods with large block repayment/rollover dates.

Financial intermediaries believe there is too much intervention in the FX market from the central bank, both physically and rhetorically, in spite of central bank claims of freely floating currencies. However, these issues are now in the open and are at least being discussed and partially, if not fully, addressed.

In conclusion, political transparency is improving, though at variable rates, and through both increased IFI participation and self regulation, corruption, though still prevalent, is headed in the right direction and there is evidence that an increasing amount of cash is finding its way into productive capacity.

Reform of the capital markets is progressive and Africa continues to enjoy being the proud owner of a disproportionate level of natural resources. One can argue about the pros/cons of overseas investments, but mines are re-opening and more of these natural resources are coming to market, garnering export receipts and gradually improving the overall standard of living for many Africans.

In her August visit to seven African countries, Hilary Clinton said: "There is so much that can be done if we can break the link of corruption and poor governance. It is a simple fact that investors are not attracted to states with failed or weak leadership, crime and civil unrest or corruption that taints every transaction and decision." My visit convinced me that much is already being done to address these issues and with real effective exchange rates either unchanged or slightly undervalued, double digit yields will be the norm rather than the exception, and with favourable base effects in place for a deflationary trend, there are many opportunities in Africa not yet reflected in current asset prices.