Quarterly Frontier Markets Recap

External Vulnerabilities Rising Due to Larger Foreign Currency Debt

Frontier market (FM) ratings continued to stabilise in 1Q21, as positive GDP growth, rising commodity prices and higher capital inflows led to a more favourable credit environment. However, a legacy of larger fiscal deficits and debt burdens, and greater external vulnerabilities due to a sharp increase in foreign currency (FC) debt, have resulted in pockets of acute stress and heightened default risk. The G20 Debt Service Suspension Initiative (DSSI) and Common Framework (CF), and discussions about a new IMF Special Drawing Rights allocation, highlight the external liquidity needs of poorer countries.

Two FMs, Ethiopia and Suriname, have been downgraded so far this year, while three others saw their Outlooks improve: Iraq and Cameroon to Stable from Negative, and Vietnam to Positive. However, 9 out of 30 Fitch-rated FMs included in JPMorgan's NEXGEM index are still on Negative Outlook, while 7 are rated below 'B-', where no Outlook is assigned. This compares to 8 Negative Outlooks and 3 ratings below 'B-' at end-2019, reflecting the fragile state which many FMs still find themselves in.

Common Framework Raises Risk of Default

Ethiopia's downgrade to 'CCC' was triggered by its intention to make use of the CF, which raises the possibility of a restructuring of debt to the private-sector that would qualify as a distressed debt exchange under Fitch's sovereign rating criteria. Unlike the DSSI, which took effect in May'20, the CF, launched Nov.'20 by the G20 and Paris Club, requires countries to seek debt treatment by private creditors comparable to that of official bilateral creditors.

However, there is room for exceptions and the modalities of comparable treatment are still uncertain. A CF treatment will depend on the specific circumstances of the sovereign, and could address not just solvency issues but also liquidity challenges, which are the focus of Ethiopia.

Ethiopia's weak external finances due to persistent current account deficits (CAD), low FX reserves and rising external debt repayments present risks to external debt sustainability and are the main reason for its intention to use the CF.

Fragile External Finances Mostly due to Rising FC Debt

Weak external accounts are a common theme among smaller emerging markets (EMs). While most of the imbalances stem from the capital account side, the pandemic has added a large shock to external revenues for many sovereigns, with 16 expected to run CADs of 5% or higher in 2021 and eight above 10% of GDP. Half of these form part of our FM portfolio (as defined by the NEXGEM index), with Mozambique standing out at 49% due to imports for massive gas projects, and Georgia also exceeding the 10% mark, while Tunisia, Uzbekistan, Armenia, Iraq and Jordan will all have CADs in excess of 5% this year. Mongolia's projected 9.2% CAD, while high, is expected to be more than compensated by net FDI inflows.

Combined with medium- and long-term external borrowing amortisations, gross external financing requirements relative to FX reserves will be highest for Mozambique, Ethiopia, Gabon, Georgia, Sri Lanka, Belarus and El Salvador, with the first five exceeding 100%. Government debt, particularly FC debt, has risen significantly over the past few years. Median FC debt now represents about 2/3 of smaller EMs' total government debt and around 40% of GDP. As a result, several FMs face substantial repayments on FC debt in 2021, including Suriname and Zambia, which are already in default, and Angola, which has reprofiled repayments to bilateral creditors.

Key Sovereign Rating Actions

Pakistan's Proposed USD Bonds Assigned 'B-' Rating

Ghana's Proposed USD Bonds Assigned 'B' Rating

Outlook on Iraq Revised to Stable; Rating Affirmed at 'B-'

Ethiopia Downgraded to 'CCC'

Paraguay's 2033 USD Bond Rated 'BB+'

Webinars/Podcasts/Videos

Uzbekistan: Macroeconomic and Banking Sector Outlook

Credit Outlook on African Sovereigns & Banks

Fragile Frontier Markets Most Exposed to 'Taper Tantrum Two' Risk


FitchRatings FRONTIER MARKETS QUARTERLY – 4Q20
Quarterly Frontier Markets Recap
Outlook Remains Negative for Most Frontier Markets

Previous Reports

Frontier Markets Newsletter - 4Q20

External Vulnerabilities Rising Due to Larger Foreign Currency Debt **(continued)**

Higher exposure to FC debt means greater vulnerability to rising global interest rates and depreciation of local currencies, with the latter adversely affecting amortization/refinancing, while delivering less benefit in terms of correcting CADs. FMs' greater reliance on official financing provides some insulation from global interest rate hikes, but official lending is not guaranteed, as lenders may deem debt unsustainable and policies incompatible with large loan disbursements.

Access to Official and Capital Market Financing Varies

Of the three Asian countries rated 'CCC' (Laos, Maldives and Sri Lanka), Sri Lanka faces particular challenges in closing its financing gaps, due to its much larger debt burden and higher interest expense relative to fiscal revenue, as well as its low and falling FX coverage. With credit spreads of almost 4x those of Pakistan and nearly 6x Mongolia's in early April, Sri Lanka remains effectively priced out of the global debt markets. Prospects for IMF support appear remote, and it does not qualify for the DSSI either. However, its external finances may benefit from the authorities' efforts to secure bilateral support. By contrast, Pakistan and Mongolia have both been able to reduce near-term external risks through FC bond sales, with Pakistan issuing a USD1bn bond earlier this year and Mongolia placing a USD600mn bond in Sept.'20.[1]

In the Americas, Paraguay was able to tap the international capital markets in 1Q21, issuing a 12-year USD600mn bond at a coupon of 2.7%. Paraguay's resilient growth – GDP fell by only 1.1% in 2020, the smallest contraction in Latin America – and relatively prudent fiscal settings support its credit profile, while its new fiscal rule proposal reinforces policy credibility. In Costa Rica, the failure to achieve the required approval by a two-thirds majority in Congress for external funding led to the rejection of two IAB loans in Nov.'20. While Costa Rica was able to agree on an IMF programme this year, pending congressional approval, implementation risks remain due to ongoing political gridlock. Positively, El Salvador's legislative elections in Feb.'21 will end that country's political gridlock, but it is not clear that this will lead to the timely implementation of policies designed to bolster public finances and secure an IMF agreement.

Ghana's USD3bn bond issuance in March, which included the first zero-coupon USD bond on the continent, may encourage other African nations to tap global bond markets. The FC debt sale allows Ghana's government to reduce its reliance on the domestic debt market, which exhibits one of the highest real policy rates in the world. On the other hand, Gabon's delay in securing a new IMF programme and recurring difficulties in obtaining planned funding make its external liquidity risks greater than for most of its peers in the Sub-Saharan Africa (SSA) region.

Import Compression and Resilient Remittances Have Supported Reserves in Some FMs

Overall, FX reserves have proven surprisingly resilient in SSA, due to currency depreciation (Angola and Zambia), import compression, official creditor support and valuation effects. In some cases, the sharp drop in imports resulting from lockdowns (Namibia), restrictions on FC access (Nigeria and CEMAC), a hit to domestic incomes and lower oil prices for net oil importers, more than compensated for the drop in exports and tourism receipts. Remittances, with the exception of Nigeria's in 2Q20, remained broadly stable for most of the region's larger recipients, although the hit could still materialize.

In Central America & the Caribbean, current account deterioration was largely contained despite plunging tourism revenue, owing to a drop in import demand (partly due to a halt in tourism culinary imports) and a jump in remittances, which supported FX receipts. However, the steep decline in imports also reflects lost household income, which will increase poverty rates and challenge a post-pandemic economic recovery.

Inflationary Concerns Increasing in European FMs

Higher international food and energy prices, pandemic-related business expenses, supply-chain disruptions and, in many cases, currency depreciation, have led to rising inflation among European FMs. Armenia was the first to raise its policy rate in Dec.'20, with Georgia following suit in March and Belarus instituting food price controls. Despite improved policy frameworks and the recent adoption of inflation targets, inflation expectations are not well anchored in the region. This makes monetary policy tightening key to maintaining macroeconomic stability. Stronger policies support creditworthiness in Georgia and Armenia, but policies are more opaque in Azerbaijan and less consistent in Uzbekistan. In Belarus, there are concerns about increased political pressure on the central bank to support growth, while political uncertainty also persists.

1. While not technically a FM as defined by JP Morgan's NEXGEM index, it is worth mentioning that Maldives was also able to tap global capital markets, raising USD200mn from a sukuk in early April.

Newsreel

Fragile Frontier Markets Most Exposed to 'Taper Tantrum Two' Risk

Many FMs are more exposed to rising US bond yields than larger EMs, reflecting larger external financing needs and high levels of FC government debt. The Fed's tapering of its QE programme, expected to begin in early 2022, and the sharp rise in US bond yields, have raised the risk of a repeat of 2013's 'taper tantrum'.

G20 Debt Deal Could Lead to Sovereign Default *and* Common Framework Access Could Lead to Sovereign Debt Default

The Common Framework (CF) is a new instrument that explicitly requires debtor countries to seek comparable treatment by private-sector creditors. There is still some uncertainty, not least because exceptions are possible and because debtors would typically prefer to exclude private-sector debt from a restructuring. The latter would likely meet Fitch's definition of a DDE and lead to a 'RD' rating.

Sub-Saharan Africa Dashboard: Foreign-Exchange Reserves

Official international reserve positions of SSA sovereigns actually improved in several cases despite the severe shock from Covid-19, and deteriorated only mildly in even the worst cases. This surprising resilience, which can also be observed in some other regions, in SSA reflects currency depreciation, import compression, official creditor support and valuation effects.

Mongolian Political Volatility Captured at Current Rating Level

The quick formation of a new government signals that the sudden collapse of the previous administration will not compromise economic policy continuity or the near-term growth outlook. The resignation of the previous prime minister highlights the fragile hold that recent administrations have had on power, with four prime ministers over the last five years.

Frontier Vision – 1Q21

FMs showed better GDP results in 4Q20 than the previous quarter, but rising inflation and unemployment rates highlight macroeconomic challenges. Annual GDP outturns improved in 4Q20 compared with 3Q20 in Armenia, Azerbaijan, Costa Rica, Guatemala, Jordan, Mongolia, Nigeria, Paraguay, Vietnam, Zambia among other countries. At the same time, labour market conditions deteriorated in 4Q20 versus 3Q20, with unemployment rates rising in Azerbaijan, Jordan, Mongolia, Nigeria and Tunisia. Furthermore, consumer price inflation has risen in recent months across many FM, including Armenia, Belize, El Salvador, Georgia, Iraq, Suriname and - especially - Nigeria, where inflation accelerated to 18.2% yoy in March 2021.

Fitch's quarterly 'Frontier Vision' chart pack tracks high-frequency macroeconomic data for the countries included in the Next Generation Markets (NEXGEM) 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, the Caribbean, the Middle East & North Africa, Europe, Asia and Oceania.

Regional Commentary

Europe

Uzbekistan Affirmed at 'BB-'; Outlook Stable

Armenia Affirmed at 'B+'; Outlook Stable

CIS+ Dashboard: Rising Inflation, Monetary Policy Tightening

Uzbekistan's Rating Resilient to Pandemic; Challenges Ahead

3 Georgian Banks' Support Ratings Downgraded on Resolution Framework

Uzbekistan Banking Sector Update Presentation

Georgia Affirmed at 'BB', Outlook Negative

Middle East & Africa

Zambia's LC IDR Upgraded to 'CCC'; FC IDR Affirmed at 'RD'

Cameroon's Outlook Revised to Stable from Negative; Rating Affirmed at 'B'

Tunisia's Labour Union Deal a Step Towards Consensus on Reforms

Kenya Affirmed at 'B+'; Outlook Negative

Nigeria Affirmed at 'B'; Outlook Stable

Ghana's Long Fiscal Consolidation Plan Has Slippage Risk

Energy Sector Debt a Risk to Ghana's Post-Pandemic Debt Trajectory

Ghanaian Banks Well-Positioned for Higher Asset Quality Risk

Gabon Faces Liquidity Risks Due to Challenging Funding Path

Nigeria's Deficit Monetisation May Raise Macro-Stability Risks

African FTA Growth Impact Too Small to Affect Ratings

Latin America & The Caribbean

Suriname's Long-Term Foreign Currency IDR Downgraded to 'RD'

Jamaica Affirmed at 'B+'; Outlook Stable

Costa Rica Affirmed at 'B'; Outlook Negative

El Salvador Vote Ends Gridlock but Policy Implications Are Unclear

Slow 2021 Tourism Recovery for Caribbean, Central America

Paraguay's Fiscal Rule Proposal Supports Policy Credibility

El Salvador's 2021 Budget Leaves Substantial Financing Gap

Asia Pacific

Vietnam's Public Finances Outperform Peers Amid Pandemic Stress

New Border Disruptions Manageable for Mongolian Mining

Vietnam's Outlook Revised to Positive, Rating Affirmed at 'BB'

External Liquidity Key Rating Risk for APAC's 'CCC' Sovereigns

Sri Lankan Banks Dashboard: 1Q21

Top Rated Sri Lankan Banks - Peer Review 2021

Banking Law Amendments to Boost Mongolian Banks' Governance

1Q21 Update: Coronavirus Impact on APAC Tourism

Vietnam Banks: Peer Review 2021

Regional Commentary

Country	Current Ratings	Last Rating Action	Outlook	Rating Action Type
Middle East & Africa				
Angola	CCC	04-Sep-2020	-	Downgrade
Cameroon	B	12-Apr-2021	▶	Affirmation
Cote D-Ivoire	B+	17-Dec-2020	▲	Affirmation
Ethiopia	CCC	09-Feb-2021	-	Downgrade
Gabon	CCC	11-Dec-2020	-	Affirmation
Ghana	B	15-Oct-2020	▶	Affirmation
Iraq	B-	24-Mar-2021	▶	Affirmation
Jordan	BB-	26-Nov-2020	▼	Affirmation
Kenya	B+	26-Mar-2021	▼	Affirmation
Mozambique	CCC	09-Dec-2020	-	Affirmation
Namibia	BB	07-Dec-2020	▼	Affirmation
Nigeria	B	19-Mar-2021	▶	Affirmation
Tunisia	B	20-Nov-2020	▼	Affirmation
Zambia	RD	12-Apr-2021	-	Affirmation
Latin America & The Caribbean				
Bolivia	B	30-Sep-2020	▶	Downgrade
Costa Rica	B	16-Mar-2021	▼	Affirmation
El Salvador	B-	30-Apr-2020	▼	Affirmation
Guatemala	BB-	01-Dec-2020	▶	Affirmation
Jamaica	B+	18-Mar-2021	▶	Affirmation
Paraguay	BB+	02-Dec-2020	▶	Affirmation
Suriname	RD	01-Apr-2021	-	Downgrade
Asia				
Mongolia	B	28-May-2020	▶	Affirmation
Pakistan	B-	17-Aug-2020	▶	Affirmation
Sri Lanka	CCC	27-Nov-2020	-	Downgrade
Vietnam	BB	01-Apr-2021	▲	Affirmation
Europe				
Armenia	B+	26-Mar-2021	▶	Affirmation
Azerbaijan	BB+	20-Nov-2020	▼	Affirmation
Belarus	B	13-Nov-2020	▼	Affirmation
Georgia	BB	12-Feb-2021	▼	Affirmation
Uzbekistan	BB-	09-Apr-2021	▶	Affirmation

Legend
▲ (positive), ▶ (stable), or ▼ (negative)
Source: Fitch Ratings

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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