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QUARTERLY FRONTIER MARKETS RECAP

INTEREST-TO-REVENUE RATIOS CONTINUE TO RISE FOR MOST FRONTIER MARKETS

Upgrades outnumbered downgrades by 2:1 across frontier markets (FMs) in 1Q24, with all rating changes taking place in the Americas (Jamaica, Costa Rica, and Bolivia). In the Middle East & Africa, Gabon was removed from Rating Watch Negative as political uncertainties eased. Despite these actions, the balance of Outlooks has remained unchanged, with four FMs on Positive Outlook (Barbados, Jamaica, Azerbaijan, and Georgia) and three on Negative Outlook (Kenya, Bolivia, Maldives). However, the overall Positive Outlook bias masks the fact that there continues to be a strong divergence in credit metrics across regions, and that FMs still face a challenging, albeit improving external environment. The median interest-to-revenue ratio is expected to rise further in 2024, and a setback to disinflation in major DMs leading to higher rates for longer and a strong US dollar, as well as a sharp slowdown in Chinese lending abroad, could add to financial strains.

AFRICAN FMs STILL HIGHLY VULNERABLE BUT REFORM EFFORTS COULD STRENGTHEN POSITIONS

The build-up of vulnerabilities over the past few years continues to pose risks across the Middle East & Africa (MEA), but gradual fiscal and external reforms by some sovereigns, combined with modest cuts in global interest rates, could provide some respite in 2024. At present, there is one FM on Negative Outlook (Kenya) and none on Positive Outlook. Five out of 14 FMs in MEA are rated below 'B-', where no Outlook is assigned, with two (Zambia and Ghana) still in default. While Zambia recently reached a deal with private external creditors, lifting a major hurdle to debt restructuring under the CF, Ghana's agreement with private external bondholders was rejected by the IMF over concerns that the deal would not fit its debt sustainability parameters.

MEA debt ratios have increased sharply since 2012, and we expect debt levels to remain significantly above pre-Covid levels for most of the region's FMs in 2024. A few countries have been able to lower their debt levels, mainly due to commodity-driven FX appreciation. While we expect debt levels to plateau in 2024 due to financing constraints and fiscal reform, risks include low revenue mobilisation, slippage on reforms, and expenditure overruns. FX depreciation has been a feature across the region, except where there are currency pegs, and debt has become more burdensome, as the median interest-to-revenue ratio in sub-Saharan Africa has more than doubled since 2014. We expect this ratio to continue to rise given the pass-through of interest rates and only a gradual fall in global rates, coupled with challenges in revenue mobilisation. The interest-to-revenue ratio is particularly high in Nigeria, followed by Kenya, Ghana (where it has remained high even after domestic debt restructuring), and Zambia. While global conditions could provide some relief, rates will remain higher than before 2022. On the domestic side, policy and market rates have gone up in recent years and now some countries have positive real rates. However, there are considerations that could prevent authorities from cutting rates, as is the case of Kenya. On the other hand, FMs such as Nigeria, Angola, and Zambia still have negative rates; for these, further monetary tightening could be in store.

KEY SOVEREIGN RATING ACTIONS

Jamaica Upgraded to 'BB-'; Outlook Positive

Costa Rica Upgraded to 'BB'; Outlook Stable

Azerbaijan Affirmed at 'BB+'; Outlook Positive

Kenya Affirmed at 'B'; Outlook Negative

Bolivia Downgraded to 'CCC'

Mongolia Affirmed at 'B'; Outlook Stable

WEBINARS / PODCASTS

Podcast: Geopolitical Tensions and Economic Risks in the Middle East and North Africa

Webinar: Fitch Upgrades Costa Rica to BB

Webinar: Sovereign Outlook for the Caucasus

Webinar: Fitch on Africa: Rating Outlook for Sovereigns and Banks in Sub-Saharan Africa

PREVIOUS REPORTS

Frontier Markets Recap - 4Q23

FitchRatings

Against this challenging financial backdrop, reform remains one of the key differentiating factors across the region. FX depreciation helps external rebalancing but also loops back into public finances, since a large portion of government debt in this region is FC-denominated. Over the past few years, fiscal deterioration has mirrored external deterioration, as looser fiscal policies have led to increased current account deficits (CADs), which have been funded by external debt rather than FDI. While we see some moderation in median CADs, there are large variations across FMs, and external debt service will still increase in 2024-2025 before slightly falling in 2026.

In **Nigeria,** reforms after the new government took office last year progressed much faster than anticipated. The fuel price subsidy was withdrawn more quickly than expected, although there has been some backtracking amid accelerating inflation. Since early June 2023, the official exchange rate has depreciated by 70% in total, including a large loss in value in January 2024. In recent weeks, the CBN has stepped up its monetary and FX reform efforts, resulting in faster-than-anticipated appreciation of the naira in both the official and parallel markets, with the spreads between the two rates narrowing significantly, from 65% in June 2023 to less than 5% currently. The currency appreciation follows the CBN's 600bp policy rate hike to 24.75% since February 2024, and its move to settle verified FX backlog and resume FX sales to BDCs. The recent actions mark progress in the country's effort to contain inflation and support a more market-determined exchange rate.

Nigeria's revenue-to-GDP ratio of 8% at end-2023 is the lowest among Fitch-rated sovereigns. While there is some upside from oil subsidy removal, non-oil tax reform, and renewed energy sector reforms, we still expect tax revenue to remain structurally low in the short term, at just below 10% of GDP. Debt servicing pressure remains high, as the interest-to-revenue ratio is nearly 4 times the 12% 'B' median (Kenya and Angola's are also high, reaching close to 30%, and Gabon's is nearly 13%). We expect a slight decline in this ratio in 2024 amid modest tax reform gains, but it will remain a key rating weakness over the near future. Renewed energy sector reforms have helped a partial oil recovery, but oil output remains persistently below its OPEC+ quota and well below the 2 million barrels/day recorded in 1H19. Oil recovery should provide some support to Nigeria's current account position, but FDI and portfolio flows will largely depend on exchange-rate liberalisation efforts and the resulting boost in investor confidence.

Kenya is facing higher external financing needs in FY24, primarily due to public sector debt maturities that include a USD2 billion Eurobond due in June 2024. Public sector debt repayment obligations will peak in 2024, with external debt service reaching USD5.5billion, or 5.4% of GDP. Limited investment inflows leave Kenya reliant on debt to finance its CAD, further contributing to external funding needs. The weakening Kenyan shilling – 21% against the USD in 2023 – and decline in FX reserves last year - highlight external liquidity strains, although the currency has stabilised in recent months, supported by increased official and commercial funding, and Kenya's useable FX reserves now cover around 3.8 months of imports. Despite improved FX liquidity, external funding constraints remain, sustaining the government's reliance on domestic funding. The CBK has hiked the policy rate by a total of 300bps to 13% since December, helping to support the shilling but further raising domestic debt costs. Kenya's debt is estimated to have peaked in 2023, at 71.8% of GDP, and is projected to moderate to 68.5% in 2025. While we expect debt to decrease in the medium term due to strong growth prospects and ongoing fiscal consolidation, gradual depreciation pressure and high interest costs pose risks to our debt trajectory. The rating is currently on Negative Outlook, and greater external financing strains, a substantial drop in FX reserves or a rapid rise in government debt/GDP could lead to a downgrade of its current 'B' rating.

FM RATING CHANGES CONCENTRATED IN THE AMERICAS

All directional rating changes in 1Q24 took place in the Americas, where FMs in Central America & the Caribbean continue to outperform their South American peers. This is evidenced by the upgrades of Costa Rica to 'BB' and Jamaica to 'BB-', as well as the downgrade of Bolivia by two notches to 'CCC' during the first quarter. It should also be noted that Paraguay, which at 'BB+' is the highest-rated FM in the Americas, was the first FM globally to tap the international capital markets this year, issuing both inaugural Paraguayan Guaraníes-denominated bonds at a 7.9% coupon and USD-denominated bonds at a 6% coupon, for the equivalent of USD500 million in total in early February.

Costa Rica's upgrade reflects its ongoing commitment to the fiscal rule that is anchoring continued structural improvement in its fiscal position, as well as robust economic growth and an improved external liquidity position. Both the entrenchment of the fiscal rule, with strict fiscal targets established under a law authorizing Eurobond issuance in 2022, and an IMF programme have been instrumental in the continued improvement in the country's credit profile. However, further declines in investment and social spending rather than additional revenue measures to comply with the rule could pose medium-term challenges. The sovereign's debt ratio has fallen in recent years but remains above 60%. Its return to international capital markets in 2023 for the first time since 2019 has improved its financing flexibility and reduced pressure in the domestic market. External spreads have compressed significantly, and local-currency yields have fallen to historic lows. However, the interest-to-revenue ratio continues to be a rating weakness with 18.6% in 2023 at the general government level and 31.5% at the central government level, compared to a 'BB' median of 9.6%, though Fitch expects it to decline to 16% by 2025.

Jamaica's credit profile has steadily improved since its 2013 distressed debt exchange, which Fitch considers a default. Debt-to-GDP has fallen every year for more than a decade, from a high of 135.3% in FY12/13 to a forecast 73% in FY23/24. Although this remains above the 'BB' median of 52.2% of GDP, it represents the third-largest decline in debt burden among all rated sovereigns over this period. The significant progress in debt reduction, backed by a sound fiscal framework and a strong commitment to deliver large primary surpluses, triggered its upgrade in March. The rating remains on Positive Outlook, reflecting our expectation of continued improvement in debt metrics (the government is targeting 60% of GDP by FY26/27) and further deepening of the policy framework over the next few years. Jamaica's external sector has also proven resilient, with small CADs amply funded by FDI. However, structural issues such as low growth potential due to weak demographics, low productivity, and infrastructure challenges, as well as high external exposure from its reliance on tourism and remittances, weather-related shocks, and high dependence on imports, particularly food and energy, are fundamental challenges to a more substantial rating uplift in the longer term. Economic diversification and deepening, as well as steps to cushion the economy from external shocks, such as the financial safety net it has begun to create in the event of natural disaster, could support higher ratings.

Bolivia was the only FM to experience a downgrade in 1Q24, as its precarious external position continued to deteriorate. Wide fiscal deficits and the absence of a concrete consolidation plan are likely to continue to put pressure on reserves. This has resulted in FX rationing and the emergence of parallel exchange rates in the context of a stabilised currency regime. Reserves fell USD2.1 billion during 2023 to USD1.7 billion, USD1.57 billion of which reflects gold reserves and just USD166 million FX. The central bank has begun to sell certified gold abroad and purchase non-certified gold from local producers, which may not be freely useable. Reduced timeliness of reserves data has added to the uncertainty. External commercial debt service remains low at USD110 million in coupon payments in both 2024 and 2025, but the 2028 Eurobond, which will mature in three instalments of USD333 million starting in 2026, could pose a greater challenge to repayment capacity in the absence of corrective policy measures. The higher fiscal deficit in 2023 was largely financed by borrowing from the central bank, and the government is likely to continue to do so in 2024, increasing the risks for macroeconomic instability given the pressure this produces on the domestic money supply and, consequently, on FX reserves. Bolivia faces general elections in 2025, which could make any changes to subsidies or policy adjustment difficult this year.

POSITIVE METRICS CONTINUE TO DEFINE EUROPEAN FMs

The ratings of all four European FMs, Georgia (BB), Armenia (BB-), Azerbaijan (BB+), and Uzbekistan (BB-) were affirmed in 1Q24, with Georgia and Azerbaijan continuing to be on Positive Outlook. While Armenia's upgrade from 'B+' last year took place only six months after it had been placed on Positive Outlook, Georgia has remained on Positive Outlook since January 2023 and Azerbaijan since October 2022, consistent with our typical timeframe of 12 to 24 months to resolve a Rating Outlook.

Azerbaijan's robust external balance sheet combined with low debt levels (21.8% at end-2023), and a commitment to a more prudent fiscal stance to manage the windfall from high oil prices, led to its Positive Outlook in 2022. However, vulnerabilities, such as still weak monetary policy, heavy dependence on hydrocarbons, and low potential growth, remain. Monetary policy continues to be constrained due to excess liquidity, an underdeveloped local market and high financial dollarisation. Some progress has been made through the introduction of new central bank instruments to improve policy rate transmission and efforts to reduce financial dollarisation, but fiscal policy remains the main lever to manage risks from oil revenue volatility. Thus, greater confidence that the strong public balance sheet will be preserved, and that improvements in the effectiveness of its policy framework will help manage external shocks and reduce macro volatility, could trigger a positive rating action.

Georgia's Positive Outlook reflects continued strong economic growth, alongside a marked fall in inflation, and greater confidence in the durability of large migrant and capital inflows since 2022 that have boosted the country's potential growth and external position. Despite the improvements in external finances, these continue to be an important vulnerability. A sizeable increase in FX reserves and/or a narrowing in the current account deficit closer to its peer levels, are considered positive rating sensitivities. Strong and sustained GDP growth leading to a reduction in macro vulnerabilities and higher GDP per capita, alongside reinforcing confidence in the strength of the policy framework, could also lead to a rating uplift. Georgia's policy framework is generally well regarded in terms of predictability. However, its IMF Stand-By Agreement (SBA) was suspended in September amid concerns over institutional independence raised by a new central bank law. The fiscal impact of the suspension has been limited, but questions over policy credibility remain unresolved. Nevertheless, Georgia's governance indicators are among the best in the region.

Armenia, which at 'B+' had been the lowest-rated FM in the Caucasus and Central Asian (CCA) region, was upgraded to 'BB-' in July 2023 to reflect strong GDP growth from migrant and capital inflows triggered by the war in Ukraine, and a substantial improvement in external balances. Armenia has continued to beat expectations after posting 8.7% GDP growth in 2023 on the back of 12.6% growth in 2022. This has led per capita income to nearly double over the last three years. It should be noted that Armenia was upgraded before the final stage of the Nagorno-Karabakh conflict, in which Azerbaijan re-took full control of Karabakh. The conflict outcome's impact will mainly be in the form of fiscal loosening to accommodate the refugee inflow, with broader credit metrics unlikely to be undermined. There has been a net influx of over 100,000 Armenians from that region, which in the short term provides an upside to growth from an increase in labour and government spending. We expect the impact on fiscal accounts to be temporary and Armenia to resume fiscal consolidation in 2025.

Uzbekistan's growth has been among the highest in the CIS region, with ongoing reforms and a strong investment pipeline providing upside to potential growth. While political commitment to reform still appears strong after substantial progress has been made over the past six years, some recent measures highlight the difficulty of transitioning to a fully market-driven economy. The second phase for energy tariff reforms scheduled for May will be a crucial test and should boost the stability of energy supplies. However, privatisation is likely to prove slower than projected, and subsidised lending continues to distort transmission of monetary policy, although the phase-out continues. Reaching medium-term fiscal targets could be challenging, due to large fiscal loosening amidst delays to energy tariff reforms and subsidised lending. Social considerations could complicate fiscal tightening as tariffs are progressively liberalised.

QUIET FIRST QUARTER FOR ASIAN FMs

There were no rating changes for Asian FMs in 1Q24, and only one rating, Mongolia's, was affirmed, reflecting favourable medium-term growth prospects and high per capita income relative to peers. Mongolia also scores well on World Bank governance indicators relative to 'B' peers, though in the past it has suffered from political volatility around issues of resource nationalism. Its ratings remain constrained by its high reliance on external funding and commodity exports to China, modest FX reserves (although buffers have strengthened recently) and a record of procyclical economic policy. Given legislative elections scheduled in June, we expect Mongolia's general government balance to slip back into a deficit of 2% of GDP in 2024, from a surplus of 3% in 2023, which will also push the current account back into a deficit. However, we expect the twin deficits to come down again in 2025. The mining revenue boom has lifted government revenue and FX reserves, enabling sharp declines in debt. If sustained and prudently managed, the commodity windfall could lead to improvements in its rating profile. Mongolia has historically experienced pronounced boom-bust cycles, however, exacerbated by pro-cyclical economic management and shifts in natural resource policies.

We expect Pakistan's new government, which took office after elections last February, to soon start negotiations with the IMF on a new medium-term arrangement, as the final disbursement of its nine-month SBA is likely to take place later this month. FX reserves have risen over recent months, but they are still low relative to external funding needs. We expect this will continue to be the case over the next few years. The exchange rate appears more stable and more market-driven after a sharp depreciation over the last two years, and informal controls on FX availability by commercial banks limit the CAD, which we forecast at around 1% of GDP in FY24 and FY25. However, the sovereign's still vulnerable FX position means that securing multilateral and bilateral financing will be a top priority for the next government. External bilateral support from GCC countries and China has been critical to stabilising Pakistan's finances in moments of stress. New bilateral funding has become more conditional in recent years, supporting reform momentum. However, negotiating a new IMF deal will still be critical to most other external financing flows, and will strongly influence the country's economic trajectory in the longer term.

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Newsreel

Pakistan's Election Outcome Highlights Risks to New IMF Deal

The close outcome of the election and resulting near-term political uncertainty may complicate the country's efforts to secure a financing agreement with the IMF to succeed the SBA. A new deal is key to the country's credit profile, and we assume one will be achieved within a few months, but an extended negotiation or failure to secure it would increase external liquidity stress and raise the probability of default.

Nigerian Banks to Benefit from Monetary Policy Rate Increases

Nigerian banks' profitability will benefit from a marked increase in NIMs driven by recent increases in the monetary policy rate. In addition, the CBN's rate rises and clearance of the backlog of overdue verified FX forwards have driven a modest recovery in the Nigerian naira, supporting the banking sector's capitalisation. However, despite the spread between the official and parallel rates narrowing, downside FX pressures persist due to negative real interest rates and low FX market confidence.

Tunisian Banks Can Help Meet Growing Sovereign Financing Needs

The Tunisian banking sector can continue to help meet the sovereign's increasing financing needs in 2024 as healthy deposit growth and weak credit demand support sector liquidity. In the absence of an agreement with the IMF and given the scarcity of other sources of external funding, Tunisia has increasingly relied on the domestic financial sector, and banks in particular, to finance its budget.

APAC Sovereigns Exposed to Flooding Risks Have Limited Capacity to Adapt

South and south-east Asian populations and economies are the most exposed to flooding risks in the Asia-Pacific region. Vietnam in south-east Asia and Bangladesh in south Asia stand out as being highly prone to flooding risks. International financing for adaptation and green transition purposes may help fill funding gaps for some sovereigns at the margins, but this is likely to be a small portion of overall funding needs.

Frontier Vision – 1Q24

FMs have continued to implement significant policy rate cuts as inflationary pressures wane. However, a handful of markets, particularly in Africa, have seen central banks increase their interest rates to combat resurgent consumer prices. Central banks in Armenia, Azerbaijan, Costa Rica, Georgia, Papua New Guinea, Paraguay, Sri Lanka, and Tajikistan have all cut rates in recent months, as inflationary pressures continue to ease. In particular, CPI in both Armenia and Costa Rica fell in March by 1.2%, the fifth and 10th consecutive negative annual outturn, respectively.

On the other hand, central banks in Angola, Kenya, Nigeria, and Zambia raised interest rates amid still-high inflation rates and weakening domestic currencies. Nigerian CPI inflation accelerated again in March to 33.2%, the highest level in almost 30 years, from 31.7% in February. The naira has been losing ground against the dollar since mid-2023 and even a recent strengthening of the Nigerian currency did not change the inflationary trend. The Central Bank of Nigeria has raised its monetary policy rate twice this year by 600bp in total, to 24.75%.

Fitch's quarterly 'Frontier Vision' chart pack tracks high-frequency macroeconomic data for the countries included in the J.P. Morgan's Next Generation Markets Index. The charts cover five years of historical data, and the choice of data series has been harmonised as far as possible across all countries to facilitate comparisons. The index comprises countries representing sub-Saharan Africa, Latin America and the Caribbean, the Middle East and North Africa, Europe, Asia, and Oceania.

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Regional Commentary

EUROPE

Uzbek Banking Reforms Gain Traction but May Face Delays

Presentation: Uzbekistan: Macroeconomic and Sovereign Credit Risk Outlook

Uzbek Insurance to Continue Double-Digit Growth

Presentation: Fitch's Outlook for the Caucasus: Azerbaijan, Georgia and Armenia

Caucasus Banks Benefit from Positive Credit Trends

Uzbekistan Affirmed at 'BB-'; Outlook Stable

Armenian Bank Metrics to Outperform Historical Norms in 2024-2025

Armenia Affirmed at 'BB-'; Outlook Stable

Georgia Affirmed at 'BB'; Outlook Positive

MIDDLE EAST & AFRICA

Nigerian Banks' New Paid-In Capital Rules to Spur Equity Issuance, M&A

Rwanda Affirmed at 'B+'; Outlook Stable

Nigeria Policy Tightening Is a Step Towards Addressing Economic Challenges

Tunisian Banks' Capital Buffers Should Absorb IFRS 9 Extra Provisioning

Kenyan Banks' Strong Profitability to Cushion Moderate Asset-Quality Weakening

African Banking Groups Have Mixed Exposure to Geopolitical Risks in West Africa

Ghanaian Banks' Profits Help Capital Recovery After Sovereign Default

Mozambique Affirmed at 'CCC+'

Gabon Affirmed at 'B-'; RWN Removed; Outlook Stable

Middle Eastern/African and CIS Telecoms Continue to See Strong Financial Structure

LATIN AMERICA & THE CARIBBEAN

Fitch Recalibrates Costa Rica's National Rating Scale Following Sovereign Upgrade

Caribbean Development Bank Affirmed at 'AA+'; Outlook Stable

Guatemala Affirmed at 'BB'; Outlook Stable

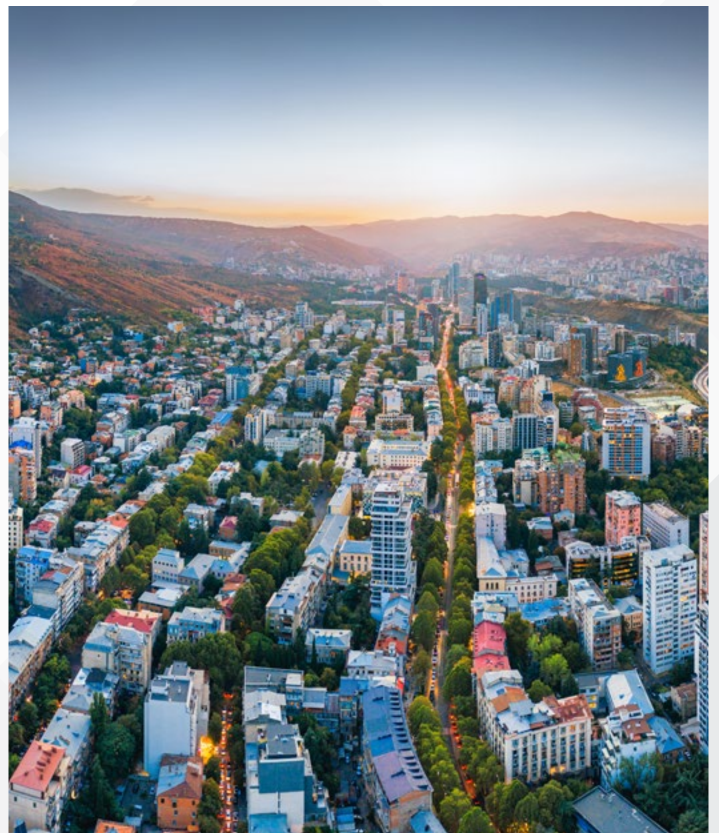
Paraguay's 2031 Global Guarani-Linked Bonds and 2036 USD Bonds Rated 'BB+'

ASIA PACIFIC

Fiscal Policy Key to Sustained Improvements in Mongolia's Credit Profile

Sri Lanka's Motor Insurance Changes to Hit Non-Life Sector

Pakistan's Islamic Finance Prospects Positive on Government Push



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Regional Commentary

Country	Current Ratings	Last Rating Action	Outlook/Rating Watch	Rating Action Type
Middle East & Africa				
Angola	B-	15-Dec-2023	▶	Affirmation
Cote D-Ivoire	BB-	04-Aug-2023	▶	Affirmation
Ethiopia	RD	27-Dec-2023	-	Downgrade
Gabon	B-	26-Jan-2024	▶	Affirmation
Ghana	RD	01-Nov-2023	-	Affirmation
Iraq	B-	04-Dec-2023	▶	Affirmation
Jordan	BB-	10-Nov-2023	▶	Affirmation
Kenya	B	16-Feb-2024	▼	Affirmation
Mozambique	CCC+	09-Feb-2024	-	Affirmation
Namibia	BB-	02-Jun-2023	▶	Affirmation
Nigeria	B-	03-Nov-2023	▶	Affirmation
Rwanda	B+	05-Apr-2024	▶	Affirmation
Tunisia	CCC-	08-Dec-2023	-	Affirmation
Zambia	RD	04-Dec-2023	-	Affirmation
Latin America & The Caribbean				
Barbados	B	17-Oct-2023	▲	Affirmation
Bolivia	B-	14-Mar-2023	▼	Downgrade
Costa Rica	BB	28-Feb-2024	▶	Upgrade
El Salvador	CCC+	05-May-2023	-	Upgrade
Guatemala	BB	13-Feb-2024	▶	Affirmed
Jamaica	BB-	05-Mar-2024	▲	Upgrade
Paraguay	BB+	01-Nov-2023	▶	Affirmation
Asia				
Maldives	B-	09-Oct-2023	▼	Affirmation
Mongolia	B	06-Feb-2024	▶	Affirmation
Pakistan	CCC	13-Dec-2023	-	Affirmation
Sri Lanka	RD	28-Sep-2023	-	Affirmation
Vietnam	BB+	08-Dec-2023	▶	Upgrade
Europe				
Armenia	BB-	26-Jan-2024	▶	Affirmation
Azerbaijan	BB+	16-Feb-2024	▲	Affirmation
Georgia	BB	12-Jan-2024	▲	Affirmation
Uzbekistan	BB-	23-Feb-2024	▶	Affirmation

Legend

▲ (positive), ▶ (stable), or ▼ (negative)

Source: Fitch Ratings

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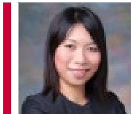
Business Development Contacts

FRANK LAURENTS
Global Strategist; EM, Sovereigns
T: +1 212-908-9127
frank.laurents@fitchratings.com

AYMERIC POIZOT, CFA, CAIA
Global Head of Investor Development – Country Head France, Belgium, Luxembourg
T: +33 1 44 29 92 76
aymeric.poizot@fitchratings.com



HELEN WONG
Head of APAC Investor Development
T: +852 2263 9934
helen.wong@fitchratings.com

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