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QUARTERLY FRONTIER MARKETS RECAP

Frontier Markets Weakened by High Inflation, Monetary Tightening

Frontier markets are still recovering from the fallout of the pandemic, with the food and oil price shock from the war in Ukraine, tightening global financial conditions, and slowing growth in developed markets (DMs) leading to additional stresses. Six frontier markets (FMs) have been downgraded so far this year, two more than all of 2021. As a result, during 1H22, the number of Negative Outlooks declined to 3 from 8, with three FMs migrating from 'B-' to 'CCC', where no Outlooks are assigned, raising the number of countries rated below 'B-' to 9, nearly a third of the 31 Fitch-rated FMs.

Most of the downgrades in 1H22 took place in the Middle East & Africa (MEA), with Namibia's in 2Q22 following Tunisia and Ghana's in 1Q22. The rest were evenly spread across regions, with one FM being downgraded in each, Emerging Europe (Belarus[1]), Asia-Pacific (Sri Lanka) and the Americas (El Salvador). This compares to only 3 positive actions in 1H22: Angola's upgrade in January, and the positive Outlook changes of Guatemala (from Stable to Positive) and Costa Rica (from Negative to Stable) in April and March, respectively.

EUROPEAN AND SSA FRONTIER MARKETS MOST AFFECTED BY WAR IN UKRAINE

The FMs most vulnerable to the adverse spillover effects from the war are those with the largest exposure to the pressure points of the shock or which already have limited buffers to absorb unfavourable developments. This is the case of European FMs, which have close economic ties with Russia, followed by sub-Saharan Africa (SSA) sovereigns, which face the shock with already weakened credit profiles.

In FM Europe, direct trade links, combined with tourism and remittance flows from Russia, are key transmission channels for Belarus, Armenia, Azerbaijan, Georgia, and Uzbekistan. However, large external buffers (Azerbaijan), higher commodity prices (Azerbaijan and Uzbekistan) or multilateral support (Georgia and Armenia) ease external financing risks. We have shaved our 2022 growth forecasts for all CIS+ economies, with Armenia's 4.4pp cut to 1.3% being the steepest after Belarus'. The growth effect will be the conflict's main transmission channel for both Armenia and Georgia, and fiscal deficits will remain above 5% for both countries this year. Average inflation is now projected to exceed 8.5% in 2022 in all CIS+ countries, driven by higher commodity prices. Price controls on key products have been introduced or extended in several countries, which will have fiscal costs. Azerbaijan, who exports gas to Europe, is the only CIS+ country for whom fiscal and external balances have improved due to the war, with Fitch forecasting a general government surplus of close to 10% of GDP and a current account surplus of almost 24% this year.

SSA sovereigns' low ratings indicate their weak starting point as debt burdens have grown sharply over the last decade. Weaker DM export demand plus higher financing costs could make debt dynamics more challenging, and in some cases add to existing financial distress. The inflationary shock from the war and heightened risk aversion is adding to pressures on domestic rates and government borrowing costs and compounding the external financing challenges from rate hikes in Europe and the US. Most SSA central banks that had not raised rates before have started doing so during 1H22.

Key Sovereign Rating Actions

Namibia Downgraded to 'BB-'; Outlook Stable

Sri Lanka Downgraded to 'RD'

Mongolia Affirmed at 'B'; Outlook Stable

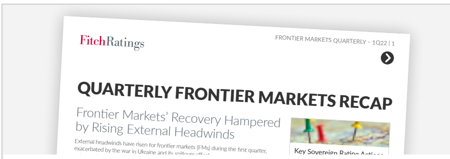
Azerbaijan Affirmed at 'BB+'; Outlook Stable

Guatemala's Outlook Revised to Positive; Ratings Affirmed at 'BB-'

Webinars/Podcasts/Videos

Nigeria Sovereign and Banks - Mid-Year Outlook: Policy Settings Limit Upside Potential From Higher Oil Prices

Fitch on Asian Frontier Economies - Navigating the Emerging Challenges



Previous Reports

Frontier Markets Recap – 1Q22

[1] Belarus, which was downgraded for the second time this year on 7 July, has been removed from JP Morgan's NEXGEM index and will therefore no longer be part of our FM universe going forward.

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The region's main oil exporters will gain from higher oil prices, but domestic fuel subsidies limit the fiscal benefit for Nigeria. Other countries, such as Cote d'Ivoire and Zambia, also subsidise or regulate the price of fuel.

MORE FRONTIER MARKETS FACE TWIN DEFICITS IN 2022

About a third of all FMs are now forecast to register sizeable twin deficits with budget and current account deficits (CADs) of at least 4% of GDP in 2022. The rise in the number of FMs with twin deficits reflects a surge in budget deficits during the pandemic and a jump in current account deficits due to higher energy and food prices caused by the Ukraine war. Pakistan, Armenia, and Ghana will run twin deficits of at least 4%, Georgia and Uzbekistan of at least 5%, and Maldives, Rwanda, Tunisia, and Namibia of at least 7% of GDP this year.

Namibia's high fiscal deficit led to its downgrade in June. Its general government deficit widened to 9.5% of GDP in FY21/22 and we expect it to remain elevated at 7.6% this year, despite growing tax revenues and a freeze on public wages. At the same time, a steep rise in its oil import bill led to a 7pp jump in its CAD to 9.2% of GDP last year, and a further widening to 11.3% is expected this year.

SOUTH ASIAN FMs MOST AFFECTED BY COMMODITY PRICE SHOCK IN APAC REGION

In FM Asia, direct trade links with Russia or Ukraine are limited, but second-round effects from subdued global demand could weigh on the region's manufacturing exporters. Vietnam's economy is forecast to expand by 6.1% in 2022 and 6.3% in 2023, boosted by rising exports and domestic consumption as pandemic restrictions ease, but slowing global demand is a downside risk. Higher energy prices could improve export prospects for Mongolia (coal), although this depends on Covid-related border restrictions imposed by its main trading partner China. All other Asian FMs are net energy importers. South Asia is particularly exposed to the commodity price shock, with Sri Lanka and Pakistan already facing external and fiscal challenges, as well as high inflation. There are subsidy spending pressures in most FMs and revenue growth could be more subdued to the extent commodity prices dampen economic performance. On the other hand, Asian FM debt has risen only slightly, except for Sri Lanka's explosive debt path.

Sri Lanka's economic and social instability have led to massive portfolio outflows, and weakening disposable incomes have prompted widespread riots. Low FX reserves continue to pressure imports, and the unprecedented spike in interest rates by a record 700bp in April, to 14.5%, will raise borrowing costs and weaken financial flexibility. Sri Lanka's LTFC IDR was downgraded to 'C' in April when it suspended debt servicing, and to 'RD' in May, following the expiry of the 30-day grace period.

Mongolia raised its benchmark policy rate by a cumulative 300bp in 1Q22 to 9% in response to its high inflation, which is now forecast at 14.2% in 2022. GDP growth will remain subdued at 1.2% in 2022, despite elevated commodity prices, as coal and other exports have been severely disrupted by closures of its border with China. However, growth should accelerate to 6.3% in 2023 and 6.8% in 2024 as headwinds from trade disruptions and the war in Ukraine wane. Generous resource endowments and improved cross-border infrastructure could unleash additional economic benefits for the country.

LATIN AMERICA & THE CARIBBEAN FMs SHOW UNEVEN RECOVERIES

The recovery from the pandemic has been uneven for FMs in Latin America & the Caribbean (LatAm). Rapid recoveries in Central America mostly reflected record high remittances from the US, while Costa Rica benefitted from the dynamism of its high-tech sectors. On the other hand, the slow recovery in Jamaica was due to its reliance on tourism while Bolivia's reflected public investment well below pre-pandemic levels.

LatAm's direct exposure to Russia and Ukraine is narrow, but the region will be affected by the price shock the war has prompted, which will erode real incomes and sentiment and could result in tighter monetary policy. Food and fuel importers, mainly in Central America & the Caribbean, are more vulnerable, but resilient remittances and a recovery in tourism are helping to cushion the shock for many commodity importers.

Stronger-than-projected fiscal recovery in 2021 contributed to the stabilization of Costa Rica's Negative Outlook in 1Q22 and the revision of Guatemala's Outlook to Positive in 2Q22. Guatemala's economy grew by 8% in 2021, which after a mild 1.5% contraction in 2020, is one of the region's strongest recoveries. Remittances from the US were a major driver of growth, along with pent-up investment, high prices for agricultural products, low interest rates and nearshoring by US companies as a response to supply-chain disruptions. The combination of modest deficits and strong economic growth will keep debt-to-GDP at low levels, even in a less favourable environment.

On the other hand, Paraguay's severe drought has significantly weakened 2022 growth prospects, with a potential knock-on effect on the fiscal deficit. We now expect a 1% contraction this year, compared to our previously projected 4% growth. The central bank has raised its benchmark rate by 600bp since August 2021 to 6.75%, providing another headwind as it tries to combat double-digit inflation driven by rising food and fuel prices. Paraguay's economic performance during the pandemic was fairly resilient, but its vulnerability to droughts reflects dependence on agriculture and hydroelectricity exports, and on river transport for international trade.

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EM Europe Sovereigns Most Affected in Stagflation, War Scenario

In an adverse macroeconomic and geopolitical scenario relating to the war in Ukraine, sovereign ratings in Emerging Europe, SSA and APAC could see numerous Outlook changes and a few possible rating changes. These are the most affected regions, but no region would experience widespread sovereign rating changes in our adverse scenario relative to our baseline.

Pakistan's Political Volatility Adds to External Financing Risk

The recent government change in Pakistan has been peaceful but raises near-term policy uncertainty even as the country faces external and fiscal challenges from rising commodity prices and an increase in global risk aversion. The authorities' policy agenda remains central to Pakistan's ability to refinance its external debt over the medium term.

Tunisia's Political Tensions Continue to Hamper Reform

Tunisia's government and the influential Tunisian General Labour Union could forge a consensus on a set of economic reforms that could unlock IMF funding and support the country's external financing position, but tensions over the future institutional setup are hampering an agreement. This increases risks to our base case of Tunisia entering an IMF programme by end-3Q22.

Nigeria's Complex Policy Approach Hampers Inflation Fight

The decision by Nigeria's central bank to raise the main policy interest rate sharply in May does not signal a fundamental shift in the country's unorthodox monetary policy, which will continue to impede efforts to rein in inflation. We believe Nigeria's complex policy approach will be maintained at least until the next presidential election in February 2023.

Frontier Vision – 2Q22

Central banks in frontier markets (FMs) are taking further steps to tighten monetary policy, raising interest rates at an unprecedented pace. As consumer and producer inflation rates keep rising and FM currencies continue to depreciate, borrowing costs have increased to levels not seen in a long time, as illustrated in Fitch Ratings' latest 'Frontier Vision' chart pack. Since 1Q22 policy rates have increased in: Costa Rica, Cote d'Ivoire, Ghana, Jamaica, Jordan, Kenya, Mongolia, Nigeria, Pakistan, Paraguay, Senegal and Sri Lanka, among others. Only the Central Bank of Uzbekistan has bucked this trend and cut its main policy rate in June by 1pp, to 16%. In Sri Lanka, where an economic crisis has sparked a wave of mass protests and political turmoil, annual national consumer and wholesale inflation rates rose in May to record highs of 45.3% and 70.5%, respectively. CPI and PPI annual inflation rates also increased simultaneously in recent months in: Costa Rica, El Salvador, Ghana, Jordan and Rwanda, among others.

At the same time, many FM currencies are losing ground against the US dollar. Nominal exchange rates have been experiencing significant depreciations in: Costa Rica, Cote d'Ivoire, Gabon, Jamaica, Kenya, Mongolia, Pakistan, Senegal and Sri Lanka. Fitch's quarterly 'Frontier Vision' chart pack tracks high-frequency macroeconomic data for the countries included in J.P. Morgan's 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.

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Regional Commentary

EUROPE

Belarus's Long-Term Foreign-Currency IDR Downgraded to 'C'

Belarus Affirmed at 'CCC'

CIS+ Sovereigns Face Weaker Growth; Balance Sheet Prospects Vary

Uzbekistan Affirmed at 'BB-'; Outlook Stable

LATIN AMERICA & THE CARIBBEAN

Costa Rica Cyber Ransomware Highlights Sovereign Cyber-Risk

Paraguay's Severe Drought Weakens 2022 Growth Prospects

Peer Reviews of Five Large Guatemalan Banks

Latam Economies Showing Uneven Momentum in Choppy 2022

ASIA PACIFIC

Government Push to Aid Pakistan Islamic Finance Growth

Losses from Sri Lanka's Riots Manageable for Insurers

Sri Lankan Mutual Funds' Outflows Rise amid Economic Turmoil

Some Sri Lankan Corporates More Affected by Stressed Environment

Weak Operating Conditions Raise Risks for Sri Lankan Insurers

Sri Lanka Downgraded to 'C'

MIDDLE EAST & AFRICA

Interest Rate Rise Adds to Tunisian Banks' Asset Quality Woes

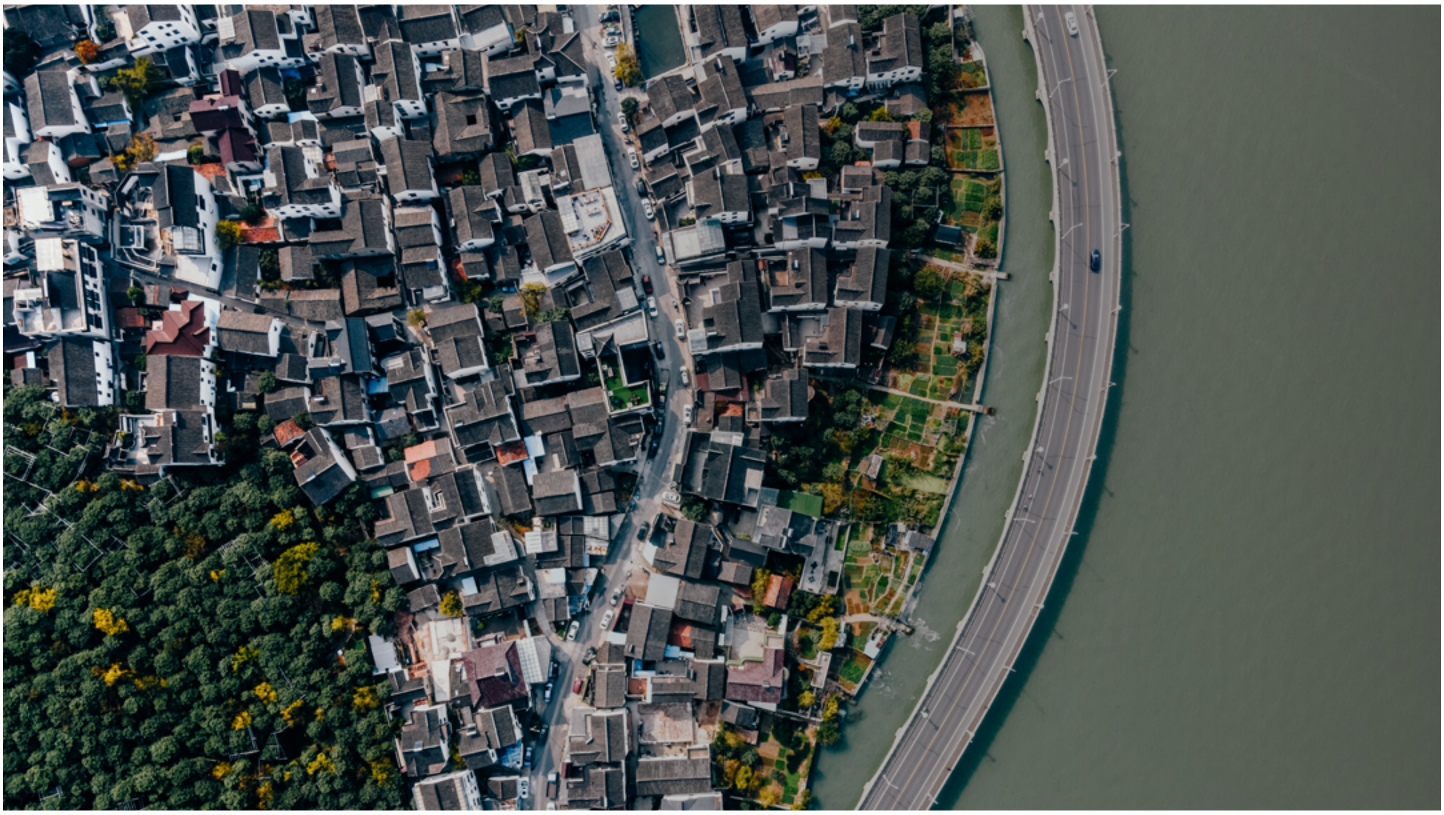
Nigerian Banks Face Global Risk Transmission Despite Oil Boost

Rwanda Affirmed at 'B+'; Outlook Negative

Cote d'Ivoire Affirmed at 'BB-'; Outlook Stable

Russia-Ukraine War Compounds Tunisian Banks' Vulnerabilities

Zambia Affirmed at 'RD'



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Regional Commentary

Country	Current Ratings	Last Rating Action	Outlook	Rating Action Type
Middle East & Africa				
Angola	B-	21-Jan-2022	–	Upgrade
Cote D-Ivoire	BB-	21-Apr-2022	▶	Affirmation
Ethiopia	CCC	27-Jan-2022	–	Affirmation
Gabon	B-	04-Mar-2022	▶	Affirmation
Ghana	B-	14-Jan-2022	▼	Downgrade
Iraq	B-	12-Jan-2022	▶	Affirmation
Jordan	BB-	07-Dec-2021	▶	Affirmation
Kenya	B+	22-Mar-2022	▼	Affirmation
Mozambique	CCC	11-Mar-2022	–	Affirmation
Namibia	BB-	24-Jun-2022	▶	Downgrade
Nigeria	B	14-Mar-2022	▶	Affirmation
Rwanda	B+	06-May-2022	▼	Affirmation
Tunisia	CCC	18-Mar-2022	–	Downgrade
Zambia	RD	05-Apr-2022	–	Affirmation
Latin America & The Caribbean	▶			
Bolivia	B	24-Sep-2021	▶	Affirmation
Costa Rica	B	11-Mar-2022	▶	Affirmation
El Salvador	CCC	09-Feb-2022	–	Downgrade
Guatemala	BB-	26-Apr-2022	▲	Affirmation
Jamaica	B+	09-Mar-2022	▶	Affirmation
Paraguay	BB+	30-Nov-2021	▶	Affirmation
Asia				
Maldives	B-	28-Oct-2021	▶	Upgrade
Mongolia	B	18-May-2022	▶	Affirmation
Pakistan	B-	28-Feb-2022	▶	Affirmation
Sri Lanka	RD	20-May-2022	–	Downgrade
Vietnam	BB	28-Mar-2022	▲	Affirmation
Europe				
Armenia	B+	18-Mar-2022	▶	Affirmation
Azerbaijan	BB+	29-Apr-2022	▶	Affirmation
Belarus*	C	07-Jul-2022	–	Downgrade
Georgia	BB	04-Feb-2022	▶	Affirmation
Uzbekistan	BB-	01-Apr-2022	▶	Affirmation

Legend

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

Source: Fitch Ratings

* Belarus has been removed from JPM's NEXGEM index and will therefore no longer be part of our FM universe

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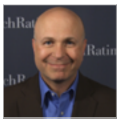
Business Development Contacts



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