TAPPING INTO THE AFRICA OPPORTUNITY

Fuelled by the insatiable appetite among global investors for alpha together with positive market reforms, African countries are projected to attract significant inflows over the next 12 months. Despite this optimism, the region does face its own unique challenges, which need to be overcome.

Investors zero in on Africa

Assuming COVID-19 vaccinations are distributed in a timely and equitable fashion, the World Bank is forecasting a strong global economic rebound, and sub-Saharan Africa (SSA) and the Middle East and North Africa (MENA) are no exception. According to the World Bank, economic activity in SSA is expected to increase by 2.7% in 2021, while MENA could grow 2.1%. "The high interest rates available through fixed income investing across emerging markets – including those in Africa – are very attractive for institutions. In contrast to the negative rates in developed markets, the average net interest margin in Africa is around 5%. Africa is generating widespread interest from asset managers and sovereign wealth funds located in places such as North America, Europe, Asia and the Gulf who are all chasing fixed income returns," said Gunsel Topbas, Citi's Head of Securities Services for EMEA Emerging Markets. "Barring South Africa, liquidity is largely absent from the region's equity markets although banks including Citi are enabling African countries to diversify beyond fixed income by supporting them with the development of their secondary trading markets," he added.

Giving international investors easier access

Regardless of all the disruption and logistical challenges being caused by COVID-19, African markets have been resilient during this whole crisis. Market participants – including the central securities depositories (CSDs) – are operating business as usual despite working from home. Local regulators have also been pragmatic in helping investors gain access to their markets amid the pandemic. "Many emerging markets are paper-based while some oblige investors to use physical proxies if they want to open up an account. We are talking with regulators about the possibility of them granting exemptions for such requirements," said Topbas.

Other regulators are embracing digitalisation so as to make it easier for foreign investors when opening accounts. Morocco for example, is poised to allow foreign institutions to open up accounts using electronic signatures. Nonetheless, the account opening processes in key African markets – principally Nigeria and Egypt – continue to be heavily dependent on manual intervention. In Egypt, regulators still require a number of documents to be notarised and authorised to open up an account, while its KYC is not automated either.

Additionally, non-resident investors in Egypt often find it difficult to procure refunds from the government if they overpay on their taxes despite the recent passage of legislation aimed at mitigating this problem.

However, experts are bullish on Egypt's prospects owing to reforms elsewhere. Most notably, the country is on course to potentially attract greater foreign investment into its government debt market. Having established a new CSD in 2020 to support settlement in government debt, Egypt is now expected to become a Euroclearable market following constructive dialogue between the Ministry of Finance and Euroclear. Euroclearability – a cross-border trading link – will give foreign investors seamless access to Egyptian government debt securities, whose yields are incredibly attractive. Expediting the processes by which investors can access local African markets will be vital in shoring up inflows.

Digitalising corporate actions

The pandemic has also sparked tectonic improvements in corporate actions and proxy voting procedures across African markets. Activities like corporate actions and proxy voting in these four countries (South Africa, Nigeria, Egypt, Morocco) have traditionally been paper-based, although this is changing because of the pandemic. The same rings true for annual general meetings (AGMs).

"Citi has worked successfully with local market participants to solve these challenges. For example, South Africa is moving towards an e-voting set-up and Citi is monitoring take-up by issuers and the investment community at large, while the authorities in Nigeria and Morocco are actively talking about it. Electronic signatures have been widely implemented and are being used in communications between the local CSD and custodians in Egypt. Egypt has also made impressive progress through the introduction of e-voting together with the automation of cash dividends between custodians and CSDs," said Topbas. In Nigeria, the passage of the Company and Allied Matters (CAMA) Act now permits virtual meetings for private companies along with e-signatures. Digitalisation of such activities will be pivotal in enticing investment. "I hope these markets do not regress back to manual processing once the crisis is over but continue on a path of digitalisation. This is something which many banks including Citi will be strongly advocating for," added Topbas.

Widening the investment pool

If investors are to participate in African markets, there needs to be a deep pool of tradable financial instruments along with robust financial market infrastructures (FMIs) underpinning them. South Africa is widely accepted to be a regional leader here, having established a derivatives market years ago, although other countries are catching up.

For example, Nigeria's Securities Exchange Commission recently approved the registration of two central counterparty clearing houses (CCP) – FMDQ Clear Limited and NG Clear Limited – in 2020, which are expected to clear exchange traded derivatives such as index futures, single stock futures, FX futures, fixed income and commodities futures as and when these instruments start trading. Similar reforms are also underway in Morocco and Egypt, which are both in the process of developing a derivatives market together with CCPs, while the latter is also looking to establish a commodities exchange.

Solving the liquidity conundrum?

Remedying the lack of liquidity in Africa's equity markets will not be easy, but experts believe that this challenge could be overcome with the introduction of a pan-African cross-border trading and settlement link. The Africa Exchanges Linkage Project (AELP) is a joint endeavour between the African Securities Exchanges Association and the African Development Bank which is designed to stimulate pan-African investment. It aims to do this by creating cross-border trading and settlement links between the Bourse Regionale Valeures Mobilieres, Casablanca Stock Exchange, The Egyptian Exchange, Johannesburg Stock Exchange, Nairobi Securities Exchange, The Nigerian Stock Exchange and the Stock Exchange of Mauritius – seven major African exchanges, which boast a combined market capitalisation of $1.4 trillion.

While previous stock exchange connectivity schemes in Africa have struggled to gather momentum for a variety of reasons, the AELP is poised to have significant traction. This is partly because the initiative has strong backing from international providers, global investors, local FMIs, and domestic regulators. "Citi is very supportive of the AELP, and we believe it is something which holds massive promise and could drive intra-regional growth by facilitating greater liquidity," explained Topbas.

Driving reform in Africa

Enormous strides have been made in the region but it still faces monumental challenges. While some jurisdictions have made efforts to automate, others are still wedded to manual processing in areas such as account openings making it harder for investors to access the domestic market. Digitalisation is vital if investors are to participate in these markets. Nonetheless, solid progress around automation is being made in areas such as corporate actions and proxy voting. And finally, investors are likely to benefit from much improved liquidity owing to the AELP scheme and the willingness among many African countries to widen the pool of tradable financial products. Overall, the future looks promising for Africa.

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