East Africa Macroeconomic Outlook

Volume III

Resilience through tough times

MAKING AN IMPACT THAT MATTERS since 1845

Content

Our publication is divided into three key sections as highlighted below:

Global, Africa and East Africa Macro Overview

This section gives a brief overview of global, Africa and East Africa's macroeconomic overview. The global industries sub-section provides an outlook on the following industries:

- Consumer
- Energy resources and industrials
- Life sciences and healthcare
- Technology, media, and telecommunications
- Financial services
- Government and public services.

Sectoral analysis

In this section, we analyse the key sectors within the East African economies between 2019 and 2021 with the expected performance in 2022. We have analysed the agriculture, industry and services sectors in Kenya, Ethiopia, Tanzania, Uganda and Rwanda – highlighting growth trends and the resilience of the sectors post COVID-19.

M&A landscape

We provide a view of the M&A landscape including an overview of the global and African scene. The East African review includes challenges facing M&A in East Africa, The ESG imperative, key trends in M&A, and Deloitte's role as the transaction advisor.

Countries covered

Kenya

Ethiopia

Tanzania

Uganda

Rwanda

Foreword

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We are pleased to present Volume III of the East Africa Macroeconomic Publication, themed: ***Resilience through tough times.***

This volume, published in September 2022, focuses on the economic rebound and sectoral resilience experienced across Kenya, Ethiopia, Tanzania, Uganda and Rwanda in 2021 and 2022. At the core of our analysis, is the exigent inflation that has:

I. Prompted central banks to vary their, hitherto, accommodative stances,

II. Precipitated a public debt crisis worldwide and

III. Resulted in a higher cost of living, owing to commodity price hikes.

Despite the headwinds brought about by the COVID-19 pandemic, the global economy rebounded from a 2.9% contraction in 2020 to a 6.1% growth in 2021, driven by the withdrawal of COVID-19 containment measures and the resumption of supply chain and trade flows.

Subsequently, the year 2022 was expected to herald pre-pandemic economic growth levels, given the curbed spread of the COVID-19 pandemic at the end of 2021. However, the conflict between Russia and Ukraine, the ensuing financial and trade sanctions imposed on Russia as well as supply chain disruptions in Ukraine, have resulted in a sharp rise in global commodity and oil prices.

Naturally, this triggered a markdown of the forecasted global GDP growth in 2022 and has resulted in unprecedented global inflation, which is forecasted to average 9.9% in 2022, up from a 4.5% average in 2021. The effects of these disruptions have far-reaching consequences and cascade down to the East Africa region, which relies on the warring countries primarily for wheat and fertiliser.

Furthermore, the surges in COVID-19 cases in China at the start of 2022 resulted in re-imposition of mobility restrictions and localised lockdowns in key manufacturing and trading hubs and further constrained trade flows.

For purposes of our analysis in this publication, we have used available data to **30 June 2022; unless indicated on specific pages**.

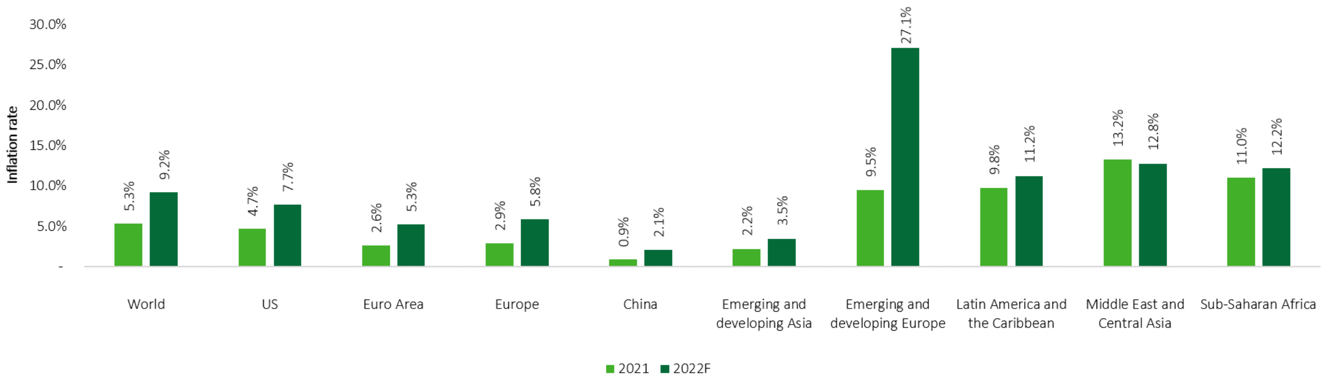
It is our hope that you find this publication insightful as we all attempt to accelerate growth beyond tough economic times imposed by high global inflation and amidst geopolitical uncertainties.

Global Economy

Introduction

Prospects of a looming cost of living crisis are growing driven primarily by higher-than-expected inflation levels globally. Global inflation is expected to increase from 5.3% in 2021 to 9.2% in 2022 attributable mainly to the high energy and food inflation that is a result of negative spillovers stemming from the Russia-Ukraine conflict

Global inflation rates



Source: IMF World Economic Outlook Database

Global inflation increased from 5.3% in 2021 to 9.2% in 2022 mainly on account of:

- Heightened energy and food inflation induced by the Russia-Ukraine conflict and low agricultural yield worldwide due to unreliable weather patterns and increased fertiliser costs respectively;
- High energy cost, a direct consequence of the Russia-Ukraine conflict as evidenced by the 42% increase in brent crude oil prices year-to-date (June 2022); and
- An aggregate demand-supply mismatch brought on by monetary policy support that released pent up demand in 2021 vis a vis prolonged supply chain bottlenecks due to COVID-19 related disruptions that created localised shortages.

Elevated inflationary pressures are compounding a looming cost of living crisis globally with the consumer price index (CPI) as at June 2021 increasing by 9.1% in the United States (a 40-year high) and by 8.6% in Europe (the highest since the inception of the European Union). The Food and Agriculture Organisation's (FAO) food price index tracked 23.1% higher in June 2022 compared to June 2021 driven by increased prices for cereals, vegetable oil and dairy products.

The risk of high costs of living is further amplified due to the mismatch between real annual wage growth and consumer price increases that have weathered consumer purchasing power. In the US, nominal salaries are expected to increase by 3.4% in 2022, which implies a 4.3% decline in real annual wages once adjusted for expected inflation in 2022. Workers in the U.K. on the other hand, have seen their real compensation fall by an estimated 8.0% year-on-year in 2022.

Global inflation is expected to increase from 5.3% in 2021 to 9.2% in 2022 attributable mainly to the high energy and food inflation that is a result of negative spillovers stemming from the Russia-Ukraine conflict.

The Global Economy

Introduction

As we delve into a new post COVID-19 norm, the current challenges may be new in magnitude but not in kind. A geo-political conflict between Russia and Ukraine poses key downside risks to economies globally including inflationary pressures, supply chain disruptions, asset bubbles and prolonged bull markets. These effects are expected to see global real GDP growth wane to 3.2% in 2022 compared to 6.1% in 2021.

Global real GDP rates

Source: IMF, AfDB

Notes: 2022F – 2022 forecast pre-conflict
2022F - 2022 forecast post-conflict*

Global GDP grew by 6.1% in 2021 compared to a 2.9% decline reported in 2020 driven by the firming up of a sustainable and resilient recovery in major advanced economies that was a culmination of large-scale fiscal support, easing of COVID-19 pandemic restrictions, and the release of pent-up demand in emerging states.

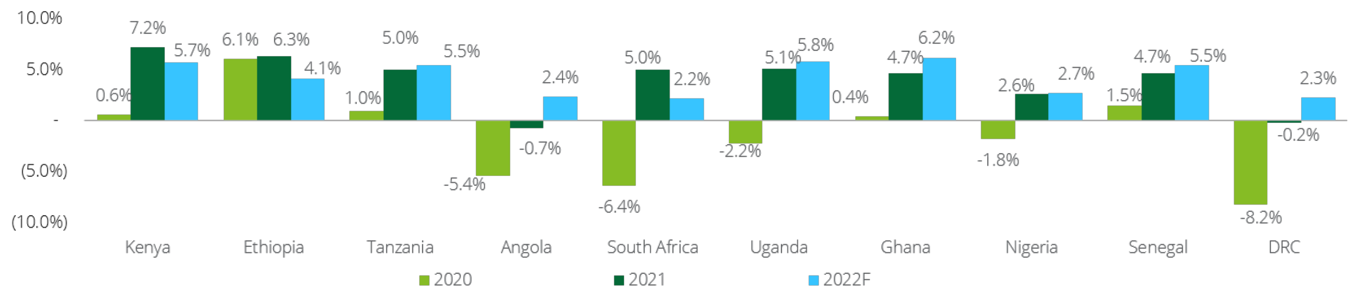
Prospects of a recovery in the global output in 2022 have been dimmed following the materialisation of higher-than-expected inflation especially in advanced economies. Global inflation is primarily driven by increasing food and energy prices, the culmination of direct spillovers emanating from the ensuing Russia-Ukraine crisis.

This, coupled with other shocks such as COVID-19 related lockdowns and a deepening real estate crisis in China, withdrawal of accommodative monetary policy and fiscal support as well as other supply chain disruptions induced by the Russia-Ukraine conflict have resulted in a markdown of GDP growth forecasts from earlier growth prospects of 4.4% to 3.2% in 2022.

Africa's Macroeconomic Overview

Africa's real GDP grew by 3.4% in 2021 compared to a contraction of 2.1% in 2020 due to a sharp improvement in global trade and commodity prices and is expected to increase marginally to 4.0% in 2022 driven by private consumption and investment, continued expansion in the services sector and deepening economic integration.

Real GDP growth in major SSA economies

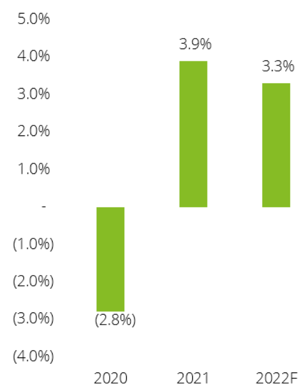


Source: World Bank, IMF, EIU, AFDB

Africa real GDP growth

Source: World Bank, IMF, EIU, AFDB

Sub-Saharan Africa real GDP growth



Source: World Bank, IMF, EIU, AFDB

Africa's GDP grew by 3.4% in 2021 driven by reduced COVID-19 restrictions and stabilisation of commodity prices. Growth is expected to reach 4.0% in 2022 driven by gradual rollback of containment measures, rising vaccination rates as well as higher commodity prices and increased investment rates.

Average inflation in the Sub-Saharan region is expected to surge from 11.0% in 2021 to 12.2% in 2022, the highest level since 2008. The surge is in line with global trends, primarily driven by the surge in food and fuel prices amid the Russia-Ukraine conflict. Food prices, which account for an estimated 40% of consumer spending in the region have been rising rapidly, exacerbated by the fact that in 2021 food prices in Africa were already affected by harvest issues and trade restrictions due to the COVID-19 pandemic. In addition, 85% of the region's wheat supplies are imported. Combined, these factors are expected to disproportionally affect poor households, by increasing the cost of living amid stagnant real wage growth.

In 2022Q1, inbound tourist arrivals in Africa increased by 96% year-on-year, attributed to easing of travel restrictions in African countries. Tourist arrivals are however, still 61% below the 2019 levels. Travel and tourism recovery is building up with international tourism activity set to rebound in the region.

SSA's current account deficit shrank to USD 13b in 2021 from USD 39b in 2020 owing to strengthening global demand for the region's exports alongside higher global commodity prices. The SSA'S overall current account position is expected to deteriorate in 2022, reaching USD 31b given that most of the countries are net importers of oil.

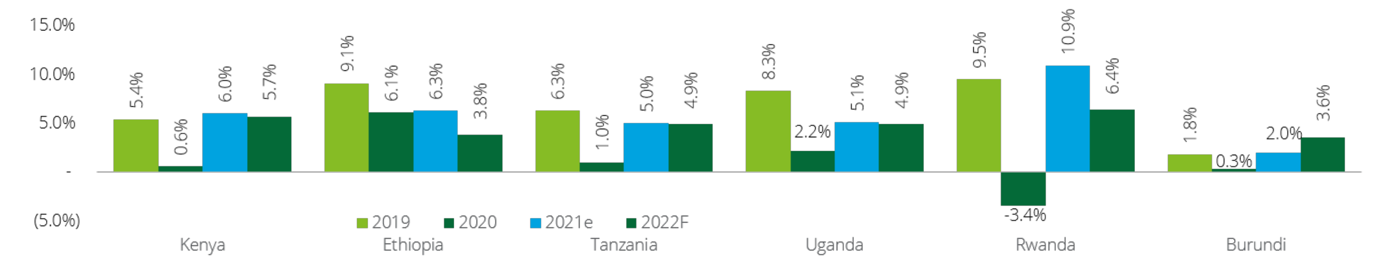
The average fiscal deficit in Africa is projected to narrow to 4.0 percent of GDP in 2022, from 5.1 percent in 2021, reflecting scaling-down of COVID-19 related interventions and relative strengthening of domestic revenues. Rising commodity prices triggered by the Russia-Ukraine conflict however, present headwinds for the fiscal situation, especially for economies that are dependent on imports of energy and food commodities.

The Russia-Ukraine conflict is set to adversely affect the continent through disruptions to agriculture production and supply chain. The rise in food prices has fueled inflationary pressures, which could exacerbate malnutrition and poverty among Africa's poor people, who allocate a greater share of their household income to food.

East Africa's Macroeconomic Overview

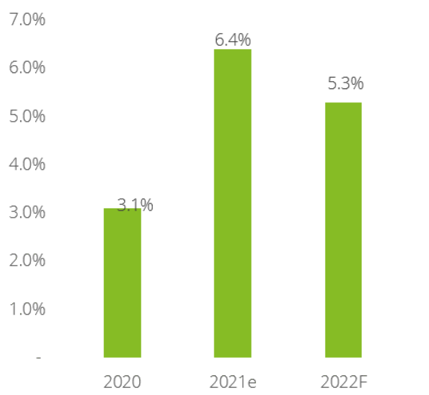
East Africa's GDP grew by 6.4% in 2021 from 3.1% in 2020 attributed to the global economic recovery from the COVID-19 pandemic. GDP growth is expected to moderate to 5.3% in 2022 due to political instability and unreliable rainfall, reducing agricultural yields.

Real GDP growth in major SSA economies



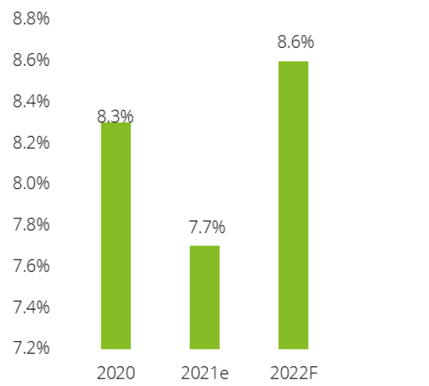
Source: World Bank, IMF, EIU, AFDB

East Africa real GDP growth



Source: World Bank, IMF, EIU, AFDB

East Africa Inflation



Source: World Bank, IMF, EIU, AFDB

EA's GDP rebounded by 6.4% in 2021, up from 3.1% in 2020 driven by growth in the agriculture, manufacturing, construction and services sector. However, the EA GDP is forecasted to decrease to 5.3% in 2022 as a result of political instability in Kenya and Ethiopia, the major economic growth drivers in the region, and reduced agricultural sector growth.

Inflation is forecasted to increase to 8.6% in 2022 from 7.7% in 2021 driven by elevated global food and energy prices, amid Russia's invasion of Ukraine. In May 2022, global wheat prices increased by 48.6%, maize by 28.7% and rice by 9.3% compared to pre-war January prices. The rise in fuel and food prices has negatively affected household spending, especially poor ones, on essential food and non-food items. The monthly price of the local food basket reached USD 17 per capita across the EA countries in May 2022, from USD 12.2 in May 2021, a 39.3% increase.

Foreign direct inflows to the East Africa region increased by 34.9% to USD 8.2b in 2021 from USD 6.1b in 2020 when the COVID-19 pandemic weighed heavily on investment flows to the region. Inflows to Ethiopia reached USD 4.3b, mainly due to a tripling of Chinese investment while FDI to the United Republic of Tanzania rose by 35 per cent to USD 922m.

In the fiscal year 2021/22, the combined government development expenditure, as per countries' budgets, amounted to USD 22b, up from USD 19b in the fiscal year 2020/21. The sustained government development expenditure is expected to drive growth in the construction sector from 6% in 2021 to 9% in 2022.

International tourism receipts in the EAC region rebounded by 13.9% in 2021, reaching USD 5.0b from USD 4.4b in 2020, primarily driven by withdrawal of lock-down restrictions and resumption of global travel activities. International receipts are expected to increase by 62.4% in 2022 driven by lifting of the COVID-19 pandemic restrictions.

Notably, in March 2022, the Democratic Republic of Congo historically joined the East African Community(EAC) becoming the 7th partner state. This is expected to increase intra-EAC trade, further deepening economic integration in the region.

The Global Economy

Select global macroeconomic indicators

- The ongoing Russia-Ukraine conflict is expected to last over the course of 2022. Amid resistance from Ukraine's forces, Russia has changed its primary objective from the full subjugation of Ukraine to the containment of Ukraine's eastern territories. Their economic resilience notwithstanding, Russia's and Ukraine's economies are expected to contract by 6.0% and 35% respectively in 2022.
- Global debt (government and non-financial corporations) increased by USD 3.3tn in Q1 2022, to reach a record USD 306tn. In 2022, global government debt is expected to increase to USD 72tn in 2022 from USD 65tn in 2021 driven by increased borrowing in Japan, the United States and China.
- Consequently, debt servicing costs are expected to increase by 14.5% to reach USD 1.2tn in 2022, on the back of rising interest rates and the impact of inflation on index-linked debt instruments.
- Growth prospects for global merchandise volume in 2022 were marked down from 4.7% to 3.0% after factoring in the supply shocks arising from the Russia-Ukraine conflict.
- Although the value of global trade increased by USD 1tn to USD 7.7tn in Q1 2022 from Q1 2021, downside risks stemming from rising central bank policy rates, winding down of economic stimulus packages, and the zero COVID-19 pandemic strategy adopted in China, are expected to preside over the decelerated growth in trade in the full year 2022.
- GDP growth in developed countries is expected to decline from 5.2% in 2021 to 2.5% in 2022 on account of:
    - Declined economic growth in the United States due to reduced household purchasing power and tighter monetary policy that has limited credit uptake growth; and
    - Slower economic growth in Europe's leading economies stemming from the negative economic spillovers from the Russia-Ukraine conflict.
- GDP growth among emerging markets and developing countries is expected to decline to 3.6% in 2022 compared to 6.8% in 2021 mainly attributable to:
    - Soaring new COVID-19 cases in China, which averaged circa 5k daily at end of March 2022, alongside the strict zero COVID strategy, is expected to cause recurrent mobility restrictions and suppress private consumption in China. This, coupled with protracted financial distress in the country's real estate sector due to the industry's highly leveraged position is set to see China's GDP growth decline from 8.1% in 2021 to 3.3% in 2022; and
    - Monetary policy tightening in response to increasing consumer price inflation from an average of 5.7% in 2021 to 9.5% in 2022.

Global industries overview

Global GDP grew by an estimated 5.9% in 2021 primary driven by the recovery of various industries. A continued impetus for growth among global industries will be blunted by the impact of the Russia-Ukraine conflict, consequently moderating global GDP growth to 4.4% in 2022.

Consumer

Global airlines reported a loss of USD 51b in 2021 compared to the loss of USD 137b reported in 2020. However, government fiscal support has prevented a crisis in the aviation sector, with over USD 240b going towards reducing losses in the sector since the advent of COVID-19. The airline industry is expected to report robust recovery in 2022, with passenger revenues expected to improve from USD 239bn in 2021 to 498bn in 2022, reflective of a 108.4% increase. Overall industry financial performance is expected to reach USD 782bn, which is 93.3% of 2019 pre-pandemic industry revenues. The accelerated recovery is mainly attributable to release of pent-up demand following the easing of travel restrictions,

The global tourism industry experienced a faster than expected recovery as tourist arrivals stood at 117m in Q12022 compared to 41m in Q12021, reflective of a 182% increase buoyed by the opening of travel destinations and release of pent-up demand from 2021. A sustained recovery momentum is set to see a 90% to 140% improvement in tourist arrivals numbers in 2022 compared to 2021. This will see the sector achieve circa 55% to 70% of 2019 industry performance levels in 2022. Subsequently, majority industry sentiment expects a full recovery of the sector in 2023.

Earlier forecasts expected the global automobile industry to grow by 3.7% in 2022 compared to 5.3% in 2021, to reach 82.4m vehicle sales. However, factoring in the impact of supply chain disruptions pegged to the Russia-Ukraine conflict as well as declining consumer purchasing power, the automotive industry is expected to see a 4.4% decline in vehicle sales in 2022.

Energy resources and industrials

Global oil supply shocks arising from the Russia Ukraine conflict alongside declining global oil refinery throughput are expected to increase oil prices to USD 104 per barrel in 2022 compared to USD 79 per barrel in 2021. Year to date (30 June 2022), brent crude oil prices had increased by 42% compared to 34% in the corresponding period in 2021. European countries have commenced weaning themselves off of Russia's liquefied petroleum gas (LPG) imports, which constitute more than 40% of the European Union's LPG imports. A full halt to Russian LPG imports is expected to result in a shortage of up to 40% of annual consumption in Central and Eastern Europe mainly due to insufficient import capacity and transmission bottlenecks limiting the pursuit of alternative sources of LPG from other source markets.

Financial services

The performance of banking institutions was resilient in the face of a post-COVID-19 pandemic world as credit losses reduced from USD 2.1tn in 2020 to an estimated USD 635b in 2021, reflective of a 230.7% decline. The improved performance is expected to continue in 2022 with credit losses expected to reduce further by 8.5% to reach USD 585b in 2022 driven by global economic recovery, growth of private businesses and improved stability in personal disposable income. Withdrawal of accommodative monetary policies by governments is also expected to improve profitability amid an increase in interest rates.

Consolidated insurance premiums rebounded by 3.3% in 2021 with a subsequent 3.9% growth expected in 2022 compared to a decline of 1.3% in 2020. The growth prospects are primarily driven by global life insurers who benefitted from heightened consumer risk awareness due to COVID-19.

Technology media, and telecommunications

The increasing development of smart cities and increasing investment in wireless communication technology in emerging markets is expected to drive the global telecommunications industry by 27.8% in 2022 to reach USD 3.5tn from USD 2.7tn in 2021.

Global entertainment and media industry is estimated to have reached USD 2.2tn in 2021 up from USD 2.0tn in 2020, as revenue from live entertainment and sports supplemented earnings from streaming services. The industry is expected to further expand to USD 2.3tn in 2022 owing to improving profitability of companies in the sector with circa 70% of firms in the sector expected to report revenue growth of above 10% in 2022.

Government and public services

Low interest rates fueled by accommodative policies and persistent uncertainty raised by new COVID-19 variants saw governments and non-financial corporations borrow USD 303tn globally compared to USD 226tn in 2020. The increase in global debt primarily came from emerging markets, who accounted for 80% of the increase from 2021.

However, the global debt to global GDP ratio reduced from 360% in 2020 to 351% in 2021 driven mainly by a revamped global economy.

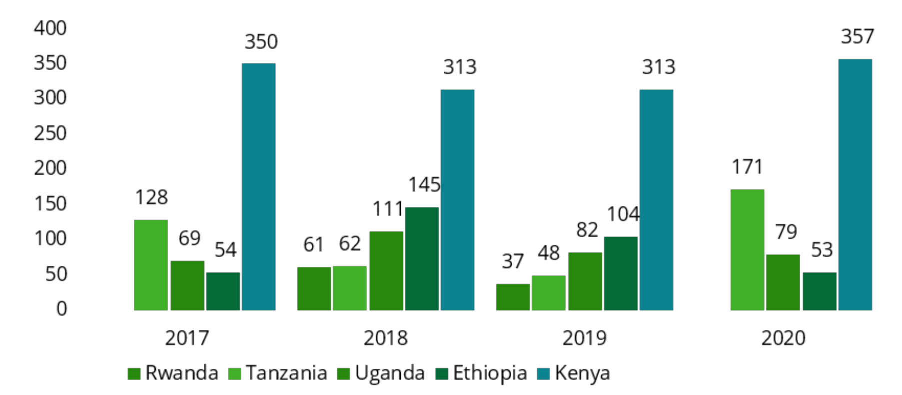
Life sciences and healthcare

The global pharmaceutical market is expected to grow from USD 1,454.7b in 2021 to USD 1,587.1b in 2022 driven mainly by recovery from the impact of restrictive containment measures brought on by the COVID-19 pandemic. Further growth prospects are expected to arise from the easing of supply chain bottlenecks for COVID-19 vaccines with production capacity expected to increase from 8.5b doses in 2021 to over 40b doses in 2022.

East Africa's Macroeconomic Overview

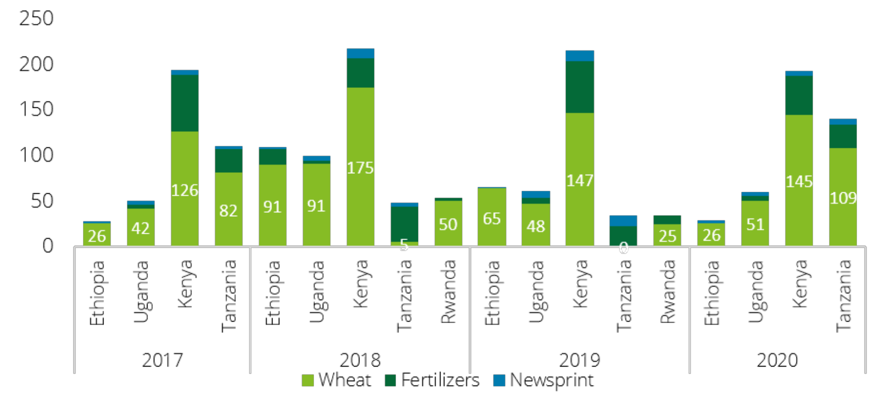
Sanctions imposed on Russia, which is a significant player in the global agricultural and energy products trade has led to supply chain disruptions and export restrictions to the East African economies, which have manifested through elevated inflation, expected to last the duration of the conflict

East Africa Import value from Russia (USD, m)



Source: UN Comtrade

Top 3 imports from Russia by value (USD)



Source: UN Comtrade

The East African economies are reliant on Russia for trade, with 2020 realising a combined import value from Russia of USD 660m for Kenya, Uganda, Tanzania and Ethiopia. Although this was a small fraction in comparison to the import value of USD 50b from the rest of the world, a significant proportion of critical inputs was sourced from Russia.

The largest quantity of products imported from Russia were wheat, fertilizers and newsprint. Wheat was however the largest, accounting for 50.2% of total imports from Russia in 2020.

Following the sanctions imposed on Russia by the international community, we expect that the global supply of these products will decline, causing a shortage and subsequently, price surges.

The East African countries, being net importers, are expected to experience a two-fold upward pressure on prices, driven by supply side shortages and global inflationary movements.

The brunt of this impact is expected to be felt in Kenya, which has the largest proportion of imports from Russia among the four countries.

An indirect impact of the conflict is anticipated in the energy sector, as the East African countries do not directly import a significant quantity of petroleum from Russia.

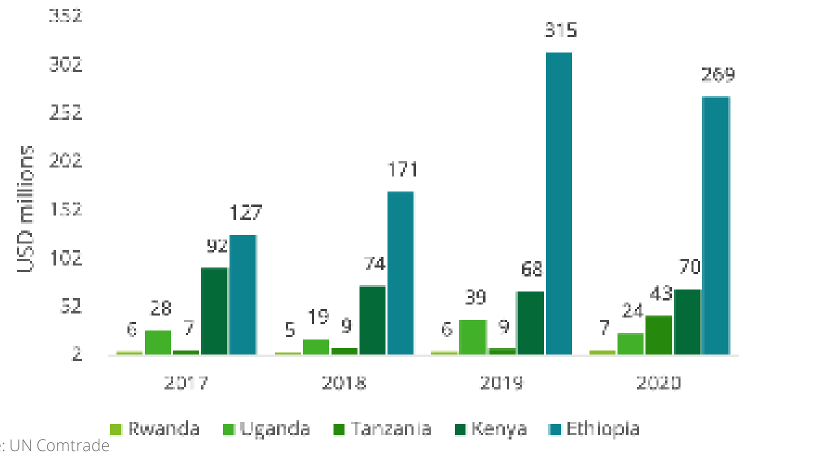
The country is the third largest oil producer globally and a significant exporter of natural gas, with the United Nations placing its daily exports at 7 million barrels a day.

Trade sanctions imposed would leave global economies competing for far less oil and as a result, price spikes are expected to last the duration of the sanctions.

East Africa's Macroeconomic Overview

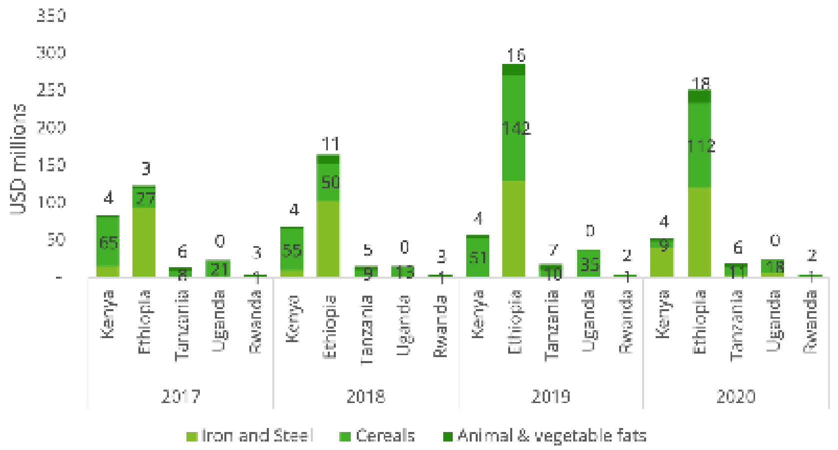
Following the invasion of Ukraine and the country's critical infrastructure, the supply chain for commodities imported by the East African economies were disrupted, posing a threat to a crucial source market for East Africa.

East Africa import value from Ukraine



Source: UN Comtrade

Top 3 imports from Ukraine by value



Source: UN Comtrade

The East African economies were similarly reliant on Ukraine with trade values amounting at USD 414m in 2020. Ethiopia was far more reliant on Ukraine, recording the highest import value, at USD 269m in 2020. This was USD 199m more than what Kenya imported in the same year from Ukraine.

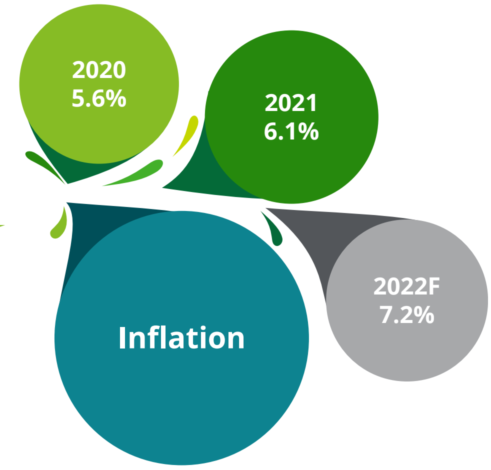
Like with Russia, the trade profile was fairly similar across East Africa, with the largest quantity of products imported being iron & steel, cereals and animal, vegetable & microbial fats and oils.

Invasion of Ukraine caused supply chain disruptions as critical infrastructure such as roads and ports were either destroyed or occupied by Russia. In addition, crucial service providers such as logistics companies ceased providing services in Ukraine, making it difficult to supply the commodities to East Africa.

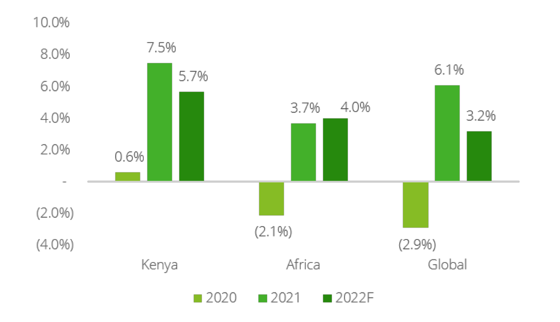
Kenya Macroeconomic & Sectoral Analysis

Kenya
Economy at a glance

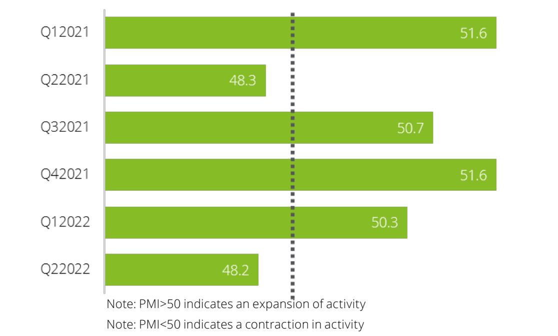
Increased cost of fuel and food as well as the withdrawal of the COVID-19 tax relief measures saw Kenya's inflation average 6.1% in 2021. Increasing commodity prices due to the Russia-Ukraine conflict are expected to drive inflation to 7.2% in 2022.



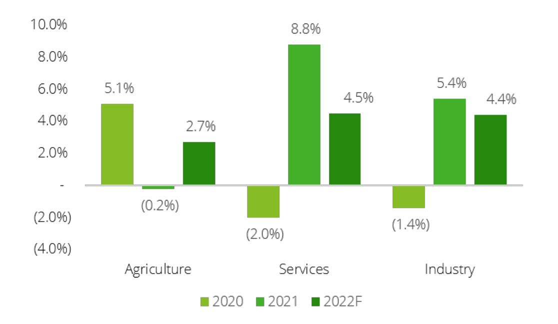
Real GDP growth rate



Kenya PMI



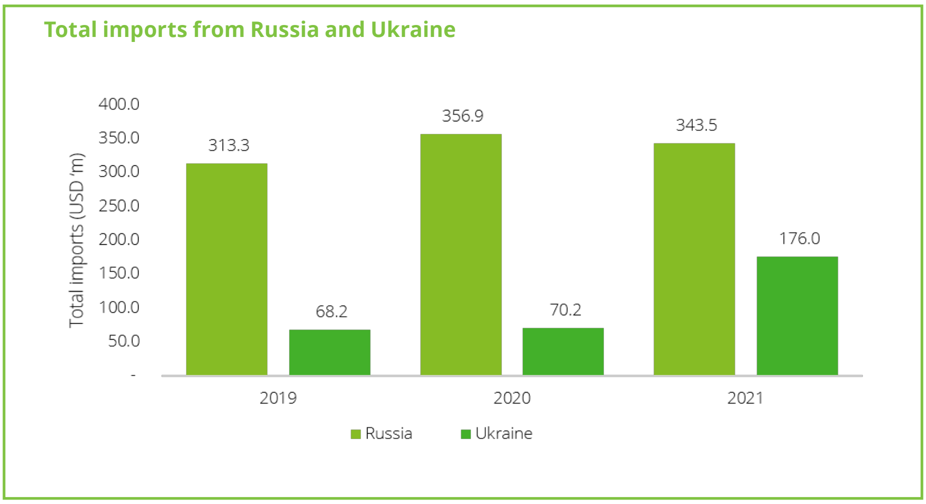
Sectoral growth

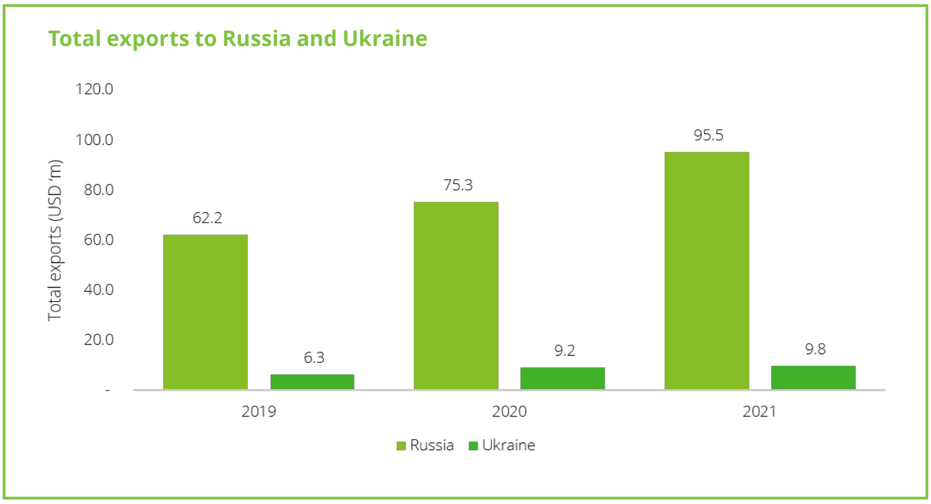


Source: Kenya National Bureau of Statistics (KNBS), UNComtrade

- Kenya's real GDP grew by 7.5% in 2021, which was 1.2% higher than the projection in Our vol.2 publication. The economic recovery was driven by strong private investment and consumption. GDP growth is expected to decline to 5.7% in 2022, owing to a wider global economic slowdown, heightened uncertainty linked to the August general elections and tighter fiscal policy.
- Kenya's debt to GDP ratio rose from 68.0% in 2020 to an estimated 70.0% in 2021 and is forecasted to reach 72.0% in 2022 due to the contraction in government income.
- Kenya's foreign exchange reserves declined to USD 8.0b (4.6 months of import cover) in June 2022 from USD 9.5b (5.5 months of import cover) in December 2021 due to elevated external debt repayments.
- The Kenyan shilling weakened against the United States Dollar (USD) to KES 109.6/USD on average in 2021, driven by a wider current account deficit. In June 2022, the shilling traded at KES 117.3/USD and is expected to weaken further to KES 119.9/USD by end-2022, exacerbated by elevated global oil prices owing to global inflation and the uncertainty linked to the August elections.
- The Central Bank Rate (CBR) was retained at 7.0% in 2021 to support credit access by borrowers especially Micro, Small and Medium Enterprises ("MSMEs") distressed by the COVID-19 pandemic. The CBR was raised to 7.5% in May-2022 owing to inflationary pressures rising from commodity price hikes and supply-chain disruptions.
- Kenya's current account deficit widened slightly to 5.4% of GDP in 2021, 0.6% higher than the projection as at the time of Our vol.2 publication. The current account deficit is expected to widen further to 5.8% in 2022 owing to fiscal pressures ahead of the August election and elevated debt service payments.
- Foreign Direct Investment (FDI) inflows to Kenya declined by 60.0%, from USD 716.8m in 2020 to USD 448.1m in 2021. FDI inflows are forecasted to increase by 81.4% in 2022, reaching USD 1.3b, driven by rising investment by private equity firms, multilateral institutions and bilateral investment bodies.

Impact of the Russia-Ukraine conflict





Source: Kenya National Bureau of Statistics (KNBS), UNComtrade

Russia is a major global producer of oil, energy and agricultural commodities. Sanctions against Russia following its invasion of Ukraine have led to increased global oil and commodity prices, which is bound to have negative effects on the Kenyan economy

Russia and Ukraine are key trade partners for Kenya, with total imports from the two countries standing at USD 519m and total exports at USD 105.2m in 2021.

Wheat imports from Russia and Ukraine stood at USD 106.4m and USD 78.3m respectively in 2021, accounting for 32.5% of total wheat imports. The ongoing conflict has led to disruption of trade linkages and supply chains leading to shortages in the market and exponential increases in these commodities' prices.

The construction sector has also been affected by the increase in the prices of cement and iron sheets, owing to high fuel costs and rising global costs of raw materials.

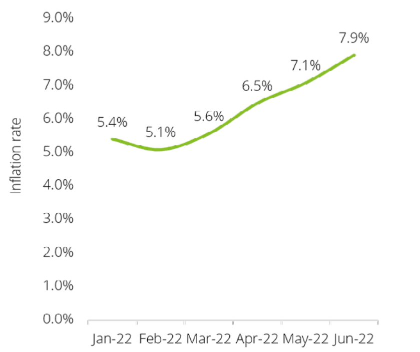
Russia is the largest importer of Kenyan products, including cut flowers, tea, coffee, fruits and vegetables. The conflict implies that the export market will be substantially subdued leading to lower export earnings.

Sanctions against Russia have resulted in a global shortage of oil supply thus driving up fuel costs exponentially. In April 2022, Kenya experienced a fuel shortage that turned into a crisis owing to supply hitches by Oil Marketing Companies ("OMCs") hoarding fuel over delays by the government to compensate them for selling fuel at subsided prices. The OMCs have opted to prioritise more attractive export markets at the expense of the local market, a move that will exacerbate the crisis as global oil prices continue to soar.

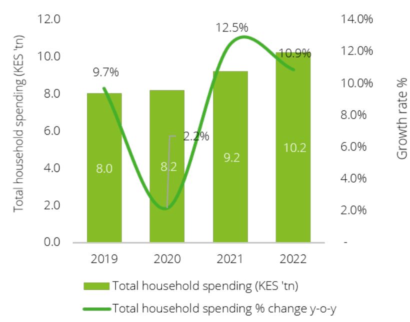
Ripple effects stemming from the conflict, inflationary pressures and supply-chain disruptions have resulted in heavy foreign outflows in the Nairobi bourse. Further, the conflict has added extra pressure on the weakening Kenya Shilling (KES), exposing the country to higher debt repayments since nearly half of the total amount borrowed is denominated in foreign currency.

Inflation – The debacle of the year 2022

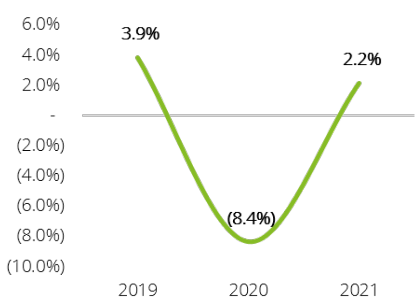
Kenya inflation rate



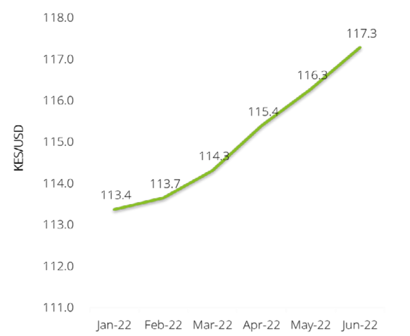
Total household spending



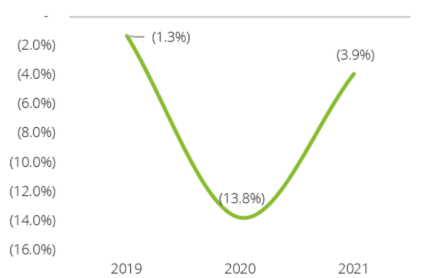
Kenya real annual wages growth rate



Kenya (KES-USD) exchange rate



Kenya real annual wages growth rate adjusted for inflation



Source: Kenya National Bureau of Statistics (KNBS), Central Bank of Kenya

Kenya's inflation soared to 7.9% in June-2022 from 5.1% in February-2022, driven by rising global prices of key foodstuffs including wheat and cooking oil, rising fuel prices and sub-standard rains during the March to May wet season. Despite ongoing subsidies, fuel prices surged by 25-30% year-on-year in June-2022, putting upward pressure on the price of most goods and further stretching household budgets.

The inflationary pressure is expected to be amplified by tax rises imposed in July-2022, with consumer inflation expected to skyrocket to the 8-8.5% range in the third quarter of 2022, eroding consumer purchasing power.

In May 2022, the Monetary Policy Committee ("MPC") raised the CBR by 50 basis points to 7.5%, the highest increase since July 2015, to further anchor inflation expectations amid the price pressures. The move is expected to curb rising inflation and stabilise the depreciating shilling.

The shilling weakened to KES 117.3/USD in June-2022 on average (8.8% weaker year-on-year), further magnifying the inflationary surge, given the country's reliance on imports, especially for fuel, fertilisers and a wide range of foodstuffs.

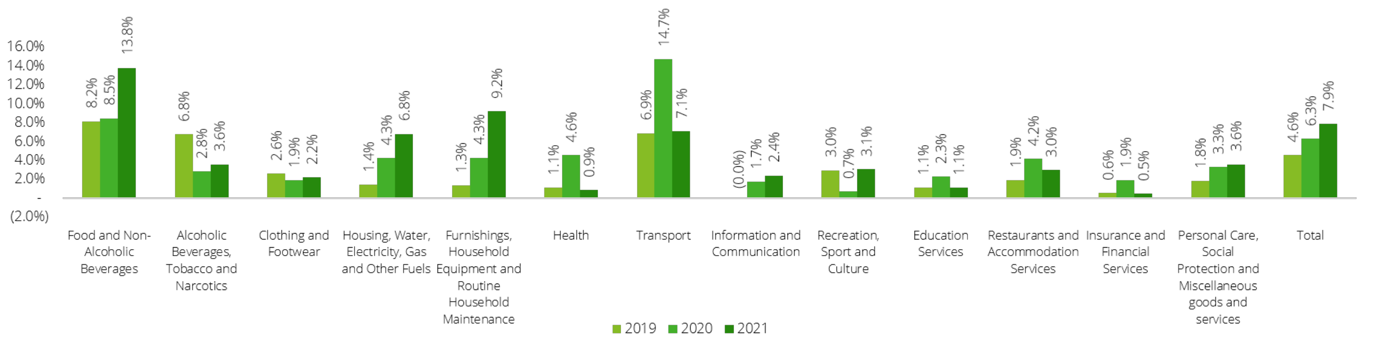
7.9%
Kenya's inflation rate as of June 2022

Cooking oil prices surged at the highest rate of 51.7% to an average of KES 388.0/litre in June-2022 from KES 255.8/litre in June-2021, while a 2-kilogramme packet of wheat flour averaged KES 186.9, a 44.2% increase. A litre of kerosine rose by 30.5% to KES 128.9, diesel rose by 29.8% to KES 140.9 and petrol by 25.0% to KES 159.9 in June-2022 compared to June-2021.

The country is expected to face further price pressures on food in the coming months owing to the rising global wheat and maize prices and reduced maize production due to elevated fertiliser costs and poor rainfall.

Impact of inflation on the Kenyan consumer

Commodities % change in prices year-on-year



Division of commodities	2019	2020	2021
Food and Non- Alcoholic Beverages	32.9%	32.9%	32.9%
Housing, Water, Electricity, Gas and Other Fuels	14.6%	14.6%	14.6%
Transport	9.7%	9.7%	9.6%
Restaurants and Accommodation Services	8.1%	8.1%	8.1%
Information and Communication	7.8%	7.8%	7.8%
Education Services	5.6%	5.6%	5.6%
Personal Care, Social Protection and Miscellaneous goods and services	4.5%	4.5%	4.5%
Furnishings, Household Equipment and Routine Household Maintenance	3.7%	3.7%	3.7%
Alcoholic Beverages, Tobacco and Narcotics	3.3%	3.3%	3.3%
Clothing and Footwear	3.0%	3.0%	3.0%
Health	2.9%	2.9%	2.9%
Insurance and Financial Services	2.2%	2.2%	2.2%
Recreation, Sport and Culture	1.7%	1.7%	1.7%
Total	**100.0%**	**100.0%**	**100.0%**

Total household spending is expected to grow by 10.9% in 2022, a deceleration from the 12.5% growth recorded in 2021, driven by high base effects and higher commodity prices. The elevated inflation, stemming from high food and fuel prices is expected to weigh heavily on consumer purchasing power.

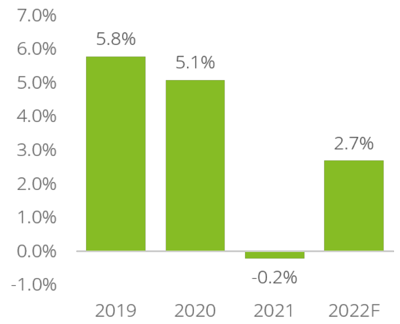
In addition, monetary tightening policies by the Central Bank of Kenya are expected to raise borrowing costs for households, resulting in lower disposable income as households allocate more of their income to debt payment.

The rise in the cost of essential commodities is expected to further narrow the shopping basket of households who have already been forced to cut on non-essential spending amid negative growth in real wages. Real annual wage growth adjusted for inflation stood at -3.9% in 2021 compared to -13.8% in 2020.

Source: Kenya National Bureau of Statistics (KNBS)

Agricultural sector

Kenya Agriculture Sector performance



Source: Kenya National Bureau of Statistics (KNBS)

- Kenya's agriculture sector contracted by 0.2% in 2021, down from a 5.1% growth in 2020 due to adverse weather conditions in most parts of the country. This was a negative change compared to the 6.8% growth we had forecasted in Our Vol.2 publication.
- Agriculture is expected to grow by 2.7% in 2022 driven by government subsidies on fertilisers and strengthening external demand. The general elections in August, Russia-Ukraine conflict and a poor weather outlook present potential downside risks to the growth forecast in 2022.
- Despite the expected growth across all agricultural commodities, Kenya is expected to remain a net importer of corn, wheat and sugar exposing the sector to supply chain disruptions and price shocks from the ongoing Russia-Ukraine conflict.
- The Russia-Ukraine conflict is expected to have an indirect impact on Kenya's agriculture sector that will be reflected in higher commodity prices, rather than an actual shortage of the commodities. Wheat imports from Russia and Ukraine stood at USD 106.4m and USD 78.3m respectively in 2021, accounting for 32.5% of total wheat imports. The global price of wheat per tonne has since increased from USD 315/MT on average in 2021 to USD 460/MT in June 2022.
- Russia is the fourth-biggest buyer of Kenyan tea (4.1% of total tea exports), having taken up produce worth USD 48.9b in 2021. Tea is a key foreign exchange earner for Kenya hence this could worsen the current account deficit and reduce foreign exchange earnings.
- The Russia-Ukraine conflict caused further disruptions to the global fertiliser industry that was already distressed owing to global supply chain shortages. This was due to fertiliser producer countries such as China restricting exports to protect their industries. Kenya imported an estimated 13.4% of fertiliser from Russia in 2021. Fertiliser prices for 50kg bags are expected to increase from an estimated KES 4k in 2021 to KES 6k on average in 2022. Higher fertiliser prices are expected to greatly compromise productivity and employment in the agriculture sector.

Tourism sector

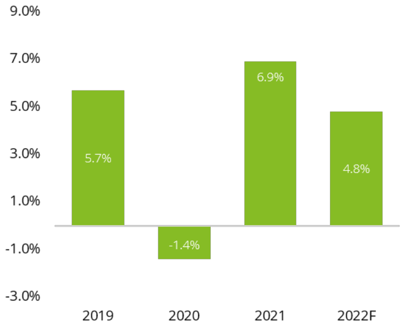
Kenya Tourism sector performance

Source: Kenya National Bureau of Statistics (KNBS), Kenya Tourism Board (KTB) EIU, Fitch Solutions

- Kenya's tourism sector recorded a strong recovery, with international tourism receipts increasing from KES 57.8b in 2020 to KES 70.8b in 2021, driven by easing of COVID-19 pandemic restrictions as a result of the increased vaccination rates. Tourism earnings are forecasted to surge to KES 128.2b in 2022, supported by the active domestic tourism segment, the country's competitive tourism offering and a fast-growing business travel segment.
- International arrivals increased from 579k visitors in 2020 to 871k in 2021, a 50.3% increase, owing to the reopening of Kenya's source markets and relaxation of travel restrictions. This was 8.1% higher than the 806k arrivals projection we had indicated in Our Vol.2 publication; reflecting regained consumer confidence for Kenya as a top tourist destination. However, tourist arrivals are still lower than the 2019 levels, which stood at 2.0m visitors.
- The diversity of Kenya's top 10 inbound arrivals bodes well for the recovery of the tourism sector by lessening reliance on any one region. Arrivals through Jomo Kenyatta International Airport and Moi International Airport increased from 71.3k in November-21 to 82.9k in December-21 reflecting a gradual resumption of travel activities in the country.
- The tourism sector is expected to have robust growth in 2022, with annual arrivals shooting up to 1.1m visitors, supported by the country's well-developed tourism infrastructure and extensive air travel connections to key source markets in Europe and USA. Growth will also be driven by the competitive tourism offering, comprising safari and beach holiday destinations.
- Re-emergence of new COVID-19 variants in China coupled with the prevailing political environment in Kenya may stunt growth prospects in 2022. Following the successful launch of the Magical Kenya marketing initiative, the Government must continue to implement similar initiatives and diversify the tourism offering to sustain momentum in the recovery of the still fragile tourism sector.
- The Russia-Ukraine conflict poses a threat to international arrivals forecasts as Ukraine was among the new markets the country was looking to tap into post-Covid-19 pandemic recovery.

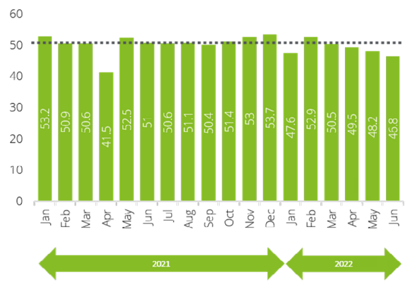
Manufacturing sector

Kenya Manufacturing sector performance



Source: Kenya National Bureau of Statistics (KNBS), Kenya Association of Manufacturers (KAM) EIU, Fitch Solutions

Kenya PMI Index performance



Note: PMI>50 indicates an expansion of activity
Note: PMI<50 indicates a contraction in activity

Source: Kenya National Bureau of Statistics (KNBS), Kenya Association of Manufacturers (KAM) EIU, Fitch Solutions

The manufacturing sector posted a strong growth of 6.9% in 2021 from a 1.4% contraction in 2020, driven by the rebound in private consumption from a contraction of 2.7% in 2020 to a growth of 7.4% in 2021. Growth is expected to slow down to 4.8% in 2022 attributable to the increase in the price of imported raw materials arising from global inflation and the global oil crisis.

Credit advanced to enterprises in the manufacturing sector increased by 8.7% from KES 1.2tn in Q32020 to KES 1.3tn in Q32021 reflecting a robust rebound in the sector.

The Kenya Association of Manufacturers' ("KAM") priority agenda in 2022 is focused on enhancement of competitiveness and levelling of the playing field for manufacturing stakeholders, enhancing local and regional market access, creating a favourable policy environment for SMEs to flourish and creation of pro-industry policy and institutional framework.

The initiative by KAM is expected to drive the increase in volumes of Kenyan manufactured exports, bridging the balance of trade deficit that has seen the country remain a net importer.

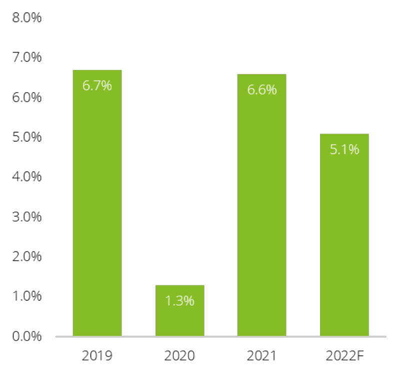
The average PMI in 2021 stood at 50.8, which was above 50, reflecting an expansion in economic activities in the private sector. The growth was primarily driven by:

- A rise in employment due to increased demand for labour;
- An expansion in supplier capacity and stronger competition among vendors, shortening overall delivery times; and
- An increase in purchasing activity owing to stronger cash flows in the economy.

The PMI fell below the 50.0 neutral mark for third consecutive month in June 2022, falling to 46.8 from 48.2 in May 2022, pointing to contraction in the country's private sector. The decline was driven by rising inflation, which resulted in subdued demand from consumers amid rising price pressures and a contraction in output by producers. Input costs and selling charges increased at a steady rate, driven by higher fuel prices, supply shortages and a strengthening USD.

Construction sector

Kenya construction sector performance



Source: Kenya National Bureau of Statistics (KNBS), EIU, Fitch Solutions

Kenya's construction sector posted a strong recovery of 6.6% in 2021 driven by the resumption of the construction of major infrastructure projects and pro-investment policies. The expected rise in the cost of imported raw materials owing to global inflation and the Government's fiscal consolidation efforts are expected to weigh in on infrastructure investment, slowing down growth to 5.1% in 2022.

Demand for infrastructure is expected to remain resilient, driven by the growing middle class, expanding population, urbanisation and Kenya's economic diversification agenda, which is aimed at establishing the country as a gateway to East Africa and cementing Kenya as a regional trade and logistics hub. The corresponding need for improved transport logistics has given rise to large-scale infrastructure projects.

Cement production increased from 7,406.9k MT in 2020 to 9,270.6k MT in 2021, with consumption rising from 7,312.7k MT to 9,126.2k MT over the same period, reflecting a continued resumption of construction activities in the country.

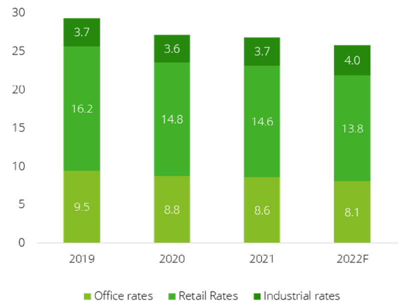
Amendments to the Public Private Partnership Act in December 2021 ("the Act), setting fit-for-purpose laws for the participation of the private sector in development projects are expected to attract foreign investment, underpinning growth prospects of the construction sector in 2022.

The Act is expected to create a conducive business environment by establishing a single national pipeline of PPP projects under the Directorate of PPPs. This will enhance efficiency in the regulatory process, improve public trust, boost investor confidence and drive local financial institutions' involvement and participation in PPPs.

The re-prioritised PPP pipeline targets to unlock an estimated KES 350b in new development capital for priority projects in 2022.

Real estate sector

Kenya real estate sector rental yield (USD/sqm)



Source: Kenya National Bureau of Statistics (KNBS), EIU, Fitch Solutions

Kenya's real estate sector has been in turmoil in recent years owing to a supply bias and waning demand due to the global economic slowdown and financing restrictions as the GoK's fiscal consolidation efforts weigh on funding access.

The residential and industrial subsectors of the real estate market are expected to drive the sector's growth owing to the resumption of private investment amid the new normal. The remote/hybrid working model which continues to be embraced by some companies is expected to continue to weigh down the overall occupancy rates of commercial office spaces. Notably though, the shift to a hybrid working model by companies who had adapted the full remote working model will help boost commercial office occupancy rates in 2022.

In 2017, the World Bank estimated that Kenya had a housing deficit of 2m units, with 61% of city-based households living in unofficial, poor-quality slum housing. In the same year, the GoK embarked on an ambitious programme aimed at building 500k affordable housing units as part of the Big Four Agenda. As of 2021, there were 21.6k affordable housing units in Nairobi, with several others currently under construction.

6.8%

Average rental yield from retail property in 2021

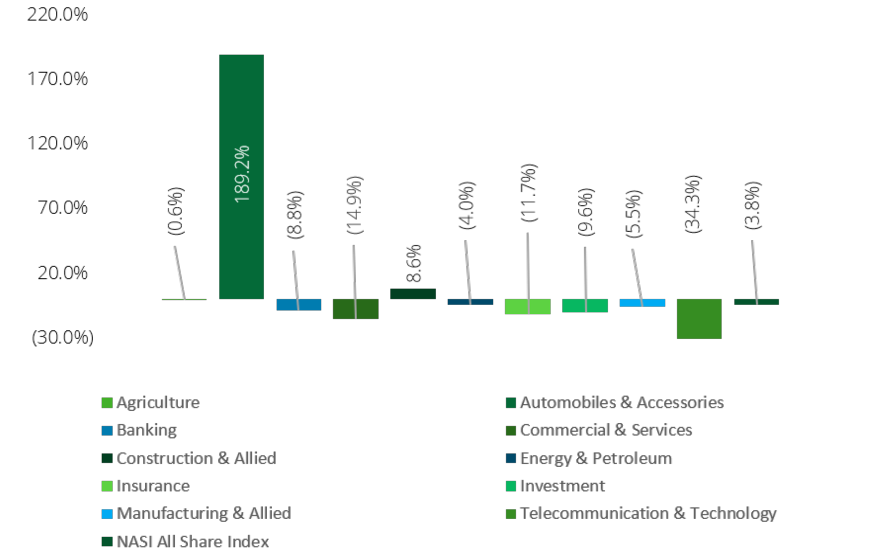
The office property subsector has continued to experience lengthened periods of rental rate decline. This is attributable to the unfavourable mismatch between supply and demand and cost savings measures by investors as they adopt a cautious approach amid the uncertainty linked to general elections and global headwinds. Rental rates for office spaces declined from USD 8.8/sqm in 2020 to USD 8.6/sqm in 2021, pointing to an oversupply of office spaces and the declining performance of commercial entities due to the COVID-19 pandemic.

Across Kenya's four cities, the retail property segment registered increased market activities, evidenced by the aggressive expansion by major local and international retailers. The retail subsector recorded an increase in average rental yields from USD 15.1/sqm in 2020 to USD15.3/sqm in 2021. Growth in the retail subsector was driven by improved infrastructure developments, aggressive expansion by local and international retailers, improvement in the ease of doing business and affordability of retail spaces.

The industrial property segment recorded marginal increases in rental property rates, driven by a steady increase in trade volumes that boosted demand for the industrial stock. The GoK's investment drive into the manufacturing sector and integration of new industrial-economic zones is expected to spur demand for industrial spaces in 2022.

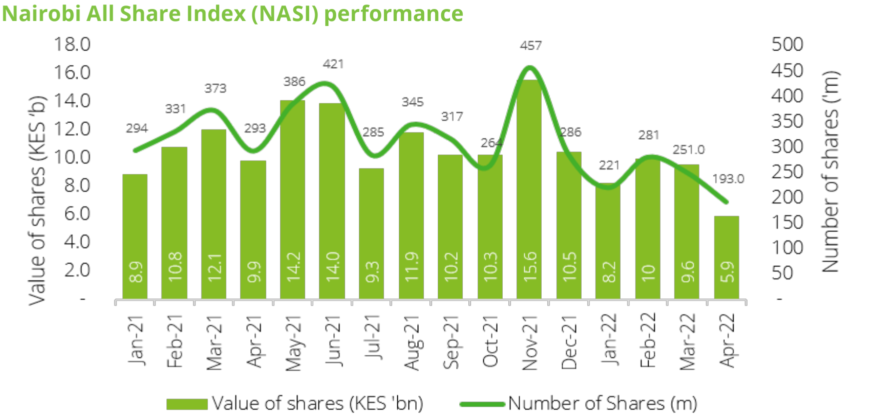
Financial services sector
Equity Markets

NASI YTD (as of 30 June 2022) performance by sector



Source: Kenya National Bureau of Statistics (KNBS), S&P Capital IQ

Nairobi All Share Index (NASI) performance



Source: Kenya National Bureau of Statistics (KNBS), S&P Capital IQ

The domestic capital markets remained resilient despite the COVID-19 pandemic, driven by measures implemented by the Government to stimulate economic recovery as well as positive investor sentiments.

KES 1.9tn

Market capitalisation at the NSE as of 30 June 2022

After falling by 29.6% in 2020, the benchmark NSE 20-Share Index stabilised in 2021, gaining 1.8% in the year. However, the index has fallen by 12.8% in the YTD22 period, the third worst performance of any primary stock market in Africa since January 2022, owing to foreign investor capital flight in the wake of elevated interest rates in developed markets that are currently facing rising inflation.

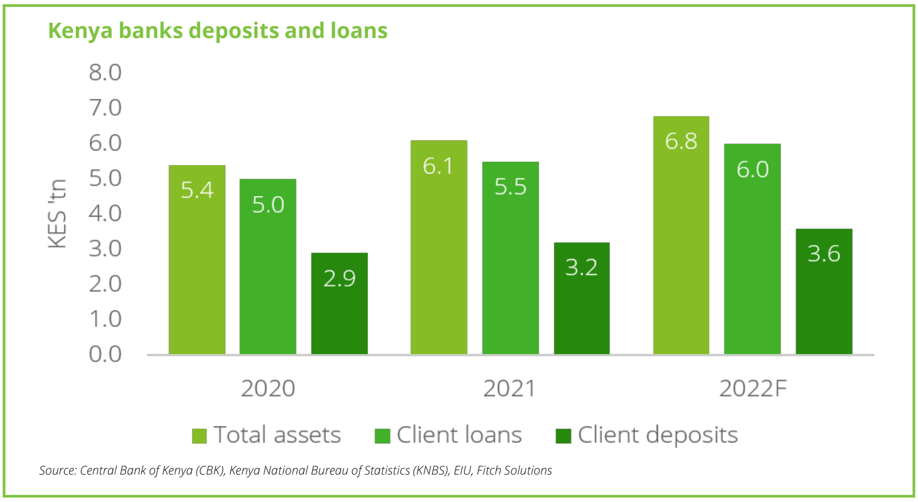
As of 30 June 2022, the three largest contractions in YTD performance were witnessed in telecommunications and technology, commercial and services, and insurance sectors, that posted a contraction of 34.3%, 14.9% and 11.9% respectively. Conversely, the most significant growth was witnessed in the automobiles and accessories sector, that posted a growth of 189.2%. The market's average price to earnings ratio (P/E) stood at 18.6x as of 30 June 2022, 100.0% above the 9.3x ratio as of 30 June 2021.

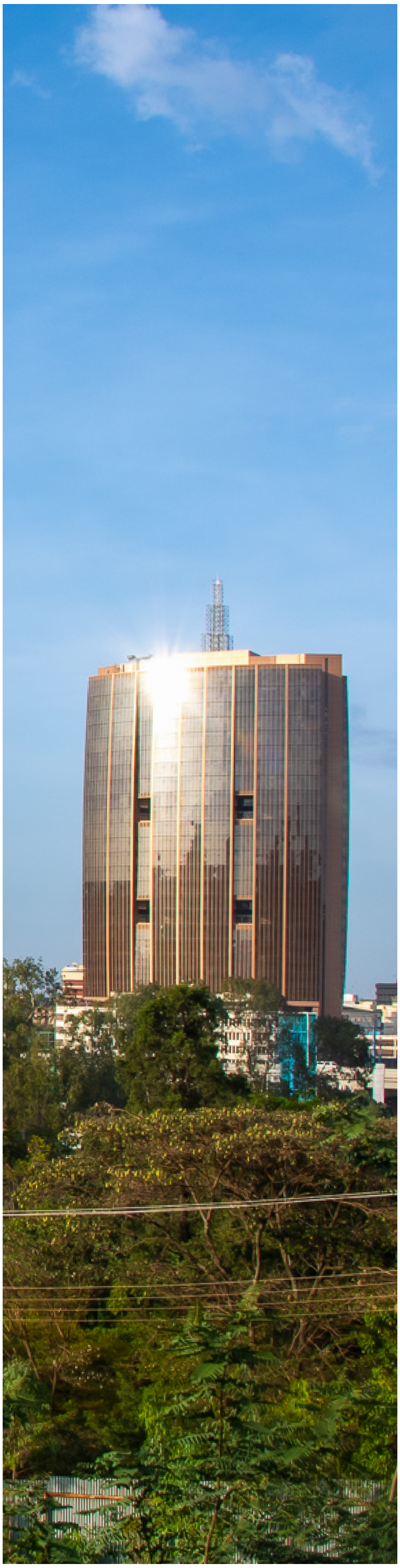
Kenya recorded its worst performance among African countries in terms of Initial Public Offerings ("IPOs") in 2021, with the drought of transactions now in its seventh year. IPOs have been a challenge in Kenya owing to public scrutiny, high cost of compliance and loss of control hence not the desired route for P.E. exits. To revive IPO activity, it will be imperative to review the stringent regulatory framework, privatise some of the state corporations through listing and support growth of entrepreneurial companies.

The NSE stepped up its push for the sale of additional government stake in Safaricom and other state-owned entities in April 2021. The state has the potential to raise KES 792.6b from the sale of stakes in listed firms including Kenya Re, KCB and KenGen.

Catalytical effects, inflationary pressures and supply-chain disruptions have resulted in prolonged bullish markets, dwindling stock prices and generally distorted capital markets. Heavy outflows of foreign investors from the Nairobi bourse have been witnessed, as they opt to invest in more stable developed capital markets.

Banking





Kenya's banking sector remained stable and resilient despite the adverse effects of the COVID-19 Pandemic. This was mainly driven by the central bank monetary stimulus and initiatives in digital products and services to match rising customer demands.

Loan loss provisions and debt recovery costs declined from KES 106.9b in 2020 to KES 55.9b in 2021 driven by a rebound in economic activity. This saw Kenya's tier 1 banks unlock a combined net profit of KES 132.4b, an 80.3% growth. Consequently, dividends nearly tripled to KES 49.2b in 2021 from KES 16.9b in 2020.

Quarterly profit before tax increased by KES 5.2b (9.1%) from KES 57.3b in March 2022, to KES 62.5b in June 2022. The increase in profitability was mainly attributable to a higher increase in quarterly income by KES 15.8b as compared to the increase in quarterly expenses by KES 10.6b.

Non-performing loans (NPLs) ratio deteriorated from 15.0% at the end of March 2022 to 14.7% in June 2021, subsequently deteriorating the quality of assets. This was attributed to an 8.6% increase in gross NPLs as compared to a 3.3% increase in gross loans.

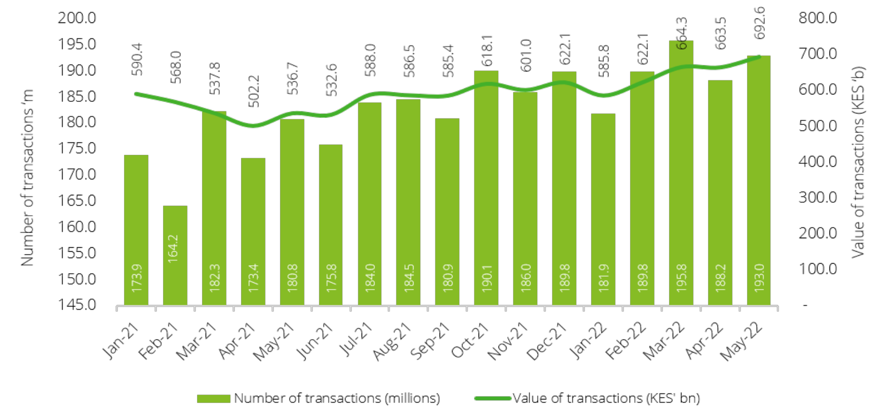
The Central Bank of Kenya ("CBK") has issued an approval to Equity Bank allowing for a risk-based pricing model, a transition from the CBK's interest rate cap model. The move will allow lenders to charge interest rates ranging between a base rate of 13% and a maximum of 18.5%. The approval is expected to be extended to other lenders, leading to increased lending to MSMEs that are presumed to have a higher risk profile.

Loan growth decreased from 8.3% in 2020 to 7.6% in 2021 owing to the continued Covid-19 pandemic and deleveraging by households and firms that were forced to borrow more in 2020. Loan growth is expected to accelerate to 9.7% in 2022 driven by improved business confidence and relatively easy financial conditions that will keep borrowing costs affordable.

The full impact of the Covid-19 pandemic on economic activity and non-performing loans remains uncertain, and loan growth rates are expected to remain subdued and unlikely to return to the 20.3% average seen from 2010 to 2015.

Technology, Media & Telecommunications sector

Kenya mobile money transactions performance



Source: Kenya National Bureau of Statistics (KNBS), Communications Authority of Kenya (CA), Fitch Solutions

The emergence of the Covid-19 pandemic in 2020 and the resultant containment measures have accelerated the use of technology in the country for the provision of essential services, driving the information technology market size from KES 74.7b in 2020 to KES 78.1b in 2021.

Kenya's information technology market size is expected to grow to KES 88.5b in 2022, driven by increased government spending on modernisation initiatives and expansion of data services provision. Consequently, there has been an increase in the uptake of digital tools as evidenced by increased activities of teleworking, online learning, online video streaming and e-commerce.

The country is expected to continue developing as a hub for fintech activity and mobile money in the region. The Covid-19 pandemic accelerated the digitisation of banking and financial services, with bank transactions from mobile phones as a proportion of all transactions expected to increase even as the effects of the pandemic continue to decline.

KES 692.6b

Value of mobile transactions as at May 2022

Mobile phone transactions increased by 9.1%, from 173.9m in January-21 to 189.8m in December-21 driven by the leveraged predominant use of mobile money and the growing number of mobile money accounts in the country. The value of transactions increased from KES 590.4b in January 2021 to KES 692.6b in May 2022 reflecting a recovery in businesses from the effects of the COVID-19 pandemic.

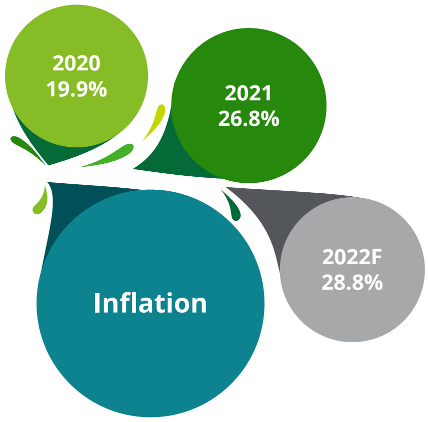
The GoK issued a directive requiring all sim cards to be re-registered by October 2022, aimed at taming fraudulent use of sim-cards and enhancing data accuracy. The move is however, expected to lead to a decline in the mobile phone subscriber base, potentially affecting profitability of mobile network operators.

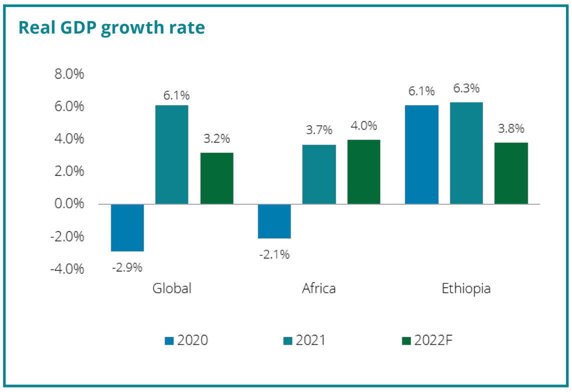
Heavy investments are expected by major telecom companies in advanced technological solutions for enhancement of their 4G and 5G coverage nationwide, particularly connecting rural areas, by installing new base stations. 4G is expected to remain the dominant technology, with 5G's growth expected to remain limited owing to high handset prices, low incomes and the price-sensitive nature of Kenyan consumers.

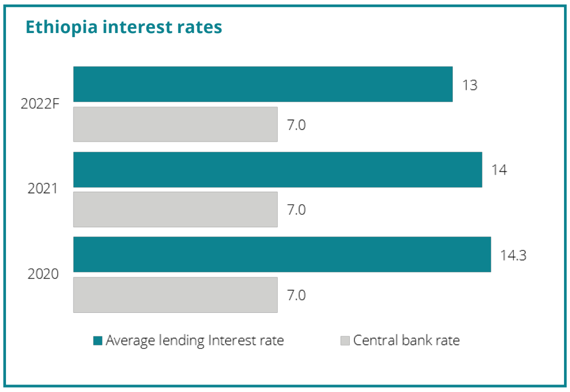
Ethiopia Macroeconomic & Sectoral Analysis

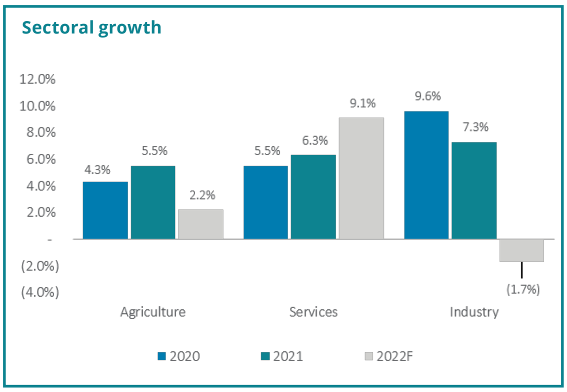
Ethiopia
Economy at a glance

The consumer price inflation rose to 26.8% in 2021, up from 19.9% registered in 2020, largely attributable to COVID-19 impact on the supply chain disruptions. Inflation is forecasted to rise to 28.8% in 2022, owing to poor performance in the agriculture and manufacturing sector, reliance on food imports and fuel prices and continued currency depreciation.







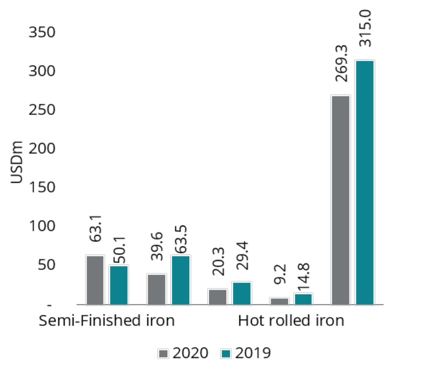


Source: World Bank, IMF, EIU, Fitch, NBE, Deloitte Analysis

- Ethiopia's GDP grew by 6.3% in 2021, higher than the projected 4.0% growth in Our Vol. 2 publication, supported by recovery in the key sectors. The GDP growth is expected to slow down to 3.8% in 2022 attributable to low investment and muted private consumption reflecting both high inflation and subdued household incomes..
- The fiscal deficit to GDP ratio increased from 3% in 2020 to 4.8% in 2021, compared to the forecast of 6.3% of GDP as per Our Vol. 2 publication. This was due to the military conflict alongside increased healthcare and elections expenditure. The ratio is expected to widen to 5.2% in 2022 owing to higher defence and rehabilitation expenditure and still-subdued government revenue.
- Ethiopia's foreign exchange reserves stood at USD 3.3bn (1.9 months of import cover) in 2021. This is a 3.2% increase from the projected USD 3.2bn as per Our Vol.2 publication. The forecast for 2022 is an increase to USD3.5b (2.0 months of import cover).
- The Ethiopian Birr (ETB) depreciated to ETB 52.0/USD as at 30 June 2022 from ETB 41.3/USD as at 31 March 2021. The ETB averaged ETB 43.8/USD in 2021 in line with government's efforts to control inflation. The ETB is expected to depreciate further to ETB 55.4/USD in 2022 as a widening trade deficit will negatively impact foreign-currency inflows, forcing the National Bank of Ethiopia (NBE) to devalue the ETB further to shore up reserves.
- The current account deficit amid high security spending widened to 6.0% of GDP in 2021 compared to 4.8% of GDP in 2020. This was a negative change compared to the 5.3% deficit that had been estimated for 2021 in Our Vol.2 publication. The current account deficit is expected to remain at 6.0% of GDP in 2022 as spending pressures ease and revenue increases.
- Ethiopia attracted USD 2.4bn worth of Foreign Direct Investment (FDI) inflows in the first nine months of the fiscal year 2021/2022, an 18.8% increase compared to a similar period in the previous fiscal year. This was attributed to efforts to support reserves deployed to manage the Birr through sustained recovery in financial account inflows.

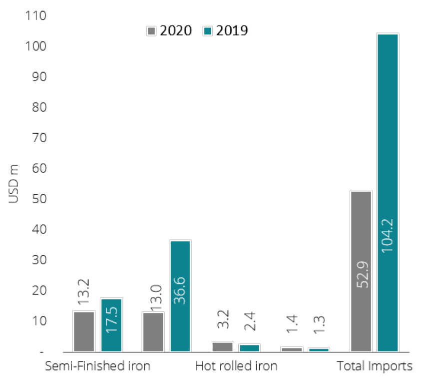
Impact of the Russia-Ukraine conflict

Total imports from Ukraine



Source: OEC, UNComtrade

Ethiopia imports from Russia



Source: OEC, UNComtrade

USD 52.6M

Total wheat imports from Russia and Ukraine in 2020

The current geopolitical environment around the Russia - Ukraine conflict has caused sharp increases to global food prices as the two countries account for about 30% of the global wheat supply. In addition, the World Food Program ("WFP") buys more than half of the wheat it distributes to the world from Ukraine.

On 8 April 2022, the Ministry of Finance issued a directive allowing importers of essential foodstuff such as wheat, edible oils, sugar, baby milk and rice to use Franco-valuta privileges without waiting for foreign exchange permits and import their items directly through the Customs Commission. This new directive thus lifted the foreign exchange permit requirements imposed in April 2021 of a minimum import threshold of USD 250k and verification of source of foreign currency with the National Bank of Ethiopia (NBE).

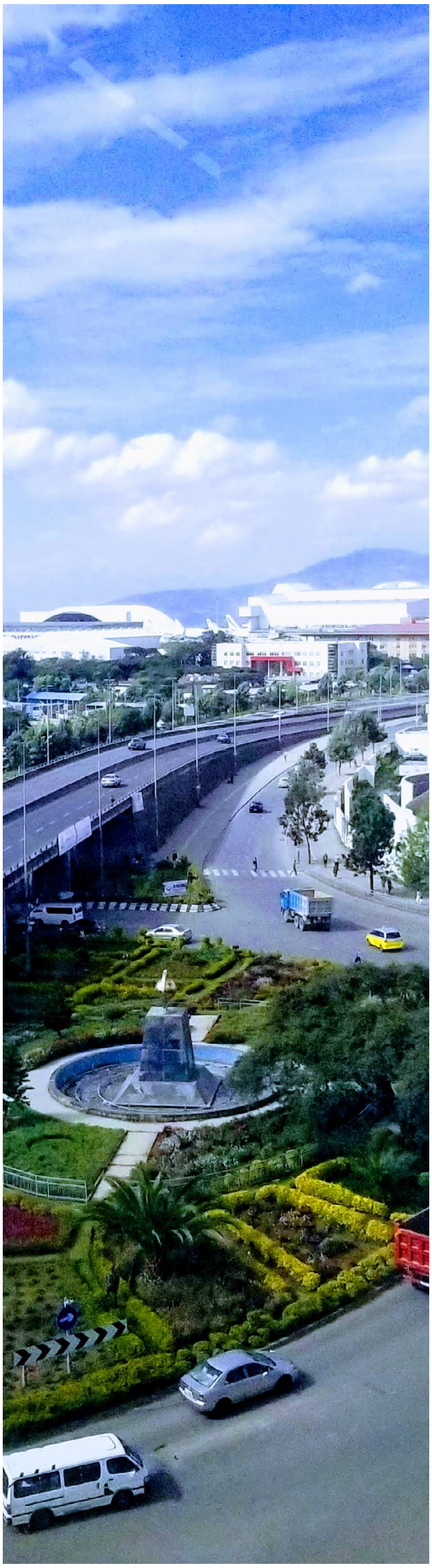
The food supply chain disruptions attributable to the Ukraine-Russia conflict in the last four months have intensified leading to increased inflationary pressure. The lifting of the government directive that allowed imports of essential food commodities without foreign exchange permits is aimed at bridging the supply-demand deficit and tackling the rising inflation.

Humanitarian aid in Ethiopia would be imperative to mitigate a potential famine particularly in the north of the country, whose population is expected to be greatly affected.

The Ethiopian government has implemented various ways to mitigate the supply chain disruptions from the Russia-Ukraine war. This includes;

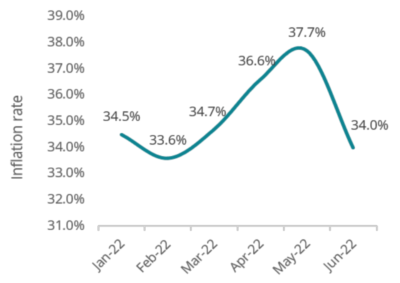
» Allocation of ETB267bn worth of loans to the private sector in the 2021/2022 budget with 34% of the beneficiaries in the agriculture sector; and

» Implementation of a nation-wide wheat planting campaign in a bid to increase local wheat output by 70% by the end of 2022.



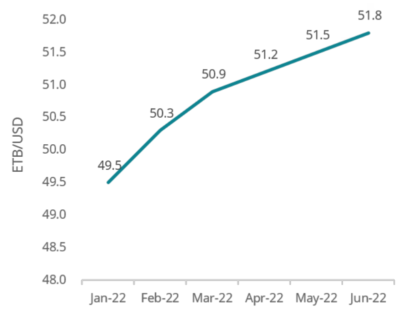
Inflation – The debacle of the year 2022

Ethiopia inflation rate



Source: Central Statistical Agency of Ethiopia

Ethiopia (ETB-USD) exchange rate



Source: Central Statistical Agency of Ethiopia

Ethiopia's inflation rate reduced to 34.0% in June 2022 easing for the first time in the last four months and a decline from 37.7% in May 2022. This was attributed to the decline in food inflation to 38.1% in June 2022 from 43.9% in May 2022 as a result of the decline in the price of imported cooking oil.

The consumer price inflation increased to 26.8% in 2021 from 19.9% in 2020 due to increased global fuel and food prices. It is forecasted to increase to 28.8% by end of 2022 owing to the persistent global fuel and food prices.

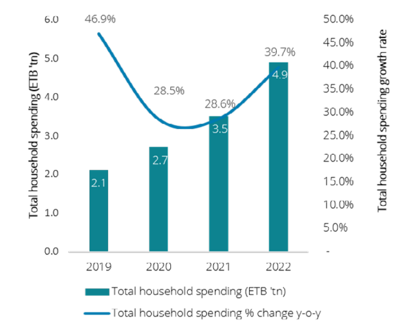
In June 2022, the food inflation recorded a decrease while non-food inflation increased. The food inflation was 38.1% with cereals and vegetables experiencing a decrease in prices while non-food inflation was 28.4% resulting from increase in prices of alcohol & tobacco, stimulants(khat), clothing and footwear, housing and repair, fuel, energy, furniture and fittings and medical care.

Over valuation of the Birr and increased inflation continues to weigh on the currency which depreciated to ETB 51.8/ USD as of June 2022 from ETB 43.80/USD in 2021. It is forecasted to depreciate further to ETB 55.4%/USD by end of 2022. This is attributed to the National Bank of Ethiopia conceding to the depreciation of the Birr to increase the foreign reserves in line with the IMF recommendations.

34.4%
Ethiopia's inflation rate as of June 2022

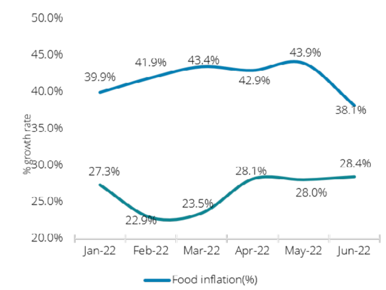
Impact of global inflation on consumer spending

Total household spending



Source: Fitch Solutions, Central Statistics Agency

Ethiopia inflation rate



Source: Fitch Solutions, Central Statistics Agency

Real household spending dropped to 2.2% in 2021 from 8.0% in 2020 attributed to the lower agricultural production, drought in various parts of the country and increasing inflation. However, it is forecasted to increase to 5.5% in 2022. The total household spending will increase to ETB 4.9tn in 2022 from ETB 3.5tn in 2021 with 70%(ETB 3.7tn) on essential spending with food and non-alcoholic drinks being the largest category.

The purchasing power is expected to be weighed down further by the rising inflation and the low levels of income. With food inflation continuing to rise, we are likely to see upward pressure on wages in the medium-to-long term.

Since January 2022, food inflation has risen above the general inflation with the highest percentage recorded in May at 43.9% impacted by the global commodity prices.

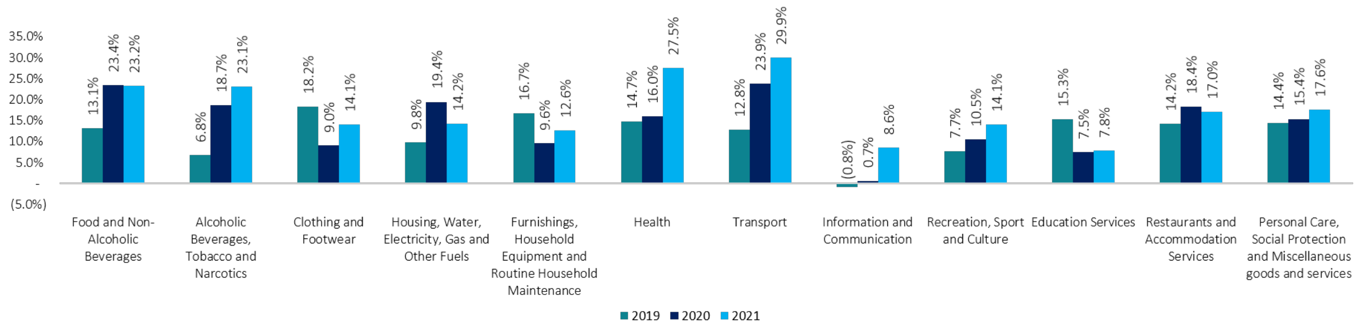
On 24 March 2022, a truce on the war in Tigray was announced. This is expected to improve the private consumption to 5.5% in 2022 from 2.2% in 2021 and resumption of agricultural activities in the areas affected by the war which will increase household consumer spending.

Notably, there is no minimum wage legislation in the country and most of the domestic force is unskilled to semi-skilled. The salaries are often determined by the prevailing market dynamics attracting foreign investors but detrimental to Ethiopian employees.

ETB 4.9tn
The forecasted household spending in 2022

Impact of inflation on the Ethiopian consumer

Commodities % change in prices year-on-year

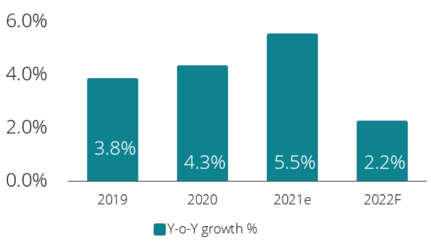


Division of commodities	2019	2020	2021
Food and Non- Alcoholic Beverages	54.0%	54.0%	54.0%
Housing, Water, Electricity, Gas and Other Fuels	16.8%	16.8%	16.8%
Transport	2.5%	2.5%	2.5%
Restaurants and Accommodation Services	5.3%	5.3%	5.3%
Information and Communication	2.0%	2.0%	2.0%
Education Services	0.2%	0.2%	0.2%
Personal Care, Social Protection and Miscellaneous goods and services	2.5%	2.5%	2.5%
Furnishings, Household Equipment and Routine Household Maintenance	4.7%	4.7%	4.7%
Alcoholic Beverages, Tobacco and Narcotics	4.9%	4.9%	4.9%
Clothing and Footwear	5.7%	5.7%	5.7%
Health	1.5%	1.5%	1.5%
Recreation, Sport and Culture	0.4%	0.4%	0.4%
Total	**100.0%**	**100.0%**	**100.0%**

Source: Central Statistical Agency of Ethiopia

Agricultural sector

Ethiopia Agriculture sector performance



Source: National Bank of Ethiopia (NBE), EIU, Fitch, IMF, World Bank

Ethiopia's economy is dependent on the agriculture sector with its share of the GDP in 2021 at 32.5% with coffee, horticulture and oil seeds as the country's main exports.

Ethiopia's economy is dependent on the agriculture sector with its share of the GDP in 2021 being 32.5%. Coffee, horticulture and oil seeds are the country's main exports.

Ethiopia's agriculture sector is forecasted to grow by 2.2% in 2022 limited by risks of weather-related shocks, rising inflation and limited room for fiscal stimulus.

The agriculture sector grew by 5.5% in 2021, a substantial growth from our forecast of 2.5% in Our Vol. 2 publication. This was driven by a 2% increase in total grains production to 341.8m quintals, despite the ongoing internal conflict ravaging some parts of the country and the lingering effects of COVID-19.

In January 2022, Ethiopia was officially delisted from Africa Growth Opportunity Act (AGOA), which will have adverse effects on its export earnings with agricultural commodities such as coffee and flowers being the largest foreign exchange-earners.

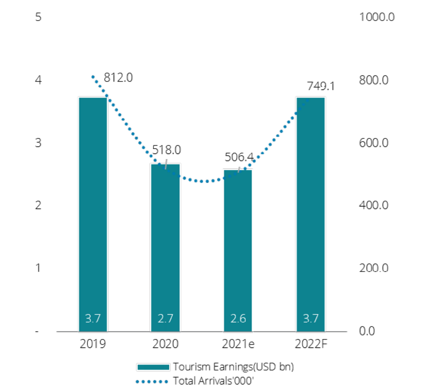
Job losses is one of the expected effects of the delisting from AGOA, which will pose downside risks to the expected 2.3% private consumption in 2022 from 0.9% in 2021.

Coffee remains Ethiopia's largest foreign exchange earner. Increase in export earnings in 2021 from coffee stood at USD 909.4m driven by a 15.9% rise in international price. The horticultural sector garnered USD 530m in fiscal year 2020/2021 with floriculture contributing 79% while vegetables, fruits and herbs shared the remaining 21%. Export revenue from flowers grew by 11.4% to reach USD 470m as both the export volume and global prices increased by 7.6% and 3.6% respectively.

Notably, Russia and Ukraine are deeply embedded in the global agricultural and food markets not only through supplies but also in agricultural inputs such as fertiliser and oil. However, the government has ramped up local production of wheat with a forecast of 2.4m tons in 2022 from 1.2m tons in 2021. This is in a bid to mitigate drought and decrease supply chain disruptions linked to the Russia-Ukraine conflict.

Tourism sector

Ethiopia Tourism sector performance



Source: National Bank of Ethiopia (NBE), EIU, Fitch, IMF, World Bank

The tourism sector remains crucial to Ethiopia's economy, contributing almost 9.0% of the GDP, while an estimated 2.2m people are employed by the sector both directly and indirectly.

Our Vol.2 publication indicated a forecasted increase in both international receipts and tourist arrivals in 2021. However, both declined by 20% and 14.9% respectively, reflective of lingering COVID-19 effects and the conflict in the northern part of the country, which broke out in 2021 with tourists preferring more politically stable countries.

The government has plans for new airports in the towns of Jinka, Robe, Semera, Hawasa and Shire. The mega expansion of Bole International Airport in Addis Ababa, funded by the China Export-Import Bank is expected to boost annual capacity to over 22m, up from 6m previously. Hotel numbers are expected to grow by 1.35% in 2022 to a total of 500.

International tourism receipts are expected to grow by 44.5% (albeit from a low base) year-on-year to reach USD 3.7b, reflecting the release of pent-up demand. Tourist arrivals are also expected to grow, reaching 749,070 reflecting a year-on-year growth of 47.9%. This recovery is however dependent upon the political stability of the country.

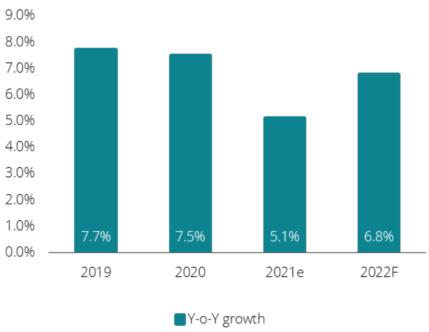
Downside risks to the sector's recovery in 2022 are expected to stem from reducing international travel demand arising from decreased disposable incomes in Europe due to the overall inflation and increased energy cost.

However, interests in Ethiopia from further afield countries such as China and India continue to develop, which is likely to support the forecasted growth in tourist arrivals.

The Chinese embassy in Addis Ababa had expressed interest in 2016, collaborating with the tourism sector in Ethiopia with both countries exploring opportunities to attract Chinese visitors to Ethiopia.

Manufacturing sector

Ethiopia Manufacturing sector performance



Source: NBE, EIU, Fitch Solutions,

Ethiopia's manufacturing sector grew by 5.1% in the FY21, a drop from 7.5% growth in FY20 and greater growth from our forecasted 1.5% in Vol 2 publication. The sector contributed 23.4% of the industry sector in 2021, marginally decreasing from the 23.9% growth in 2020.

The Ethiopian government in 2021 invested ETB 1.2bn which was utilised by 242 manufacturing projects. This was an increment from ETB 0.7bn in 2020, which was utilised by 42 projects . The Home-Grown Economic Reform Agenda, which aims to transform Ethiopia from a largely agrarian low-income country to an industrialised lower-middle-income country by 2030, has rapidly accelerated the growth of the manufacturing industry in recent years.

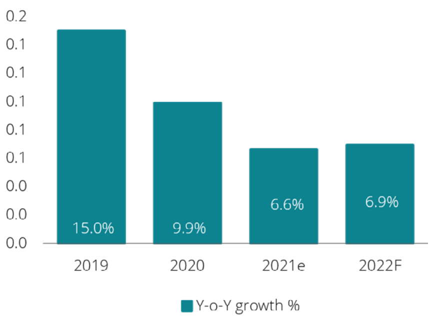
The production capacity of domestic manufacturing industries reached 46% during the past six months of the current Ethiopian budget year slightly short of the 50% government target. Subsequently, out of the 177 shades in the various industrial parks, 104 have become fully operational.

Ethiopia's textile and apparel industry exported USD 223m worth of products in the first five months of FY22 achieving 120% of the target set for the budget year. Ethiopia was removed from the US African Growth and Opportunity Act (AGOA), a duty-free agreement that allows African countries to earn more each time they export their products to the US, due to the escalation of the Tigray conflict. The US buys about 10% of Ethiopia's exports and the loss of eligibility is expected to adversely affect the textile and apparel sector.

The manufacturing industry is forecasted to grow by 6.8% in 2022 on account of the increasing overall production in the industrial parks, supported by increasing investment by foreign firms drawn by cheaper electricity and labour costs. The government is expected to attract other textile-related investments through the Africa Continental Free Trade Area (AfCFTA), which has reduced tariffs by up to 90% on goods traded in the area, effective January 2022.

Construction sector

Ethiopia Construction sector performance



Source: National Bank of Ethiopia (NBE), EIU, Fitch, IMF

Ethiopia's construction sector growth slowed down to an estimated 6.6% in 2021 from 9.9% in 2020 attributable to the unstable political environment in the country.

The construction industry is forecasted to rebound to a growth of 6.9% in 2022 as the Tigray conflict in the country subsides. This will still be well below the historical pre-COVID 10-year industry average of 22.5%, reflecting the persistent risk of conflict and high near-term inflation, which will undermine consumer purchasing power and weigh on demand for residential and retail construction.

The construction sector features a sizeable presence of both Chinese and Ethiopian contractors, occupying 46% and 36% of respective construction roles in the country's project pipeline respectively. Indian firms hold the least at 4%. Infrastructure projects are predominantly funded by multilateral and development banks including the Export-Import Bank of China.

In February 2022, the Ethiopian and Kenyan governments signed a USD 1.3bn agreement for an electricity transmission interconnector between the two countries.

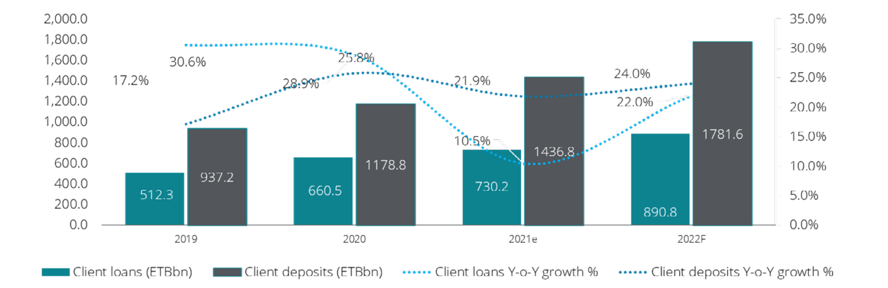
Notable infrastructure and construction projects which commenced in June 2021 include (i) the USD 110m Modjo dry port by the China Civil Engineering Construction Corporation backed by financing from the World Bank; and (ii) the USD 154m Adama-Awash Expressway, a joint venture between India-based JMC Projects and China-based LRBCL backed by a USD 98m grant from the African Development Bank (AfDB).

In August 2021, the NBE instructed banks to suspend the issuing of loans backed by collateral such as land and property, to guard against the fleeting value of the Birr. The subscribers of such loans were said to be taking money out in foreign exchange through the parallel market leading to a sharp rise of the value of foreign currencies against the Birr.

Whereas this suspension has been lifted, other suspensions regarding the transfer of lease rights and related services as well as the provision of design and building permits are still in place for an indefinite period. These are expected to impede market players and investors in the property market slowing down activities in this sector in 2022.

Financial services sector

Ethiopia Banks' deposits and loans



Source: National Bank of Ethiopia (NBE), EIU, Fitch, IMF

The financial services sector's contribution to GDP was 9.0% in 2021.

During Q1 of the 2021/2022 fiscal year, ETB 65.3bn fresh loans were disbursed, an 18.7% annual increase, with the major beneficiary being domestic trade (20.3% or ETB 13.3bn). Loans are forecasted to grow from ETB 730bn (10.5%) in 2021 to ETB 890bn (22%) in 2022 as economic activity recovers supported by strengthening of household and business finances enabling banks to increase lending.

On 18 May 2022, the Ministry of Finance and Ethiopia Investments Holdings and Financial Sector Deepening (FSD) Africa signed an agreement to establish the Ethiopia Securities Exchange (ESX) with the aim of establishing a local stock exchange. The ESX is projected to be complete in 18 months.

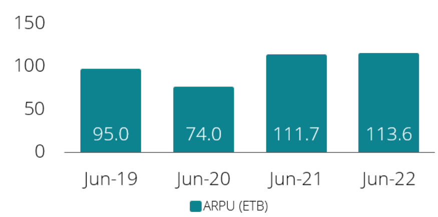
Deposits grew by 22% from ETB 1.2tn in 2020 to ETB1.4tn in 2021due to the demonetisation efforts in Q3 of 2020, which led to increased deposit funding following the cash hoarding and cash withdrawals witnessed during the first phase of the COVID-19 pandemic. Further ETB 1.8tn (24%) increase in deposits is anticipated in 2022, which will ensure commercial banks remain adequately funded and able to extend more credit.

Recent entries into the banking sector include Zamzam Bank, the first entity to receive a license to carry out Islamic banking activities, which formally started operations in June 2021, as well as Hijra Bank. In October 2021, Goh Betoch Bank also opened its doors as the first private mortgage bank in the country.

In February 2022, as part of the liberalisation package of Ethiopia's banking sector, the country announced a policy amendment is underway to open its banking industry to foreign competition due to the need for additional wealth and hard currency. As of May 2022, the foreign banks must operate in cooperation with local banks to improve both foreign capital and local acquisitions. According to the World Bank, only about 35% of Ethiopia's adult population have bank accounts which present an opportunity for foreign banks to expand their loan book in this market positively impacting financial inclusion and bank penetration.

Technology, Media & Telecommunications sector

Average Revenue Per User (ARPU)



Source: National Bank of Ethiopia (NBE), EIU, Fitch, IMF, World Bank

Ethio Telecom achieved revenue of ETB 61.3bn in the fiscal year 2021/2022, 8.5% increase from the previous fiscal year and 87.6% of its target for the full year. This was attributable to network and system expansion and optimisation works to enhance customer experience and satisfaction.

Further, the telecom devised a cost optimisation strategy that led to cost savings amounting to ETB 5.4bn .The number of total subscribers increased by 18.4% to reach 66.6m subscribers, achieving 104% of the subscriber base target. Mobile voice subscribers reached 64.5m, data and internet users 26.1m, fixed services users 0.9m and fixed broadband subscribers reached 0.5m as from 1 July 2021 to 30 June 2022. These were attributed to telecom density reaching 63.3% over the same period.

Ethio Telecom partnered with Thunes, a leading global payments platform, to facilitate cross-border transfers to its telebirr users. This was aimed at tapping into the large, influential diaspora market.

Since the launch of the telebirr in May 2021, Ethio Telecom reported it had garnered over 22m subscribers with a total transaction value of ETB 32bn.

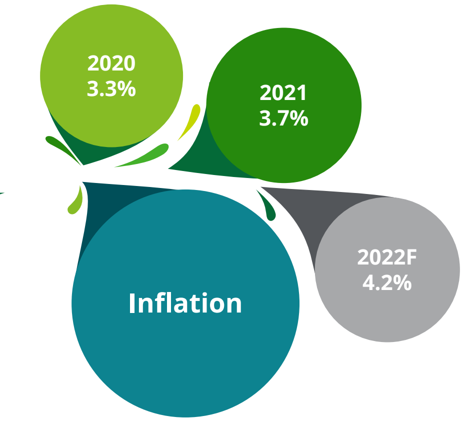
Ethio Telecom has partnered with Dashen Bank to start digital financial services. These include (i) Telebirr mela - a service that allows individual customers, agents, and merchants to borrow money for any transaction or withdrawal; (ii) Telebirr Endekise - a service that enables customers to borrow money when they are short of balance in their telebirr account while making transactions; and (iii) Telebirr sanduq- a saving service which is available with interest-free and interest rate based micro saving services.

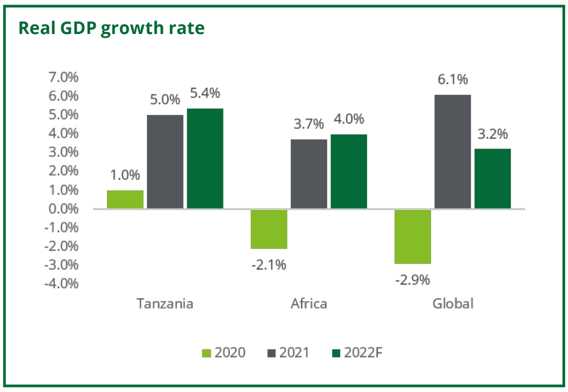
In September 2022, Investment Finance Corporation (IFC) announced plans to invest USD 160m in Safaricom Telecommunications Ethiopia PLC intended for its infrastructure as well as licence fees payments. In June 2021, Safaricom acquired a telecom licence worth USD 850m from Ethiopian Communications Authority (ECA) making it the first private operator to do so. In August 2022, the pilot services on 2G, 3G and 4G networks began in Dire Dawa.

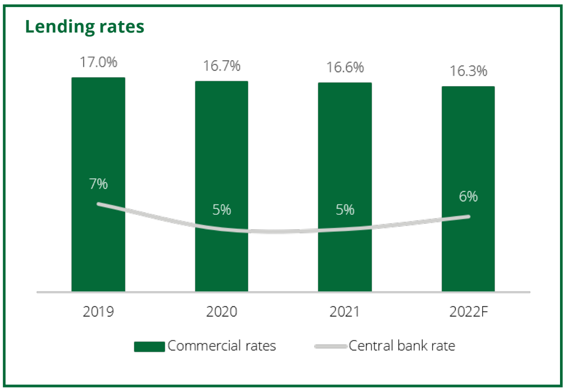
Tanzania Macroeconomic & Sectoral Analysis

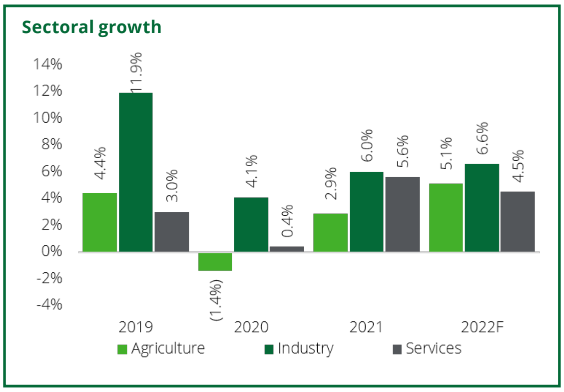
Tanzania
Economy at a glance

Consumer inflation increased from 3.3% in 2020 to 3.7% in 2021 on the back of food supply shortages that drove up food inflation as well as an uptick in global oil prices. The global commodity shortage, coupled with recovering private consumption, is expected to drive up inflation to 4.2% in 2022.





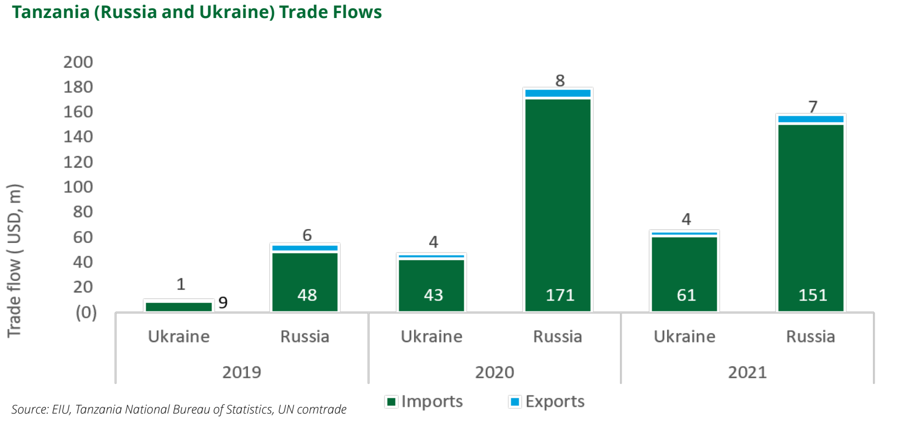




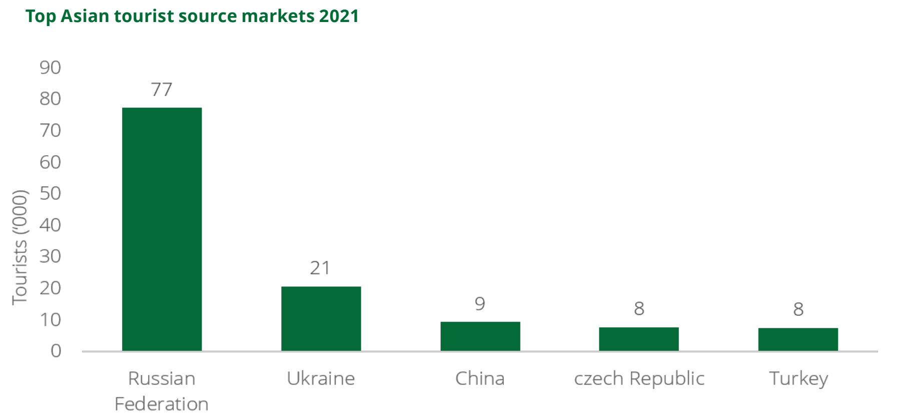
Source: Tanzania National Bureau of Statistics, Fitch Solutions, IMF

- Tanzania's GDP grew by 5% in 2021, from 1.0% in 2020, which was 20 basis points below our indicated projection in the 2021 Vol.2 publication. This growth was largely driven by a rebound in private sector consumption and sustained investment by the government in public infrastructure and utilities.
- The country has continued to keep its debt stock lower than that of its East African peers, despite the increase in the total debt stock from USD 31.1b in 2020, to USD 37.1b in 2021. Total debt to GDP ratio stood at 40% in 2021 and it is expected to remain constant, at 40.2% in 2022.
- Foreign exchange reserves remained optimal, standing at USD 6.4b as of December 2021, up from USD 4.8b in December 2020. This was equivalent to 6.6 months of imports, well ahead of both the country and EAC benchmark of 4 and 4.5 months, respectively. As at May 2022, the reserves had declined to USD 5.2b, driven primarily by increased imports.
- Current account deficit increased from 1.7% of GDP in 2020 to 3% in 2021. This increase was driven by a significant increase in value of imports compared to the increase in exports and more specifically, importation of oil, which increased by 62% in 2021 and in 2022, the deficit is expected to further widen, reaching 3.7%.
- The Tanzanian shilling (TZS) exchanged at fairly constant rates against the dollar from TZS 2,299 as at 30 June 2021, when we published our Vol. 2 publication to TZS 2,304.19 as at 30 June 2022. The TZS is expected to weaken against the dollar to an average of TZS 2,335 in 2022, driven by sustained demand for the dollar for purchase of global commodities.
- The Bank of Tanzania is expected to adopt restrictive monetary policies in 2022 in a bid to contain inflationary pressures that have arisen from increasing global energy and commodity prices. This is ,therefore, expected to result in an increase in the central bank policy rate from 5.0% in 2021 to 6.0% in 2022.

Impact of the Russia-Ukraine conflict



Source: EIU, Tanzania National Bureau of Statistics, UN comtrade



Source: Tanzania National Bureau of Statistics

Russia and Ukraine have been significant trading partners of Tanzania, with trade flow from Russia and Ukraine amounting to USD 158m and USD 65m respectively in 2021.

In 2021, Imports accounted for the greater part of the trade flow, making up an average of 95% for both Russia and Ukraine.

The trading profile was similar for the two countries, with wheat and fertilisers as the top import products into Tanzania, while tobacco and tea were the top export products from Tanzania.

The ongoing conflict, presents a challenge to Tanzania, particularly in the agricultural, manufacturing and hospitality sectors.

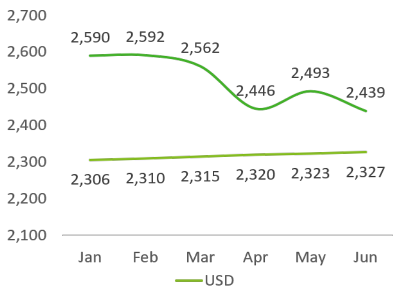
The conflicting countries were a source of tourists for Tanzania and consequently a key source of foreign currency reserves. In 2021, Russia and Ukraine contributed 8.4% and 2.2% of total tourist flows into Tanzania.

Although Tanzania had, as at the time of this publication, not directly imposed sanctions on Russia, critical companies facilitating trade (e.g. AP Moller Maersk and SWIFT) had either ceased service provision or were divesting from the country.

Conversely, the conflict also presents an opportunity for Tanzania to explore new international relations and diversify its source and destination markets.

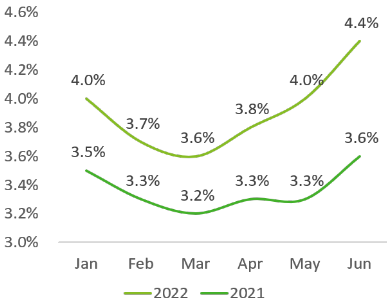
Inflation – The debacle of the year 2022

Exchange rate movement



Source: EIU, Tanzania National Bureau of Statistics

Month-on-month inflation



Source: Bank of Tanzania

Precipitated in part by the global commodity shortage resulting from sanctioning of commodities from Russia and disruption of the supply chain in Ukraine, inflation in Tanzania has been on the rise in 2022.

Inflation averaged 3.9% as at June 2022, compared to 3.4% over the same period in 2021. The steepest increase in comparison to the previous year occurred in June when the headline monthly inflation stood at 4.4%, compared to 3.6% in 2021

Despite this increase, inflation remained well within the bands of Bank of Tanzania and EAC benchmarks. In 2022, inflation is forecasted to average at 4.2%.

Unlike the currencies of its East African peers, the Tanzanian shilling (TZS) remained fairly stable against the United States dollar (USD) amid the prevailing global conditions. The TZS only suffered a year-to-date depreciation of 0.9% against the USD, moving from an average of TZS 2,306 in January to TZS 2,327 in June.

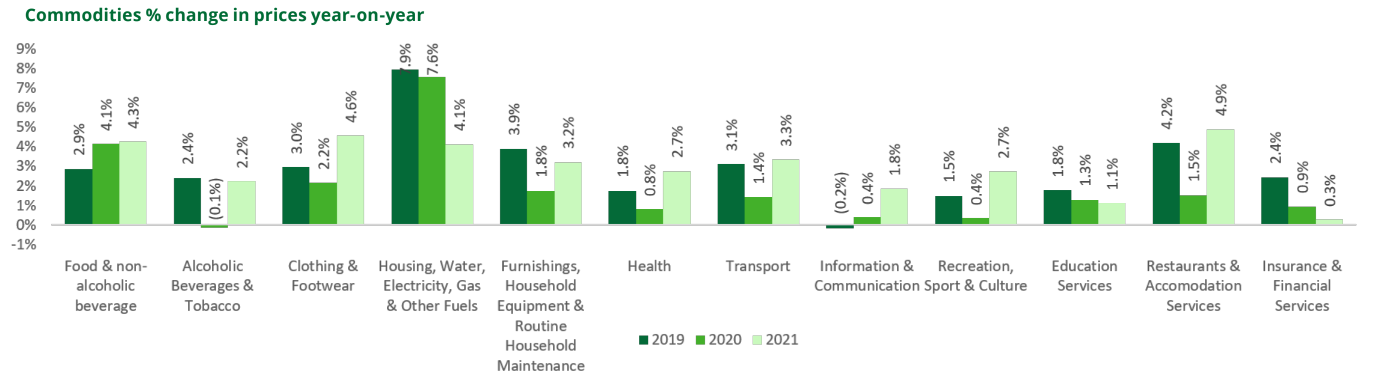
Conversely the TZS rallied against the Euro (EUR), with a 5.8% year-to-date appreciation and an 11.1% appreciation for the year ending June 2022. This could however have primarily been driven by the weakening of the Euro against the USD.

The performance of the TZS has been attributed to an increase in the amount of exports in the year. More specifically, the export of diamond, cloves and cashew nuts, which increased in export value as at April 2022, by 1,381%, 7,182% and 185% respectively from a similar period in 2021.

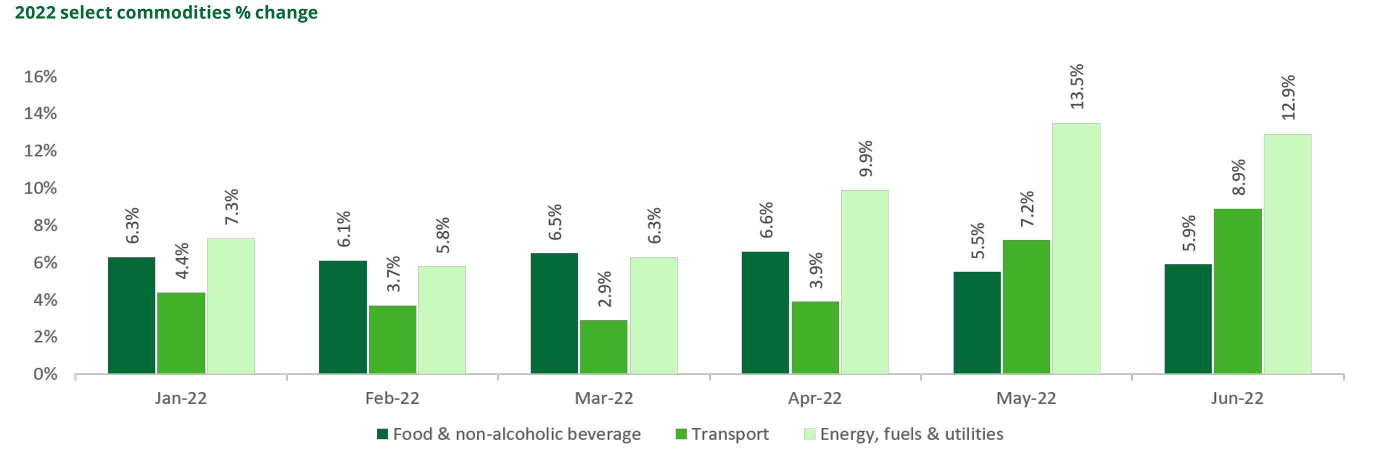
4.4%

Inflation rate as of June 2022

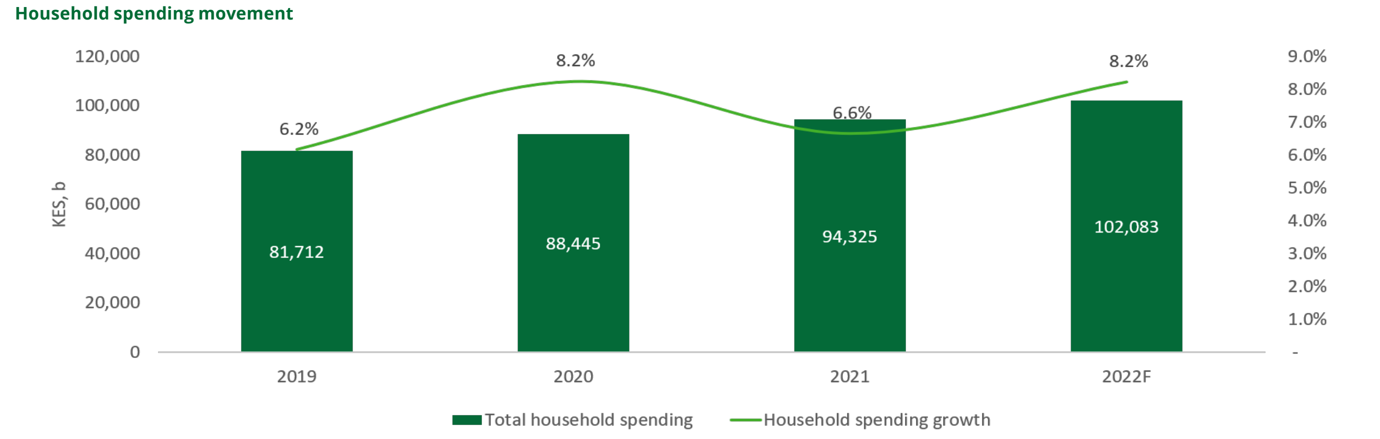
Impact of inflation on the Tanzanian consumer



Source: Tanzania National Bureau of Statistics



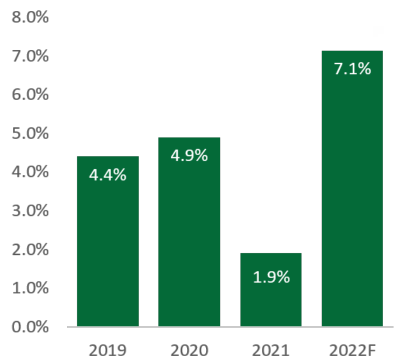
Source: Tanzania National Bureau of Statistics



Source: Tanzania National Bureau of Statistics, Fitch Solutions

Agricultural sector

Agriculture Sector performance



Source: EIU, Tanzania National Bureau of Statistics

The sector remains a pivotal contributor to Tanzanian GDP, increasing from 26% of GDP in 2020 to 28% in 2021.

Resumption of global supply chains resulted in an increase in Tanzanian exports, with two of its main agricultural exports, cloves and coffee increasing by 203% and 14% respectively in export value in 2021.

In 2022, an increase in production, driven by increased demand for agricultural products and bolstered by favourable weather, is expected to see the agricultural sector grow by 7.1%.

Russia has been a key trading partner to Tanzania in relation to agricultural products. In 2021, tea and tobacco accounted for 78% of Tanzania's total exports to Russia while wheat and fertiliser imports accounted for roughly 43% and 16% of total wheat and fertiliser imports into Tanzania respectively.

The economic disruptions stemming from sanctions imposed on Russia have driven prices of key agricultural inputs upwards.

In 2022, global prices of DAP and Urea fertilisers increased by 76.3% and 153.7% respectively for the period ending May. This led to a 108.4% increase in Tanzania's expenditure on fertiliser importation.

Similarly, wheat prices increased by an average of 52.8% for the year ending May 2022, contributing to the increase in expenditure on the importation of food and foodstuff from USD 120.5m as at April 2021 to USD 196m as at April 2022.

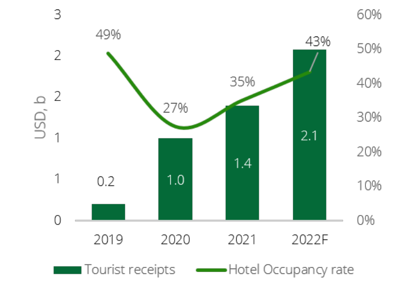
Production is however expected to increase, owing to favourable weather and a general rise in private consumption.

7.1%

Expected growth of the agriculture sector in 2022

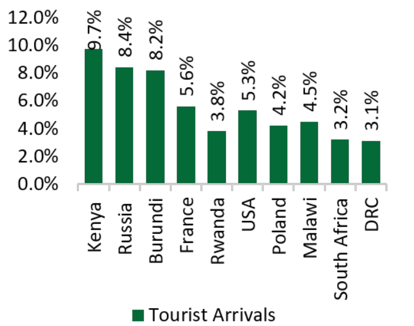
Tourism sector

Tanzania Tourism Sector performance Y-o-Y growth



Source: EIU, Tanzania National Bureau of Statistics

2021 Tourist arrivals by origin



Source: EIU, Tanzania National Bureau of Statistics

The tourism sector saw an improvement in 2021, as international tourism receipts increased from USD 1b in 2020 to USD 1.4b in 2021, in tandem with the hotel occupancy rate, which increased from 27% in 2020 to 35% in 2021.

This improvement of the sector was largely driven by resumption of international travel, on the back of relaxed global travel restrictions.

With vaccination rates increasing from 0.2% as at 8th August 2021 to 12.6% as at 30th June 2022, continued vaccination is expected to boost tourist confidence and subsequently drive the increase in tourist arrivals by 42% in 2022.

The Government of Tanzania continues to implement marketing campaigns and identify new tourism offer packages, in a bid to achieve its plan to attract 5 million tourists annually.

Reports indicate that the sector is on track to reabsorb the estimated 5,000 workers who had been laid off during the pandemic.

By comparison, the cumulative number of tourist arrivals for the year ending May 2022, was only 11% behind the arrivals of a similar period in 2019, indicating that the sector is on track to get back on its feet.

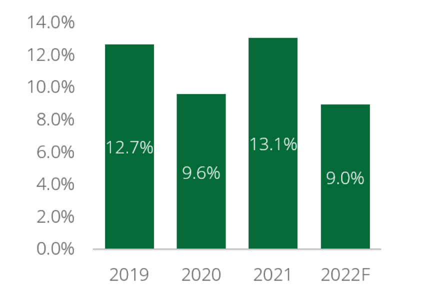
The sector could however face further disruption in the year, with downward pressure arising particularly from the ongoing conflict between Russia and Ukraine.

In 2021, Russia was the second largest source of tourists for Tanzania, contributing 8% of the total international tourist flow, second only to Kenya, which contributed 10%.

The latest data shows that tourist arrivals from Russia have declined by 97% as at May 2022, compared to the same period in 2021.

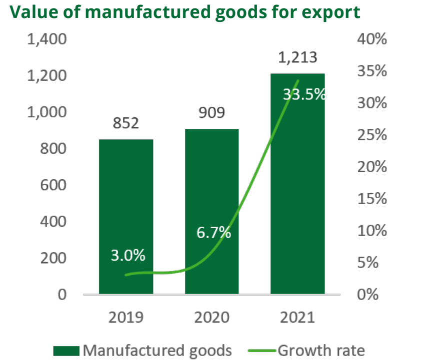
Manufacturing sector

Tanzania Manufacturing Sector performance Y-o-Y growth



Source: Fitch Solutions, Tanzania National Bureau of Statistics

Value of manufactured goods for export



Source: Bank of Tanzania

The manufacturing sector grew from 9.6% in 2020 to 13.1% in 2021, largely attributed to an increase in private consumption locally.

In addition, increased global demand for manufactured goods further contributed to the growth, as manufactured goods exports increased by 10% from USD 909m in 2020 to USD 1.2b in 2021. Top manufactured goods exported were cosmetics, iron & steel, plastic and paper products.

In 2022, the sector is expected to grow by 9.0%, driven by increased domestic and foreign demand for manufactured goods and government initiatives targeted toward increasing the share of manufactured goods to total exports from 35% in 2020 to 40% by 2026. This includes giving newly set up manufacturers a discounted tax rate of as low as 20% from the existing 30%, for the first five years.

The subdued growth in the sector in 2022 is due to increased costs of critical inputs, such as petroleum and refined petroleum products, which face a global shortage. This comes on the back of several world economies banning or committing to phase out the use of Russian oil and gas.

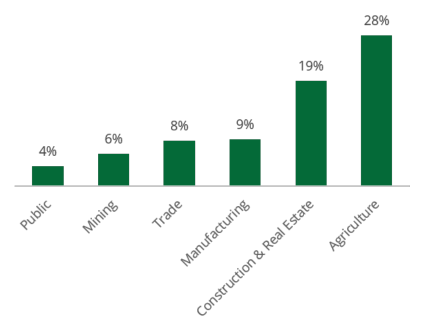
The resulting supply chain shocks and raw material shortages, coupled with the competitive dynamics of manufactured products in global markets is expected to dampen Tanzania's manufactured goods exports, consequently widening the current account deficit.

9%

Expected growth of the manufacturing sector in 2022

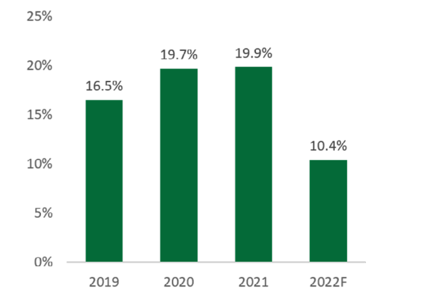
Construction sector

Sectoral contribution to GDP 2021



Source: Fitch Solutions, Tanzania National Bureau of Statistics

Tanzania Construction Sector performance Y-o-Y growth



Source: Fitch Solutions, Tanzania National Bureau of Statistics

In 2022, the sector is forecasted to grow by 10.4%, driven by a sustained focus on the ongoing projects and embarkment of new projects under the Five Year Development Plan III, which include the construction of government buildings and civil housing.

10.4%

Expected growth of the manufacturing sector in 2022

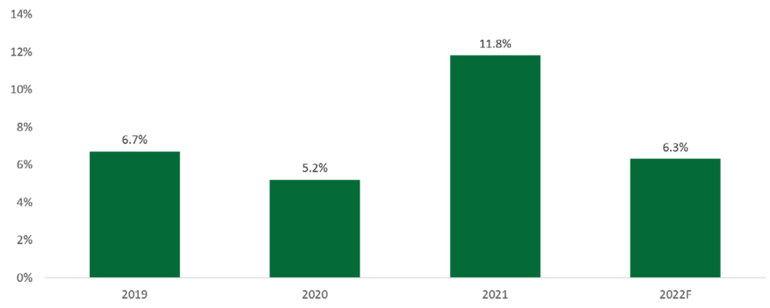
Construction and real estate contributed 19% to the GDP in 2021, second only to agriculture which contributed 28%.

Growth in the sector was attributable to government expenditure on infrastructure and public utilities.

Key projects prioritised by the government in the 2020/2021 budget included the completion of 4 hydropower plants with a combined capacity of 2,633 MW and the construction of the standard gauge railway. These projects were allocated approximately USD 1.1b in 2021.

Real estate sector

Tanzania Real Estate Sector performance Y-o-Y growth



Source: Fitch Solutions, Tanzania National Bureau of Statistics, Knight Frank

The Real Estate sector grew from 5.2% in 2020 to 11.8% in 2021, driven by a recovering economy and an increase in FDI inflows from USD 1.0bn to USD 4.1bn.

In addition, the 5% average annual urbanisation rate in Tanzania contributed to the growth in 2021, as more people continue to move to urban centres, creating demand for urban housing.

In 2022, growth in the sector is forecasted to decline to 6.3%, as foreign investment tapers off to pre-pandemic levels. However, with an estimated housing deficit of 200,000 units annually, the sector is expected to continue to grow in the long term.

Demand for low cost housing is expected to continue to grow, as it remains the first domicile point for rural – urban migrants. Latest data from UN- Habitat indicates that 40% of the urban population of Tanzania lives in informal settlements.

In 2021, housing prices experienced a 4.1% percent increase compared to a higher 7.6% increase in 2020. This increase was driven by increase in cost of construction, especially in the medium and high-end market segments.

On the commercial properties front, the working strategies of the pandemic era which have prevailed in 2022, have resulted in an oversupply of commercial spaces.

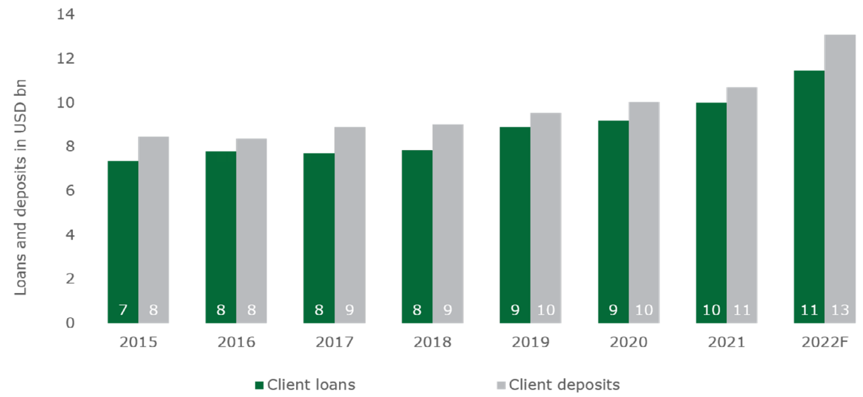
As a result, reports indicate that rental prices have declined by an average of 30% from USD 15 per square meter, forcing landlords and lessors to become more flexible in negotiating for rent and lease rates.

6.3%

Expected growth of the real estate sector in 2022

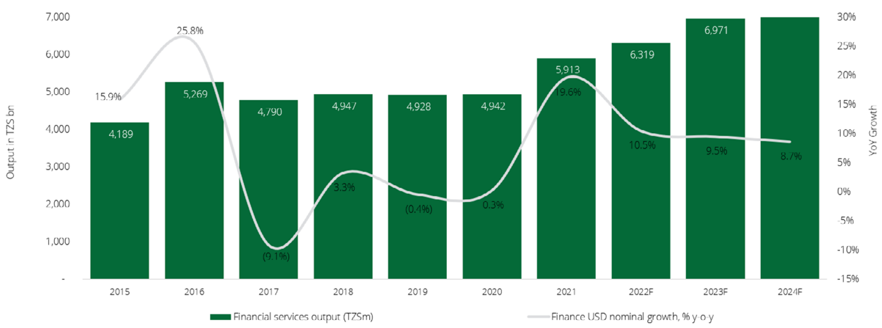
Financial services sector
Banking

Clients loans and deposits



Source: EIU, Tanzania National Bureau of Statistics, Fitch Solutions

Financial services GDP Contribution



Source: EIU, Tanzania National Bureau of Statistics, Fitch Solutions

The financial services sector grew by 19.6% in 2021 compared to 0.3% in 2020, buoyed by improving business activity, increased private sector lending and the expansion of bancassurance in the country.

Consequently, loan uptake increased by 8.7% in 2021 compared to 3.2% in 2020, driven by an economic rebound over the same period that consequently spurred increased credit demand.

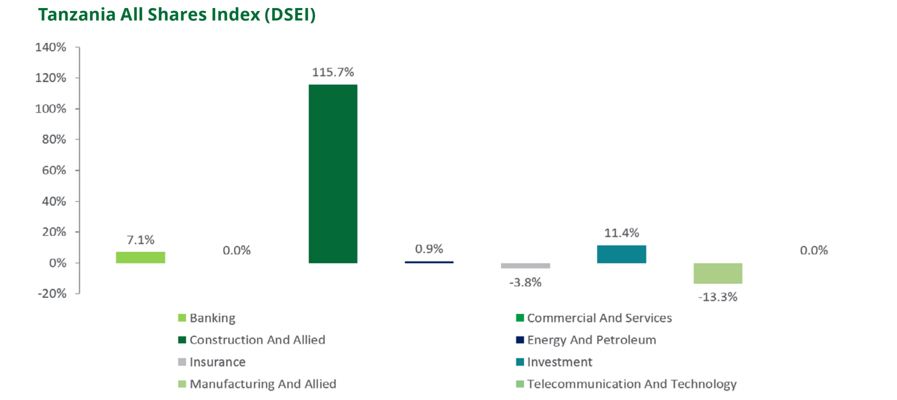
Credit extended to the private sector increased by 10.0% in 2021 compared to 2.6% in 2020 supported by an accommodative monetary policy regime that bolstered lending growth. In particular, credit to the agricultural sector was bolstered following a directive by the Bank of Tanzania (BoT) that saw the central bank allow commercial banks that lend to the agricultural sector at an interest rate of less than 10%, can maintain a lower statutory minimum reserve.

The industry non-performing loan (NPL) ratio saw a decrease from 9.3% in June 2021 to 8.2% in December 2021, in line with rebounding business activity that led to lower default risk. Bank of Tanzania (BoT) mandated that lenders achieve an NPL of below 5% and a cost-to-income ratio not exceeding 55%, effective 31 December 2022. This is expected to bolster risk management among industry players and subsequently improve their loan assets portfolio quality.

The central bank rate (CBR) is expected to hold at 5% in H1 2022 in order to support economic recovery. Subsequently, this will buoy lending activity with loan uptake expected to grow by 10.2%. A 100 basis points increase in the CBR to reach 6% is expected in H2 2022 supported by a strengthening economy and improved credit growth, which are expected to provide room for monetary tightening.

Customer deposits are expected to post an 18.2% growth in 2022, up from 10% in 2021. This is indicative of the continued resurgence in disposable income levels in the economy.

Financial services sector Capital Markets



Source: EIU, Tanzania National Bureau of Statistics, Absa Bank, Investing.com, Capital IQ, Fitch Solutions

The Dar es Salaam Stock Exchange (DSE) continues to be underdeveloped mainly owing to limited liquidity and lack of sufficient depth in the bourse. Long-term growth prospects, albeit from a low baseline, are expected to be driven by privatisation of state-owned assets and increased listings from SMEs.

In addition, Tanzania All Share Index (DSEI) reported a 2.2% YTD loss as at 30 June 2022, driven by negative investor sentiment, with April recording the largest drop in the year.

Market capitalisation reported a 5% growth in 2021 driven by an Initial Public Offering by Jenga Afya Tokomeza Umaskini (JATU) in August 2021, where it successfully issued 15.5m new shares into the Dar es Salaam bourse.

Listed companies, Tanga Cement and National Microfinance Bank, reported the highest Year-to-Date (YTD) change of 32.9% and 22.9% respectively, as at 30 June 2022, reflective of the rebound in their respective sectors.

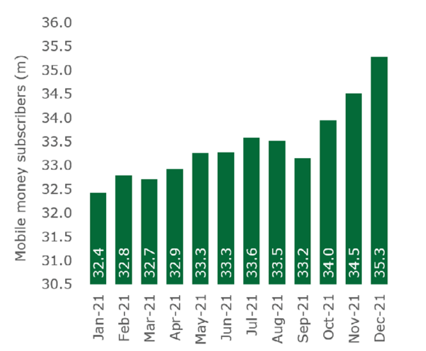
Bond turnover in the bourse increased from TZS 688.5b in Q32020 to TZS 785.0b in Q32021 driven by an increase in market capitalisation and liquidity in the fixed income market.

On the other hand, the value of traded treasury bonds increased from TZS 2.12tn in December 2020 to TZS 2.14tn in December 2021 mainly attributable to increasing levels of financial literacy and the launch of the 20-year and 25-year treasury bonds in April 2021.

Tanzania ranked 7th in the Absa Africa Financial Markets Index report in 2021, up from 16th in 2020 attributable to improved transparency around monetary policy decisions.

The DSE bourse's performance is expected to improve in 2022 sustained by Tanzania's economic recovery from the COVID-19 downturn, continued deepening and regulation of the financial services sector and stabilisation of business climate in the country.

Technology Media & Telecommunication sector



Source: EIU, Tanzania National Bureau of Statistics, Tanzania Communications Regulatory Authority, Fitch Solutions

The information and communication sector reported a 10.2% growth between Q12021 and Q32021 compared to 8.9% posted over the same period in 2020. This was translated into an improving Average Revenue Per User (ARPU) that grew from TZS 5,159 in 2020 to TZS 5,248 in 2021.

The improvement in ARPU was mainly due to the suspension of the mandatory biometric sim card registration service by the Tanzania Communications Regulatory Authority (TCRA) that limited subscribers to only one sim card.

Significant downside risks on the growth prospects of Tanzania's mobile financial services (MFS) industry stem from the amendment of the Electronic and Postal Communication Act in July 2021 that imposed a tax levy on mobile money transactions.

The tax levy is expected to increase the cost of transaction for consumers thus driving down demand for MFS in the country. Consequently, this is expected to drive the sector's ARPU downwards to TZS 5,211 in 2022, reflective of a 0.7% decline.

Tanzania is among Africa's largest mobile money markets and was the first nation in Africa to introduce interoperability between rival mobile financial services providers.

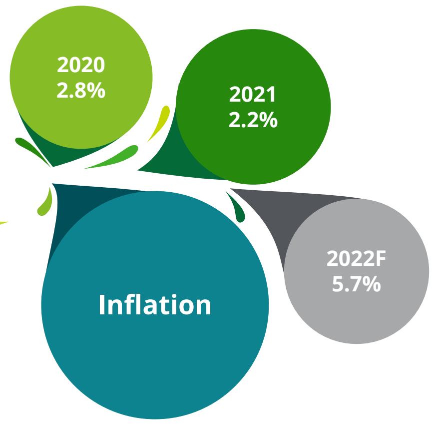
The value of mobile money transactions in Tanzania is expected to grow from a value of USD54.4b in 2021 to USD 120.4b in 2027 driven by increasing ubiquity of smartphones and internet coverage among the populace in the country.

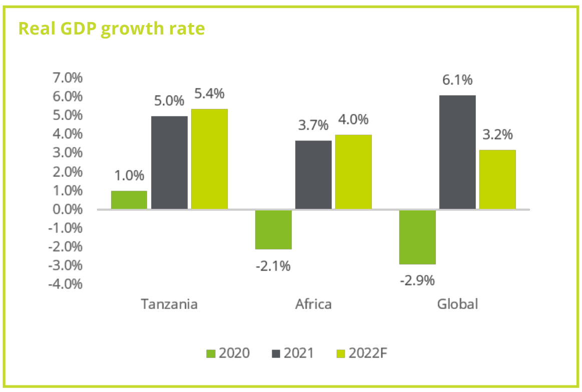
Mobile money users increased from 32.4m in January 2021 to 35.3m in December 2021, reflective of an 8.8% increase compared to 21.8% increase over the same period on 2020. The subdued growth was on account of the introduction of the 'patriotic levy that disincentivised investment in infrastructure and agent networks by industry players.

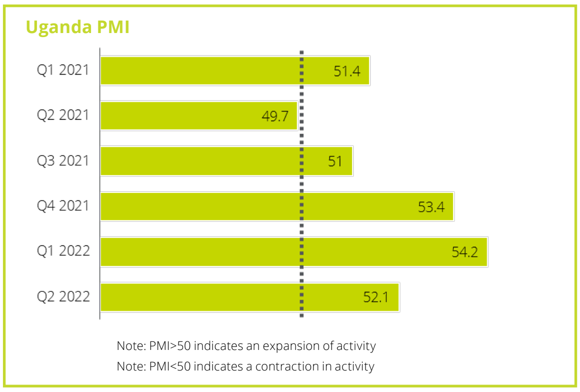
Uganda Macroeconomic & Sectoral Analysis

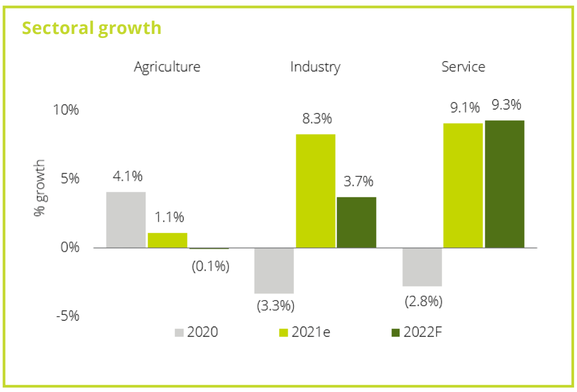
Uganda
Economy at a glance

Inflation declined to 2.2% in 2021 on account of the policy support measures put in place by the government to cushion against adverse pandemic effects. Inflation is expected to rise to 5.7% in 2022 owing to the rise in global commodity prices (including fuel and food) largely brought about by the Russia-Ukraine conflict.







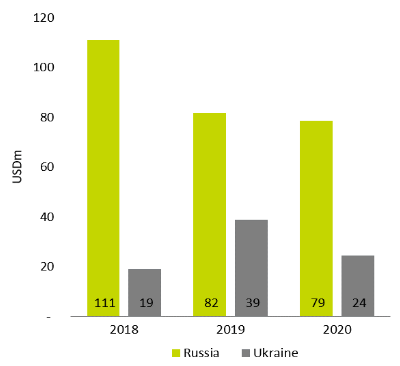


- GDP grew by 6.1% in 2021 up from a 2.2% contraction in 2020 mainly driven by a resumption of service sector activities – most especially trade and transport – following the roll-back of lockdown measures. The 4.8% growth forecasted in 2022 will be driven by developments in the oil and gas sector following the final investment decision reached on 1 February 2022 on the Lake Albert Oil project, which is expected to attract more Foreign Direct Investment and create job opportunities.
- Uganda's Purchaser's Manager Index (PMI) averaged 51.4 in 2021, reflecting continued recovery in business activity in the manufacturing sector. PMI contracted in Q2 2022 compared to Q1 2022 reflective of waning manufacturing activity that was attributable to inflationary pressures arising from increasing raw material prices.
- The Ugandan shilling strengthened from UGX 3,717.5 in 2020 to UGX 3,584.7 in 2021 as robust growth in US dollar earnings outpaced demand. However, the shilling is set to depreciate to UGX 3,695.0 in 2022 owing to strengthening investor sentiment towards the US dollar amid heightened global uncertainty given the Russia-Ukraine conflict.
- Foreign exchange reserves improved from USD 3.8b in 2020 to USD 4.3b in 2021 signifying an increase in ability to cover any external financing needs. Reserves are expected to decrease to USD 4.1b in 2022 owing to the ongoing rising inflation, which increased the cost of imports.
- The current-account deficit improved from 9.6 % of GDP in 2020 to 8.8% of GDP in 2021 owing to a 42.8% increase in travel receipts as mobility restrictions were relaxed. The deficit is forecasted to increase to 10.3% in 2022 owing to a decline in goods exported and higher import prices caused by Russia's invasion of Ukraine This will also contribute to the depreciatory pressure on the shilling.
- The public debt-to-GDP ratio rose from 48.5% in 2020 to 52.1% in 2021 owing to borrowings by the Ugandan government to finance pandemic related expenditures. The ratio is forecasted to increase from 52.1% in 2021 to 52.9% in 2022 as the government borrows to finance the Lake Albert Oil Project scheduled to commence in 2022.

Source: Bank of Uganda, EIU,, Fitch Solutions, Stanbic Bank PMI

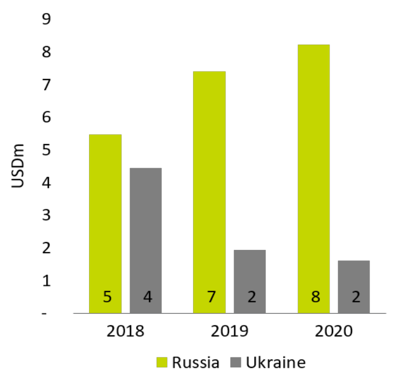
Impact of the Russia-Ukraine conflict

Total imports to Russia and Ukraine



Source: Bank of Uganda

Total exports to Russia and Ukraine



Source: Bank of Uganda

Russia is a major trade and investment partner with Uganda while trade between Uganda and Ukraine is not as significant. The two countries, combined, produce almost half of the world's wheat and the conflict has affected production and supply not only in the country but globally.

Russia's main exports to Uganda in 2020 were wheat at USD 41.9m (57.4%), Semi-Finished iron at USD 7.65m (10.5%) and Newsprint at USD 4.76m (6.52%) of the total exports to Uganda.

Ukraine's main exports to Uganda in 2020 comprised of wheat at USD 15m (68.7%), Hot rolled iron bars at USD 3.98m (18.1%) and Semi-finished iron at USD 0.9m (4.14%) of the total exports to the country.

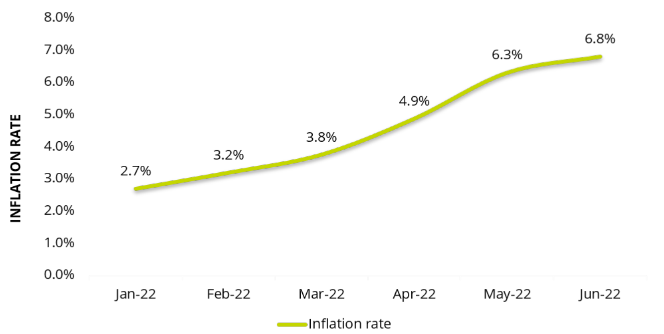
In 2020, wheat was the 6th most imported product in Uganda with Russia and Ukraine accounting for 48.1% of the total wheat imports. In addition,13% of total fertiliser imports came from Russia. The shortage of wheat and fertiliser due to the ongoing conflict between Russia and Ukraine is expected to lead to an increase in the cost of farm inputs and wheat products in Uganda, thus adversely affecting food security.

The Russia-Ukraine conflict has led to major supply-chain disruptions triggering an upsurge in the cost of fuel, agricultural and metal commodities globally as both countries are major oil producers. As the government of Uganda ruled out fuel subsidies citing fiscal sustainability concerns, fuel prices are likely to remain elevated throughout the year as demand for the commodity overrides supply.

Uganda should consider increasing farming outputs as well as hastening the oil production expected this year from Tilenga and Kingfisher blocks. These measures will help to mitigate the effect of the supply chain disruptions resulting from the Russia-Ukraine conflict on the Uganda economy.

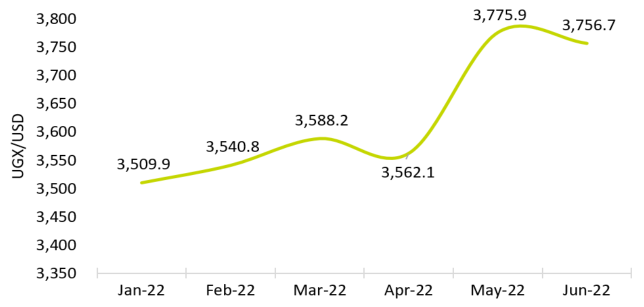
Inflation – The debacle of the year 2022

Uganda M-o-M inflation rate 2022



Source: Bank of Uganda

Uganda (USD/UGX) Exchange rate



Source: Bank of Uganda

Uganda's inflation increased from 2.7% in January 2022 to 6.8% as of June 2022 driven by rising in fuel, food and transport prices attributable to the increase in global commodity prices because of the supply chain disruptions stemming from the Russia-Ukraine conflict. The inflation rate is forecast to rise to 7% by end of 2022.

The prices of essential commodities such as cooking oil, soap, fuel, transportation and food have gone up. Cooking oil and food crop prices increased by 43% and13.6% respectively in May 2022. Core inflation rose to 5.5% in June 2022.

In July 2022, the Bank of Uganda (BoU) increased the Central Bank Rate (CBR) from 7.5% to 8.5% in June 2022 and intervened through the purchase of dollars to accumulate reserves in a bid to mitigate the surging inflation rates. The increased cost of borrowing is expected to result in decreased purchasing power due to higher loan servicing payments.

7%

Forecasted inflation rise by the end of 2022

The UGX in May 2022 highly depreciated against the dollar at UGX 3,775.9/USD. This decrease was a 2.6 % loss of value to the dollar month-on-month and 2.3% decrease year-on-year. This was brought about by strong demand for the dollar amongst importers due to the tightening of monetary policy by the US Federal Reserve system that agitated offshore investors in Uganda.

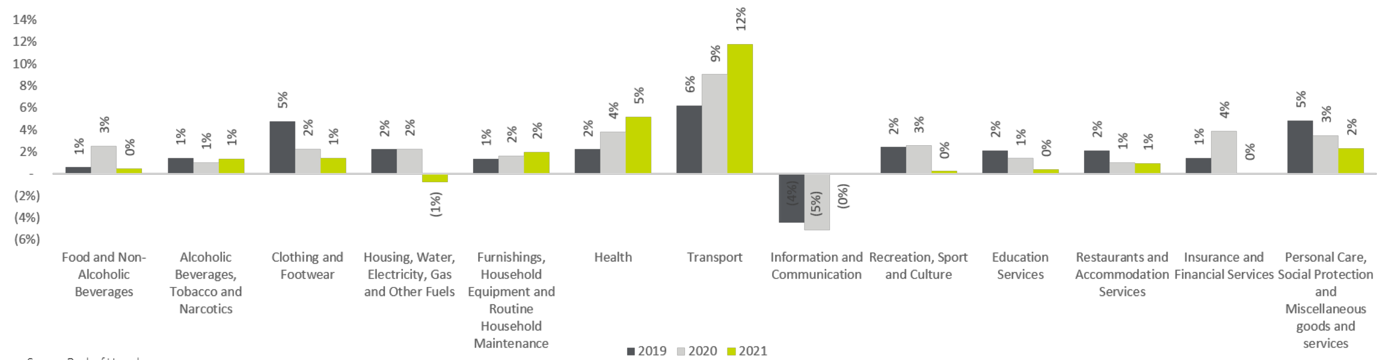
Real household spending grew by 4.5% attributable to the economy rebound in 2021 from the 0.6% contraction in 2020 that was as a result of the negative impacts of COVID-19 in the economy.

Real household spending growth in Uganda is expected to accelerate in 2022, reaching 5.5% from 4.5% in 2021 as ongoing economic growth improves the wages and employment prospects of consumers. Unemployment is forecasted to decrease by 2% in 2022.

However, effects of the Russia-Ukraine conflict, supply-chain disruptions and rising fuel prices have impacted inflation in Uganda over 2022 and are key risks to the improving consumer spending through the year.

Impact of inflation on the Ugandan consumer

Commodities % change in prices year-on-year

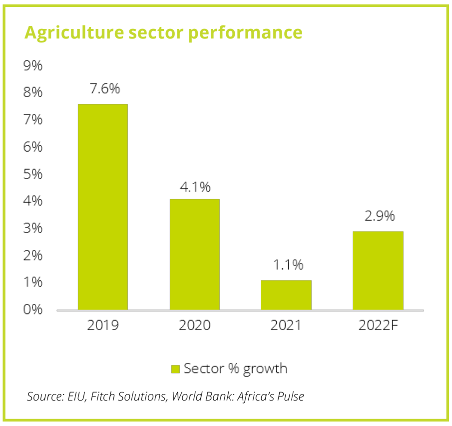


Source: Bank of Uganda

Division of commodities	2019	2020	2021
Food and Non- Alcoholic Beverages	27.5%	27.5%	27.5%
Housing, Water, Electricity, Gas and Other Fuels	10.4%	10.4%	10.4%
Transport	10.5%	10.5%	10.5%
Restaurants and Accommodation Services	8.7%	8.7%	8.7%
Information and Communication	4.4%	4.4%	4.4%
Education Services	5.8%	5.8%	5.8%
Personal Care, Social Protection and Miscellaneous goods and services	5.4%	5.4%	5.4%
Furnishings, Household Equipment and Routine Household Maintenance	4.8%	4.8%	4.8%
Alcoholic Beverages, Tobacco and Narcotics	3.9%	3.9%	3.9%
Clothing and Footwear	6.9%	6.9%	6.9%
Health	4.8%	4.8%	4.8%
Insurance and Financial Services	2.3%	2.3%	2.3%
Recreation, Sport and Culture	4.9%	4.9%	4.9%
Total	**100.0%**	**100.0%**	**100.0%**

Source: Bank of Uganda

Agricultural sector



In 2021, agriculture accounted for about 22.7% of GDP, 31% of export earnings and employed about 70% of Uganda's working population.

The sector is estimated to have grown by 1.1% in 2021, underperforming from a 4.1% growth in 2020. The decline in growth was mostly driven by unfavourable weather conditions and the UGX 103bn decrease in the agriculture budget following the reduction of funds from donors and lingering effects of the C0VID-19 pandemic on global supply chains.

Coffee export earnings hit a record USD 719m in 2021, attributed to the rise in coffee prices globally, coupled with the coffee roadmap established by the government in 2015, which has been instrumental in growing coffee production over the years.

As of 30 September 2021, the Agriculture Credit Facility (ACF), a private-public partnership with the end goal of modernisation, commercialisation and value addition of raw outputs in the agricultural ecosystem, had a loan book worth UGX 624.7b, signifying increased credit demand from UGX 581.3b in December 2020.

Growth in the sector is expected to rise to 2.9% in 2022, driven by improved productivity through sector-specific projects, such as the Acomai irrigation scheme and export-focused production of cash crops. Downside risks to the growth prospects are expected to come from the increasing frequency and intensity of climate shocks in the country.

Prices of staple sorghum and maize among other stable food prices are increasing steadily attributed to the growing food inflation. Food and related inflation rose to 13.6% in May 2022 from 3.7% in January 2022.

In February 2022, Uganda exited the International Coffee Organisation citing unfair tariffs and is currently boosting domestic coffee production with a forecast of producing 5.95m 60kg bags in 2022 owing to harvests from recently established platforms and good weather.

Like many economies around the globe, Uganda has not been spared from the effects of the Russia-Ukraine conflict. Uganda's main exports to Russia and Ukraine are leaf tobacco and coffee, and the ongoing conflict is expected to stifle trade thus negatively affecting export earnings.

Tourism sector

Tourism inflows increased to USD 249.3m in Q3 2021 from USD 84.3m in the corresponding period of 2020. This improvement was largely due to the relaxation of travel restrictions on international travel. Despite the relaxation of the travel restrictions, travel and tourism activities are expected to pick up at a slow pace.

The Uganda Tourism Board (UTB) in October 2021 launched a strengthened multi-level tourism campaign to attract residents from the UAE and other gulf counties to select Uganda as a tourism destination. In May 2022, UTB in partnership with Jinja City Authority (JCA) announced plans to develop Jinja in FY23, making it a getaway tourism city.

UTB has also entered a partnership with the Uganda Electricity Generation Company Limited to package and market the hydropower dams at Karuma and Isimba as infrastructure tourism products.

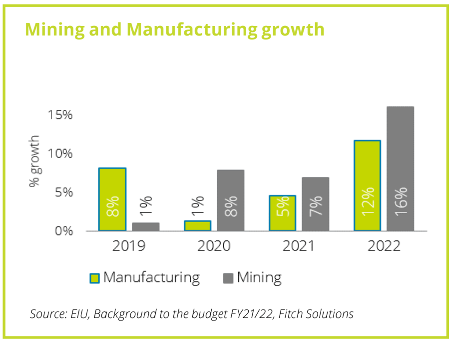
The tourism sub-sector will continue to remain heavily reliant on regional travel with visitors from other African countries accounting for more than 74.6% of total tourist arrivals in 2021, an increase from 64.9% in 2020, with Kenya being its largest tourist market in Africa due to proximity and the free labour movement.

Uganda's hotels and accommodations are largely dominated by cost-effective, locally owned guest lodges and hotels. The total occupancy rate increased marginally to 18.6% in 2021 from 16.9% in 2020 and is forecasted to grow to 26.2%, attributable to the increase in total overnight stays from 0.2m in 2021 to 4.3m in 2022.

Uganda Airlines (UA) announced plans to start operating routes to China and the United Kingdom (UK) by end of 2023 after securing landing slots at Guangzhou Baiyun International Airport.

A recovery in tourism is in place with tourist arrivals arriving for business and leisure forecasted to increase by 107.7% in 2022 to 600,100 from an estimated 289,900 in 2021. This will increase tourism receipts to USD 0.3b in 2022 from USD 0.2b in 2021.

Industry (Mining/Quarrying, Manufacturing)



Manufacturing grew by 5% in 2021 on account of increased foreign direct investment arising from the final agreements on the Lake Albert development project and increased activity in processing and preserving of meat and pharmaceuticals.

Uganda has been keen on deepening relations with the Democratic Republic of Congo (DRC) by encouraging business transactions in order to exploit the DRC's natural resource deposits, thus granting Uganda wider access to raw materials for manufacturing.

Manufacturing is forecasted to increase to12% in 2022 driven by policies aiding local manufacturing such as Local content Bill that is currently in parliament, the PPDA guidelines of 2018, the Parish Development Model and the Investment Code Act 2019, which prioritise local manufacturing.

In FY 2020/21, the Government through Uganda Development Bank (UDB) issued UGX 455.2b to support private investments by offering low interest financing to manufacturing and agribusiness.

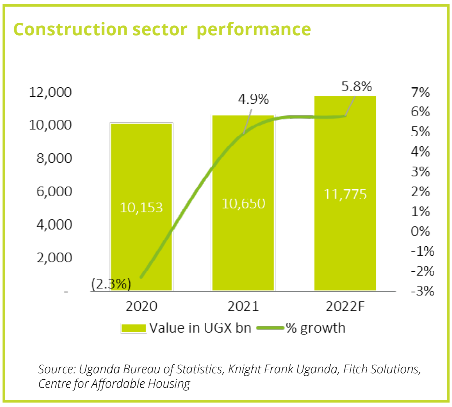
On the other hand, mining and quarrying contracted by 7% in 2021 from 8% in 2020 due to the unavailability of credit facilities, which negatively affected mining and quarrying activities.

Mining is expected to rebound to 16% in 2022 driven by the availability of low-interest financing and rapid expansion in electricity generation driven by the completion of the 600MW Karuma Hydropower Plant which will boost the supply from an estimated 0.9TWh in 2021 to 1.2TWh by 2023.

Furthermore, the Mining (Amendment) Bill, 2021, which imposes an export levy amounting to USD 200 per kg on processed gold and un-processed minerals, was passed in February 2022 and is expected to encourage the processing of minerals in Uganda moving forward.

In February 2022, the Mining and Minerals Bill was passed which supports the establishment of the Uganda National Mining Company, which will manage the government's commercial holding and participating interests in mineral agreements.

Construction & Real Estate sector



Uganda's construction sector achieved a 4.9% growth in 2021 to reach UGX 10.7tn despite the COVID-19 pandemic disruptions which delayed projects due to supply chain issues; and weakened domestic revenue generation thus limiting public investment in the sector.

Ambitious infrastructure projects undertaken by the government were the drivers of growth in 2021, some of which included the launch of a UGX 19.0bn road project in Busia on the Kenya border; and the release of UGX 73.1bn by the Uganda Road Fund for the maintenance of public roads.

The construction sector is expected to grow by 5.8% from UGX 10.7tn in 2021 to UGX 11.8tn in 2022 driven by the development of the Lake Albert oil fields and investment in supporting infrastructure.

In February 2022,Total Energies and China National Offshore Oil reached a final investment decision to invest more than USD 10bn in the Lake Albert Oil Project.

The Residential Property Price Index (RPPI) – which measures the change in the average level of prices paid by households for residential properties sold – averaged 106.9 in 2021. This was a 2.2% contraction from an average of 109.1 in 2020, mainly as a result of the tightened lockdown in Q3 2021 which subdued property demand.

According to Knight Frank Uganda, in 2021, the general retail property market performed approximately 12% below pre-Covid 19 numbers due to depressed spending by consumers and restricted trading hours. However, prime residential properties registered a 12% growth in occupancy in H2 2021 compared to H2 2020 following the return of expatriates after the lifting of travel restrictions.

Following the signing of key oil agreements, increased leasing activity is expected from the oil and gas sector in 2022, alongside an increase in the number of expatriates coming into the country. This will have a positive impact on the occupancy rates and rents of prime residential properties and office spaces.

Financial services sector

Banking

Deposits and Loans

Source: Bank of Uganda, EIU, Fitch Solutions

The Bank of Uganda lowered its policy rate from 7.0% in January 2021 to 6.5% in June 2021 to ensure the stability of the financial markets. In order to mitigate the rising levels of inflation, the policy rate was raised to 7.5% in June 2022 and further to 8.5% in July 2022.

The value of new loan applications rose by 9.8% from UGX 4.1tn in Q4 2020 to UGX 4.5tn in Q4 2021, signifying increased demand for credit, which was reflective of increased economic activity following the gradual easing of lockdown measures.

Credit supply increased from UGX 2.4tn in Q4 2020 to UGX 2.5tn in Q4 2021, 30% of which was personal and household loans. This signified increased confidence by banks in their customer base. However, credit supply was yet to reach pre-pandemic levels of UGX 4.8tn.

Non-performing loans (NPL) ratio averaged 5.2% in 2021, down from 5.5% in 2020 indicating improved asset quality.

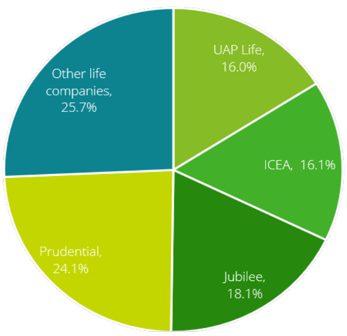
The aggregate net profits after tax for commercial banks increased from UGX 846.2bn to UGX 1.1tn in 2021. The 26.9% growth was largely driven by increases in interest income from Government securities and loans. Return on assets also improved from 1.8% in 2020 to 2.7% in 2021.

Commercial lending rates are expected to rise to 20.4% in 2022 from 18.5% in 2021 owing to the Bank of Uganda implementing a tighter monetary policy in order to contain demand pressures. This will lead to an increase in the cost of borrowing for households and businesses, thus slowing the uptake of credit.

Client loans and deposits are expected to grow by 10.1% and 13% respectively in 2022. While improving macroeconomic conditions supported growth in credit demand in H1 2022, rising inflation is expected to weigh down on business sentiment and household spending thus limiting credit demand in H2 2022.

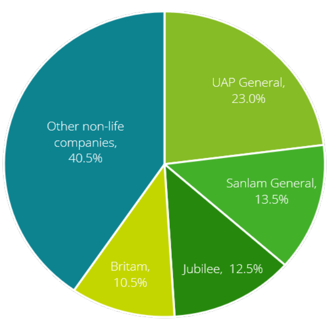
Insurance

Life insurance market share as at December 2021



Source: Fitch Solutions, Insurance Regulatory Authority of Uganda

Non-life insurance market share as at December 2021



Source: Insurance Regulatory Authority of Uganda

The insurance sector closed the year at UGX 1.19trn in 2021 up from UGX 1.06trn in 2020, driven by a UGX 71.5b increase in life premiums, which closed the year at UGX 395.5b. Prudential Life, Jubilee, ICEA and UAP Life comprised 74.3% of total life premiums.

Non-life premiums slightly declined by 0.04% closing at UGX 664.7b in December 2021 with UAP General, Sanlam General and Jubilee comprising 49% of these premiums.

Growth was mostly driven by the efforts of the regulator to try and ensure innovation of products that addressed people's needs. Prompt claims payment also enhanced confidence in the sector, supporting its growth.

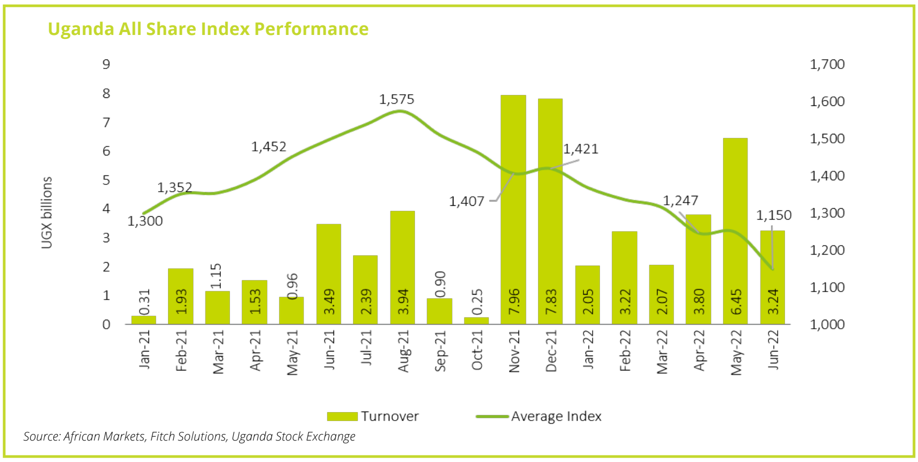
The sector is expected to get more resilient to withstand shock as the regulator moves to enforce the 200% Capital Adequacy Ratio, which will improve the liquidity of insurance companies and consequently their ability to meet their claim liabilities.

The launch of the Assured Lives Mortality Table (ALMT) in April 2022 is expected to drive growth by offering up-to-date reflective statistics that will be used by life insurance companies as a baseline for costing risk thus promoting accurate pricing of insurance products and valuation of technical provisions.

Gross life premiums are forecasted to grow by 8.1% in 2022, driven by the regulator's efforts to increase access and affordability of life insurance, while gross non-life premiums are expected to grow by 7.5% on the back of continuing innovation and new product launches.

Growth in the insurance sector was driven by the 18% increase in premiums in the life insurance market. The 7.8% forecasted growth in total gross premiums is set to face downside risks owing to the rising inflation that will reduce purchasing power, thus curtailing demand

Equity Markets



Uganda All Share Index Performance

Source: African Markets, Fitch Solutions, Uganda Stock Exchange

Total market capitalisation increased by 33.6% from UGX 18.3tn at the end of 2020 to UGX 24.4tn in 2021 mainly driven by MTN Uganda's first Initial Public Offering (IPO) where it raised UGX 535.3bn, making It the first IPO on the Uganda Stock Exchange (USE) since 2018 and the largest IPO on the USE since the exchange's inception.

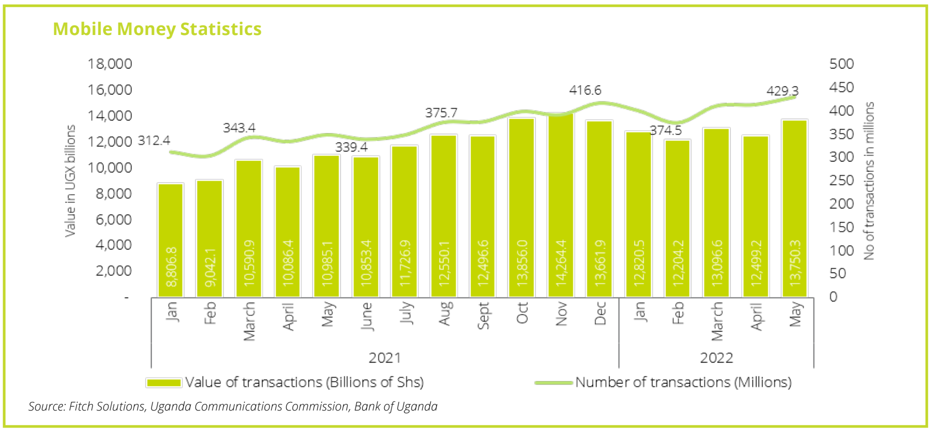
November and December 2021 recorded turnovers of UGX 7.96bn and UGX 7.83bn respectively owing to MTN Uganda's IPO activity in November, while Stanbic accounted for 81.7% of the total turnover in December 2021.

The stock exchange is expected to expand further following the government's announcement requiring local telecom operators to list a minimum of 20% of their shares on the bourse by 2022. Lycamobile and Uganda Telecom are expected to list by the end of 2022.

As of 30 June 2022, the USE's total market capitalisation stood at UGX 19.7tn. This is a 19.3% decline from UGX 24.4trn in December 2021, driven by market volatility which negatively affected share prices.

UMEME was the most traded counter in Q2 2022 with a turnover of UGX 8.9bn, accounting for 66.6% of the total quarterly turnover.

Technology, Media & Telecommunications sector



Mobile Money Statistics

Source: Fitch Solutions, Uganda Communications Commission, Bank of Uganda

Mobile money penetration stood at 76% driven by the 6.8% y-o-y growth in registered mobile money subscribers from 30.7m in Q4 2020 to 32.8m in Q4 2021. This was mainly due to consumers pivoting away from cash to mobile financial services owing to the Covid-19 pandemic.

Active mobile subscriptions totaled 30.2m in Q4 2021 up from 27.8m in Q4 2020 translating into a 69% penetration rate, despite the stricter second lockdown, which slowed down business and subsequently had an encumbering effect on new SIM acquisitions.

As at Q4 2021, total active internet connections stood at 23.9m up from 21.4m in Q4 2020, translating into a penetration rate of 52%. This can mainly be attributed to increased demand over the festive season in Q4, characterised by heavy promotional campaigns for both gadgets and data offerings.

The 12% excise duty tax imposed on internet usage that replaced the daily social media tax, was made effective on 1 July 2021 and is expected to stifle innovation and restrict internet access due to the resulting price hike. This will negatively impact the growth of internet subscribers in 2022.

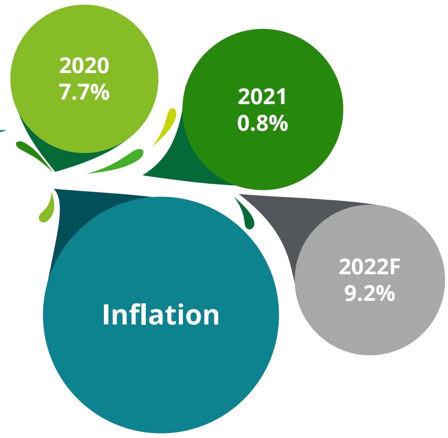
Increasing government intervention in the sector is also expected to hinder growth mainly because of favouritism towards the state-run Uganda Telecoms, which has a 53% market share. Furthermore, low urbanisation levels – an estimated 74.4% of the population was living in rural areas in 2021 – is expected to have a limiting impact on investment opportunities for telecoms operators.

As of the end of Q1 2022, total active internet connections stood at 23.5m, a 1.7% decline from Q4 2021, mainly owing to the return to school and workplaces that has dampened the demand for Study From Home (SFH) and Work From Home (WFH) packages. However, mobile money accounts grew by 2% attributed to mobile money activation campaigns and loyalty programs targeting incumbent non-users.

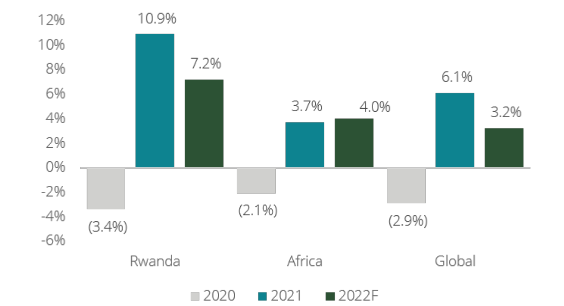
Rwanda Macroeconomic & Sectoral Analysis

Rwanda
Economy at a glance

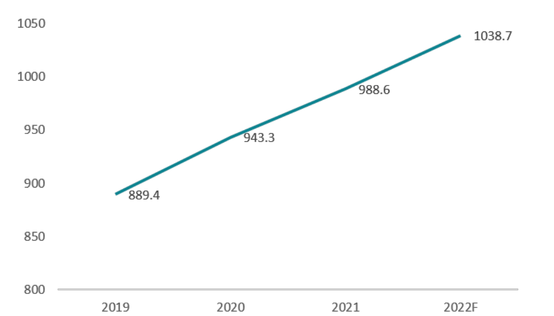
Inflation eased from 7.7% in 2020 to 0.8% in 2021 mainly as a result of increased agricultural yields and a rebound in transport activities following the gradual re-opening of the economy, which eased food and transport services inflation respectively. Inflation is expected to increase to 9.2% in 2022 owing to the increased costs of imports as global oil and commodity prices rise following the Russia-Ukraine conflict.



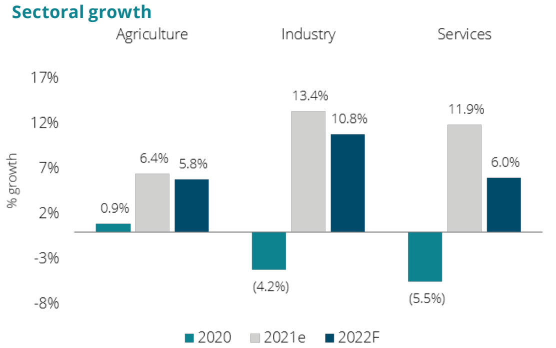
Real GDP growth rate



Rwanda exchange rates



Sectoral growth

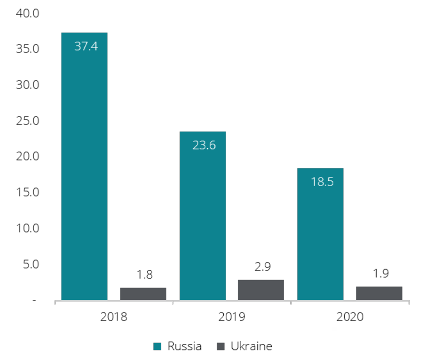


Source: World Bank, IMF, EIU, Fitch, NBE, Deloitte Analysis

- In 2021, Rwanda's economy achieved a broad-based recovery and grew by 10.9%, underpinned by a recovery in external demand for commodities, resumption of construction activity and steady growth in the services sector. The 7.2% forecasted growth in 2022 will be driven by an expected recovery in tourism activities. However, the Russia-Ukraine conflict poses a downside risk.
- Money remittance inflows increased from USD 274m in 2020 to USD 379m in 2021, a 38.3% growth, which was reflective of the rebound in the global economy. The main driver of this growth was the shift from costly remittance channels to cheaper alternatives such as mobile network operators.
- The Rwandan franc (RWF) depreciated by 4.8% against the USD from RWF 943.3 in 2020 to RWF 988.6 in 2021, owing to persistently higher imports of capital and intermediate goods and high Covid-19 related spending. Further, the RWF is expected to depreciate to 1,038.7/USD in 2022 owing to an increased current account deficit.
- The stock of foreign exchange reserves as of December 2021 stood at USD 1.9bn, covering 5.3 months of imports of goods and services. Owing to the increased build-up of foreign reserves, coverage is estimated to remain adequate, covering 4.6 months worth of imports in 2022.
- The current account deficit improved to 10.9% of GDP in 2021, driven by higher remittances and Government budgetary grant inflows. The deficit is expected to widen to 11.9% in 2022 owing to a rise in the goods and services import bill.
- Public debt to GDP ratio is expected to average 62.1% in 2022-2023 and will be funded mostly by international concessional borrowing.to finance the Lake Albert Oil Project scheduled to commence in 2022.

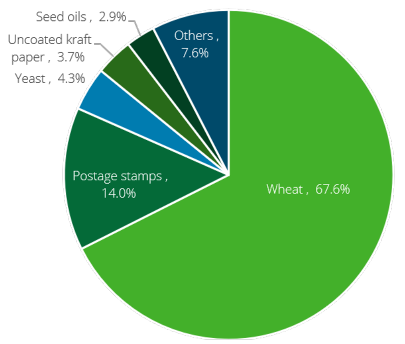
Impact of the Russia-Ukraine conflict

Total imports from Russia and Ukraine (USD 'm)



Source: EIU, National Institute of Statistics Rwanda

Composition of total imports from Russia and Ukraine to Rwanda in 2020



Source: EIU, National Institute of Statistics Rwanda

Rwanda is heavily reliant on Russia for wheat imports, with an estimated 64% of Rwanda's wheat coming from Russia. The Russia-Ukraine conflict is expected to weigh in on Rwanda's economic recovery owing to worsening external conditions, including further price spikes in international commodity and energy prices and a slower pace of recovery in trading partners.

Higher global energy and commodity prices are expected to add to the inflationary pressure and further widen the current account deficit. Inflation is now expected to average 8.0% in 2022, from 0.8% in 2021.

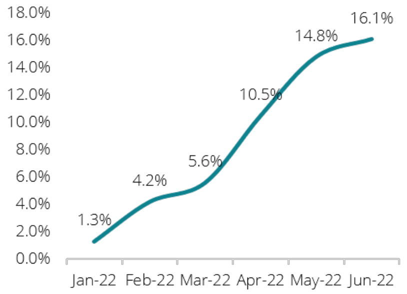
Russia and Ukraine were the leading origin markets for wheat and sunflower oil in 2021. Russia stood as the world's leading exporter of nitrogen fertilisers and the second leading supplier of both potassic and phosphorous fertilisers. Wheat, fertilisers and sunflower oil products make up a large share of Rwanda's imports from Russia and Ukraine, representing an estimated 64%,14% and 10% of total imports on average respectively for the past five years.

The conflict has resulted in disruptions to global supplies of wheat and driven up the prices of related products such as flour and bread, with the price of a 25-kg bag of wheat flour soaring from RWF 20k before the conflict to over RWF 25k after the conflict. Rwanda is now seeking alternative source markets of wheat, while also considering other options, including mixing wheat flour with flour from other products sourced locally such as sweat potatoes and cassava to make bread.

Amid instability in the global oil market caused by the conflict, the prices of petrol and diesel were increased by the Rwanda Utilities Regulatory Authority (RURA) in early April. The price of petrol was hiked by 8.2% to RWF 1,359 per litre and diesel by 13.9% to RWF 1,368 for a period of two months, a move that has resulted in higher prices of other commodities.

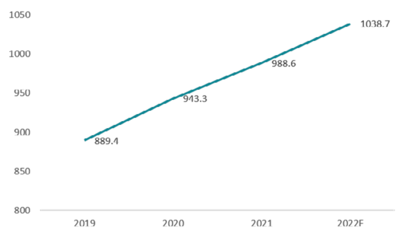
Inflation – The debacle of the year 2022

Rwanda inflation rate



Source: National Institute of Statistics Rwanda, National Bank of Rwanda

Rwanda (RwF-USD) exchange rate



Source: National Institute of Statistics Rwanda, National Bank of Rwanda

Rwanda's inflation increased from 1.3% in January 2022 to 16.1% in June 2022, a 13-year high, driven by elevated global food, commodity and fuel prices attributed to supply chain disruptions stemming from the Russia-Ukraine conflict.

The year-on-year prices of food and non-alcoholic beverages surged by 26.1%, furnishings and household equipment increased by 19.3%, transport by 8.8% and housing, water, electricity and other fuels by 9.2%. Low agricultural production in season A (September 2021 to February 2022) is expected to further fuel inflation through a rise in food prices.

Natural gas prices surged by 182.7% in 2022Q1 compared to an increase of 76.2% in 2021Q1 and are projected to increase by 88.3% in 2022. This is reflective of the global oil supply shock owing to Russia's invasion of Ukraine and related sanctions and policies.

16.1%

Rwanda's inflation rate as of June 2022

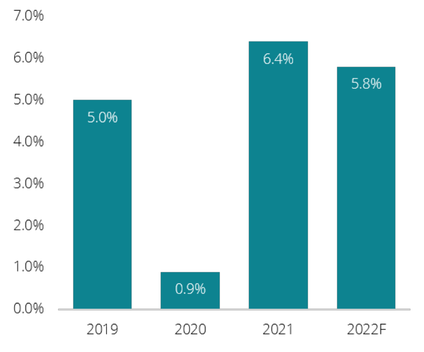
The Rwandan Franc weakened slightly against the USD from RWF 1,012.5/USD in Jan 2022 to RWF 1,022.2/USD in May 2022 owing to the mismatch between foreign currency inflows and outflows. The mismatch was attributed to the increased cost of importation of capital and intermediary goods as a result of supply chain disruptions.

The National Bank of Rwanda (NBR) increased the Central Bank Rate (CBR) from 4.5% in April 2020 to 5.0% in February 2022 to tackle inflationary pressures amid rising domestic and global demand and increasing commodity prices. Despite the move, inflation pressures remained high, mainly due to global supply challenges as well as lower domestic agriculture output.

In light of this, Rwanda's inflation is projected to average 12.1% in 2022. Given these developments and economic outlook, the National Bank of Rwanda increased the CBR by 100 basis points from 5.0% in February to 6.0% in August to tame the inflationary pressures and hence preserve consumer purchasing power.

Agricultural sector

Rwanda Agriculture sector perfomance



Source: EIU, National Institute of Statistics Rwanda

Agriculture has historically served as the mainstay of Rwanda's economy, employing 72% of the population and contributing 27.8% to GDP in 2021. The contribution of agriculture to GDP is expected to decrease as the country missions to develop from an agriculture-based economy into a knowledge-based economy.

Growth in the agriculture sector is expected to moderate to 5.8% in 2022, from 6.4% in 2021 due to the anticipated unreliable weather conditions. Increased food crops and forestry activity as well as expansion in export-focused subsectors such as coffee, horticulture and tea present upside growth opportunities for the agriculture sector in 2022.

Tea and coffee are Rwanda's principal exports, comprising over 29% of total exported goods while plantains, cassava and beans are the highest yielding crops. Wheat and edible oils are not dominant food staples for most households, hence changes in world prices do not have a large effect on domestic prices.

Rwanda earned USD 158.5m in revenue from the exportation of agricultural products in Q2 of the 2021/2022 fiscal year, a 39% increase from USD 114.1m in Q2 of the 2020/2021 fiscal year, driven by the increase in export revenues from traditional commodities such as coffee, tea and pyrethrum.

Export revenues from tea sales increased by 25.5% in Q2 of the 2021/2022 fiscal year, reaching USD 23m from USD 18m in Q2 of the 2020/2021 fiscal year. The increase was due to a 6.9% increase in tea export volumes coupled with a 14.8% increase in the average international tea prices where a kilogram of tea increased to USD 3.1 from USD 2.7.

Coffee export revenues increased to USD 38m in Q2 of the 2021/2022 fiscal year from USD 26m in Q2 of the 2020/2021 fiscal year. The growth was attributed to the 15.5% increase in coffee export volumes coupled with a 32.4% increase in the average international coffee prices, where a kilogram of coffee rose to USD 4.9 from USD 3.7.

Rising fertiliser prices may cause some farmers to reduce their use of this input, leading to lower agricultural production and higher food prices.

5.8%
Expected growth of the agriculture sector in 2022

Tourism sector

Rwanda total tourist arrivals

Source: National Institute of Statistics Rwanda, Fitch Solutions

Tourism is the largest earner of foreign exchange in Rwanda and the biggest contributor to the national export strategy, a framework aimed at accelerating export growth.

Tourism earnings increased from USD 131m in 2020 to USD 164m in 2021 driven by government support through the Economic Recovery Fund (ERF), diversification of tourism products, the sport tourism strategy, strong presence in global media, and the exemplary COVID-19 response and management efforts by the Government of Rwanda (GoR).

Total tourist arrivals grew by 17.3% in 2021, reaching 827k visitors from 705k visitors in 2020, reflecting a gradual resumption of travel and tourism activities. Arrivals are expected to grow by 75.7% in 2022, soaring to 1.5m visitors, driven by the easing of travel restrictions in 2022. Expected arrivals in 2022 will, however, still be 10.3% below the 2019 numbers.

75.7%
Expected growth in total tourist arrivals in 2022

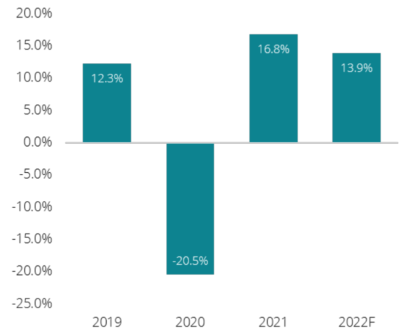
Growth in tourism was also supported by activities conducted under the Arsenal Football Club("AFC") and Paris-Saint Germain("PSG") partnerships including co-branding with AFC, the launch of the PSG academy in the Huye District and promotional videos on Kigali's Golf Course featuring top PSG players.

Upcoming infrastructure projects, comprising expansion works at Kigali International Airport and the construction of Bugesera International Airport are expected to lead to an increase in international tourism arrivals, supporting recovery in the tourism sector.

The International Finance Corporation in February 2022 announced a partnership with 3B Group of Hotels aimed at strengthening Rwanda's tourism sector by supporting the company's expansion and upgrade of current lodges.

Transport and Aviation sector

Rwanda Transport sector performance



Source: National Institute of Statistics Rwanda, EIU

Rwanda's transport sector posted a 16.8% growth in 2021 largely driven by the resumption of travel activities due to the easing of COVID-19 restrictions.

The sector is estimated to grow by 13.9% in 2022 driven by the Government's eagerness to improve regional integration for the landlocked country. This will be achieved through building of new road and rail links, as well as the rehabilitation of existing ones, and investment in airport infrastructure.

Notable projects in Rwanda's pipeline comprise the 51km extension of the Base-Nyagatare road linking Rwanda to Mombasa port along the eastern DRC which is supported by a USD 74.4m loan from the African Development Bank (AfDB), the rebuilding of the 136km road at a border post near Uganda as well as the 120km road on the Tanzanian border at a cost of USD 237.7m.

Expansion works at Kigali International Airport began in May 2020, involving expansion of the arrival terminal to have an extra passenger processing line and extension of the runway strip to 3.1km. Phase 1 is expected to be completed in 2023, with phase 2 expected to become operational in 2032, with an estimated annual passenger handling capacity of 14m passengers.

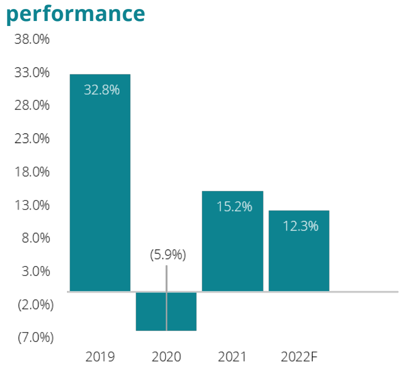
13.9%
Expected growth of the transport sector in 2022

The construction of Bugesera International Airport near Kigali, is one of the largest projects currently in the pipeline in Rwanda, involving development of passenger and cargo terminals and a 4.2km runway, expected to achieve an annual handling capacity of 7m passengers.

Completion of the Isaka-Kigali SGR and port facilities at Nkora and Karongi on Lake Kivu are expected to drive down the cost of freight transport, improve transport logistics in the region and reduce the risk of disruption on the country's road network. Once complete, Nkora is expected to have an annual freight handling capacity of 0.6m tonnes and 0.5m passengers, while Karongi is expected to have a capacity of 0.3m tonnes and 0.3m passengers.

Construction sector

Rwanda Construction sector performance



Source: National Institute of Statistics Rwanda, EIU

Rwanda's construction sector rebounded strongly in 2021, posting a 15.2% growth that was primarily driven by stable external financing and the resumption and initiation of major construction projects. These included the USD 560m Gisagara peat-fueled power plant and the USD 468m Rusumo Falls hydropower project.

Growth is expected to moderate to 12.3% in 2022, driven by the construction of Kigali Innovation City, with an expected cost of USD 300m (around 2.3% of GDP). Growth will also be underpinned by construction works on the Rusumo hydroelectric plant, with a total cost of USD 468.6m and major drainage-related infrastructure investment in Kigali.

The cost of importation of construction equipment has been increasingly driven by rising inflation and supply chain disruptions. This presents downside risks to the growth forecast in 2022.

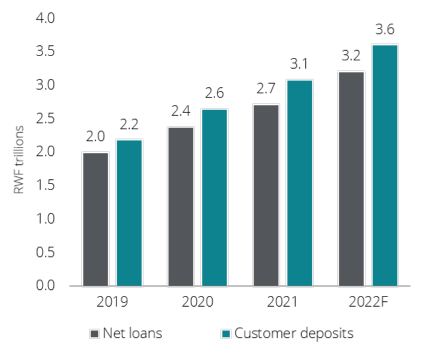
The Government of Rwanda is keen to diversify the agriculture-reliant economy to a knowledge-based economy, with investment in the power, transport and ICT sectors central to this aim. Investment flows are expected to focus on the expansion of the power grid, given the vital role it plays in the country's ICT sector, while driving the construction of non-residential centers housing national and international ICT firms.

12.3%
Expected growth of the construction sector in 2022

Demand for low and affordable housing is expected to rise, driven by the rising population, an emerging and growing middle class and government expenditure on infrastructure expansion. The country is targeting the construction of 150,000 housing units annually to meet its housing demand of 5.5m units to accommodate an estimated 22m people by 2050.

Growth in the non-residential subsector is expected to be driven by the implementation of the Kigali City Master plan and secondary cities. Growth will also be underpinned by the Government's efforts to establish knowledge-based and financial sector hubs in Kigali. This will complement private sector-led efforts to develop refining capacity, exemplified by the expected launch of the country's first coltan refining capacity in 2022.

Financial services sector
Banking and Equity Markets



Source: Fitch Solutions, National Bank of Rwanda, African Markets

The Central Bank Rate (CBR) remained constant at 4.5% throughout 2021 in order to support economic recovery. However, given the growing inflationary pressures, the rate was raised to 5.0% in February 2022 to contain inflation while continuing to support economic recovery.

Commercial lending rates slightly declined from 16.4% percent in 2020 to 16.2% in 2021, partially linked to the increase in low-priced long-term loans. On the other hand, deposit interest rates increased from 7.6% in 2020 to 8.1% in 2021, which contributed to a rise in deposits by corporates.

Following the relaxation of the Covid-19 related restrictions and an improving economic outlook, there was a 15.3% increase in the value of new loan applications from RWF 1.3tn in 2020 to RWF 1.5tn in 2021, thereby signifying rising demand for credit.

Net loans grew by 12.5% in 2021 compared to a 20% growth in 2020 mainly on account of the re-instatement of the credit classification and provisioning regulation which requires banks to write off loans that are overdue for more than two years. This led to an increase in loan write-offs from RWF 22bn in 2020 to RWF 75 bn in 2021.

4.6%

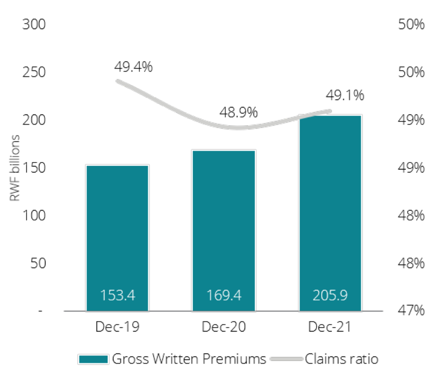
Non-performing loans ratio as at December 2021

The non-performing loans ratio stood at 4.6% in December 2021 compared to 4.5% in December 2020 owing to the phasing out of pandemic related loan moratoriums and credit relief measures that expired in September 2021. Mortgages formed majority of the non-performing loans comprising 46.5%, followed by trade loans at 28.3%.

The CBR was increased from 5.0% in February 2022 to 6.0% in August in order to reduce inflationary pressures while commercial lending rates will slightly increase to 17%. Growth in net loans and client deposits is expected to average 19% and 16% respectively based on expected economic growth.

The Rwanda Stock Exchange All Share Index closed 2021 at 145.3 points, down from 148.2 points in 2020. The Memorandum of Understanding (MoU) signed with the Luxembourg Stock Exchange in March 2022 is expected to yield better performance on the Rwandan bourse with the possibility of future dual-listing schemes between the two exchanges.

Insurance



Source: National Bank of Rwanda

Rwanda's insurance sector is composed of 13 private insurance companies, 9 of which offer non-life insurance products, 3 offer life insurance and 1 micro-insurance business. Public insurance comprises of 2 health insurance companies.

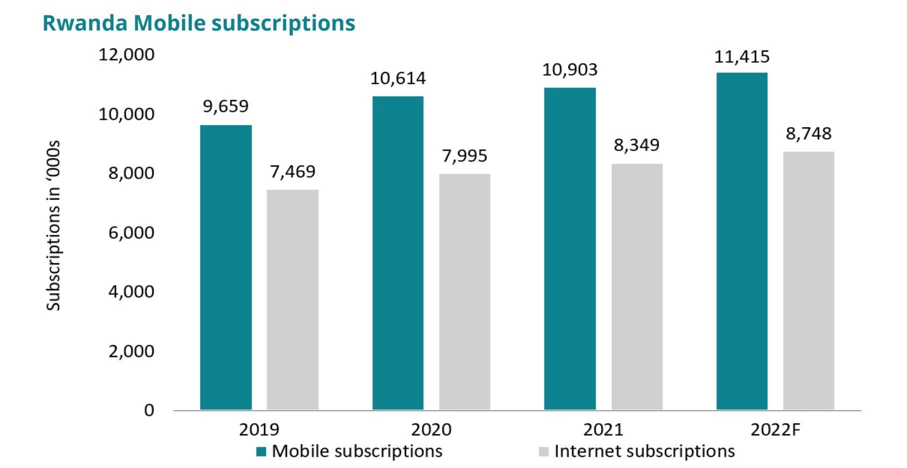
Gross written premiums increased by 22.0% from RWF 169.4bn in 2020 to RWF 205.9bn in 2021 mainly on account of:

- Growth in medical claims associated with an increase in the price of drugs in Q3 2021; and
- Growth in motor claims associated with an increase spare parts prices and increased road accidents mainly due to the rush to beat curfew hours imposed to contain the spread of coronavirus.

The claims ratio increased to 49.1% in 2021 from 48.1% in 2020 mainly driven by:

- Growth in medical claims associated with an increase in the price of drugs in Q3 2021; and
- Growth in motor claims associated with an increase spare parts prices and increased road accidents mainly due to the rush to beat curfew hours imposed to contain the spread of coronavirus.

Technology, Media & Telecommunications sector



Source: National Bank of Rwanda, Rwanda Utilities Regulatory Authority, Fitch Solutions

Rwanda's telecommunications sector is dominated by 2 players; MTN Rwanda and Airtel-Tigo whose market shares stood at 64% and 36% respectively as at the end of Q1 2022.

Q1 2022 registered a 2.8% decline in mobile subscribers from 10.9m in Q4 2021 to 10.6m owing to the implementation of the new requirements for SIM registration and swapping which started in September 2021, in an effort to curb fraud.

The removal of charges on transfers between bank accounts and mobile wallets led to a 36.8% increase in the value of mobile money payments from RWF 3.8tn in 2020 to RWF 5.2tn in 2021, and an 87.4% increase in the value of mobile banking transactions from RWF 277bn in 2020 to RWF 519b in 2021.

Despite strong government support and operators' efforts to extend network coverage to the country's rural population, their low purchasing power will discourage further expansion as low returns are expected from this consumer base.

As of Q4 2021, internet penetration stood at 64.4%, 48.9% being 2G internet. 3G services took a while to take off in the country, mainly because of the high cost of international bandwidth and data-enabled devices. 82.2% of the population lives in rural areas and has low purchasing power.

The completion of Rwanda's terrestrial fibre optic network linking international submarine cables through Kenya and Tanzania, and the growing demand for data services among Rwanda's young population is expected to drive growth in 3G internet services.

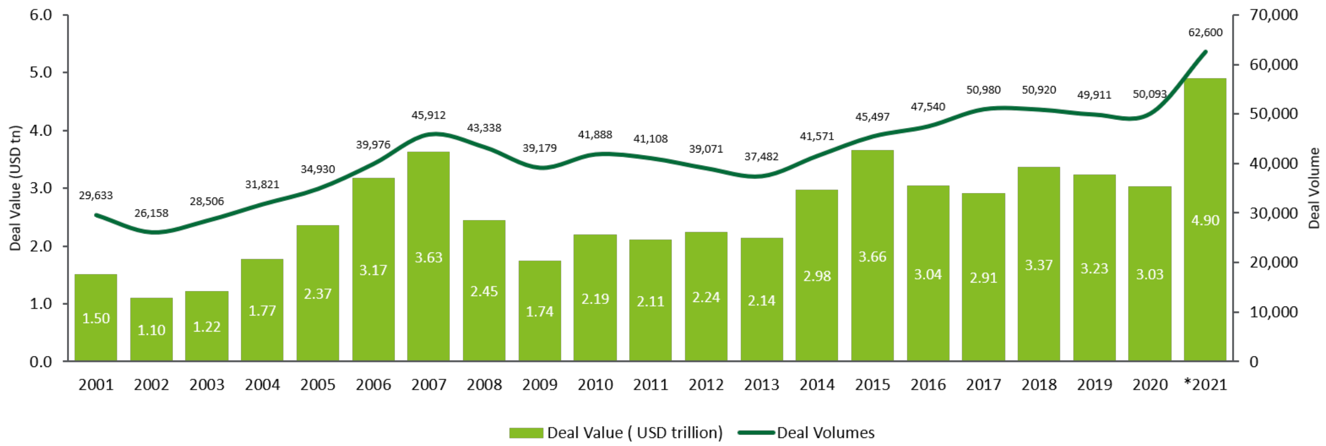
82.1%

Mobile penetration rate as at the end of Q4 2021

M&A Landscape

An overview of the Global, Africa, and East Africa scene

Global M&A Activity



USD 3.5tn

Global corporate cash reserves Q2 2021

USD 5.8tn

Value of investment grade bonds raised by corporates in lieu of low interest rates

USD 2.3tn

Private Equity dry powder August 2021

USD 4.9tn

Worth of deals were announced in 2021, the highest ever for a year on record

USD 1tn+

First time ever that announced deal value has surpassed USD 1tn in all the quarters of a year

USD 1.3tn

Value of deals announced in TMT sector, a 59% y-o-y increase in activity

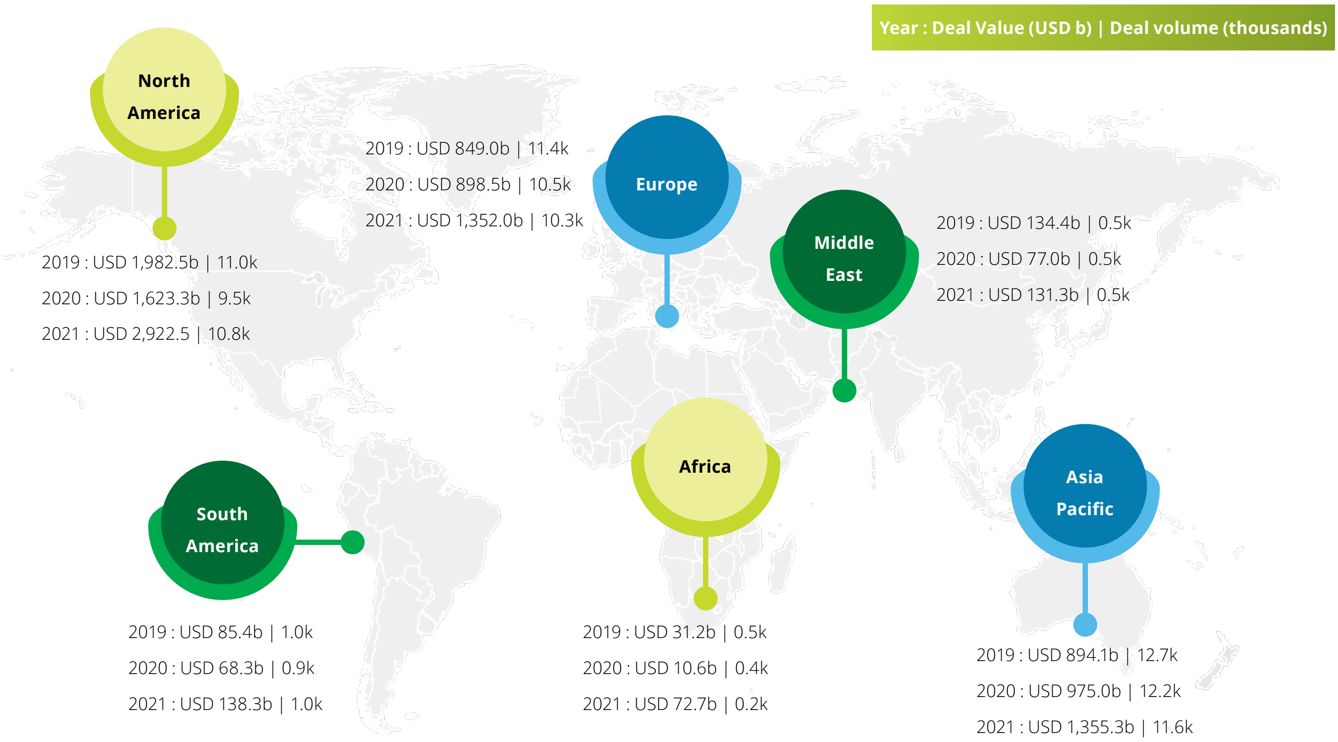
144

Mega deals (>5B) announced, accounting for 23% of the total value

Source: Deloitte M&A Insight. Data for Oct 2020 to Sept 2021 unless otherwise stated.

Global M&A Activity

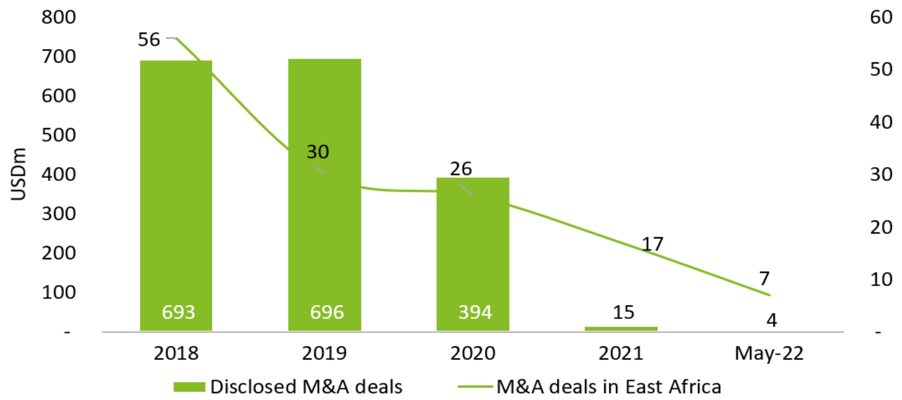
Africa M&A activity revamped in 2021, amid a 586.9% increase in deal value driven primarily by finalising of pending deals in 2020 and improved investor confidence in line with improving economic recovery over the same period. Cross border M&A shaped global M&A activity in 2021 with cross border deal value accounting for 70% of Africa's total deal value in 2021



Source: Mergermarkets, Refinitiv

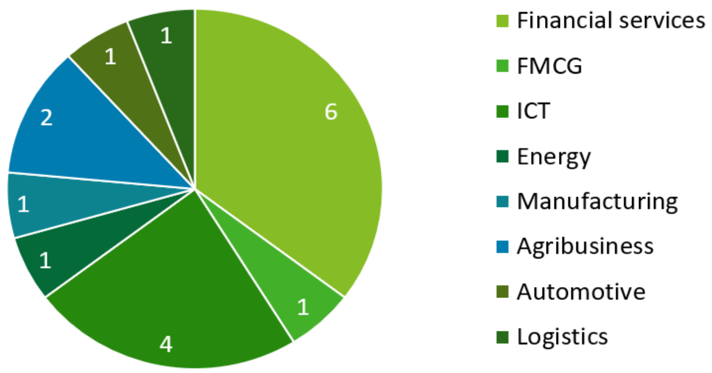
East Africa M&A Activity

M&A deals and the amount disclosed in East Africa



Source: Thomson Reuters, Deloitte research

M&A Deals by sector in 2021 in East Africa



Source: Thomson Reuters, Deloitte research

M&A in Africa exhibited a rebound in 2021 from a challenging 2020 due to the COVID-19 pandemic. M&A deal value was estimated at USD 72.7b with nearly 200 deals, partly attributable to the post-pandemic boost, which saw transactions that were postponed and delayed in the previous year being able to proceed in 2021.

Sub-Saharan Africa, in the first quarter of 2022 announced M&A deals valued at USD 7.0b, a 13% decrease in deal value compared to the similar period in 2021 despite a 11% increase in the number of deals.

Technology, Media and Telecommunications (TMT) led in the deal value while the financial services sector led in deal numbers in the region. South Africa led the region recording USD 2.5b worth of M&A deals, 48% of the total M&A deal value in Q1 2022.

M&A deals in East Africa declined by 34% by number of deals with 17 deals in 2021 in comparison to 20 deals in 2020 due to COVID-19 effects. It is forecasted to decrease further with the increased preference for Private Equity (PE) over M&A due to availability of developmental capital in developed economies.

Following a turbulent 2020, 2021 was viewed globally as the recovery year. The prevalence of PE deals in the region with 76 PE deals and 5 PE exit deals in 2021 is an indicator of the preference of PE over M&A. This is as a result of; increased availability of developmental capital from Developmental Finance institutions (DFIs) that work with PE firms as co-investors as well a conducive business environment that favoured PE over M&A in the developing countries.

M&A in East Africa is forecasted to decrease further in 2022 with businesses still recovering from the effects of COVID-19 and the impact of the August elections in the Kenyan economy, which hosts most of the deals in East Africa. If the prevailing operating challenges are not addressed, foreign-driven transactions are expected to dip further. Notwithstanding, the increase of distressed businesses requiring buy-out, bolt-on acquisitions, or fresh capital injection is expected to increase the number of local M&A deals.

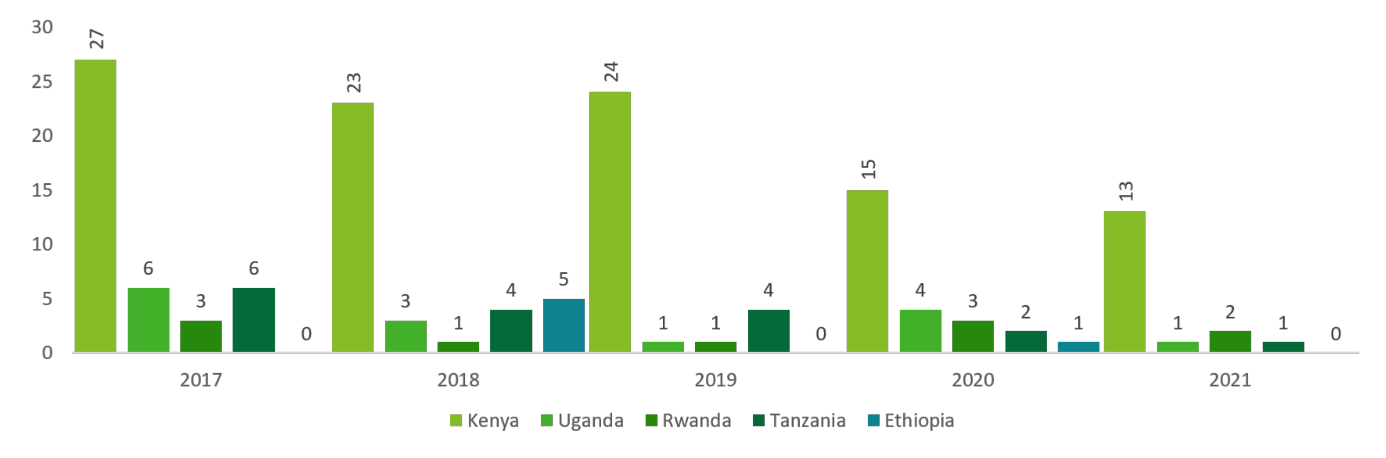
Acquisition roll-ups are expected to increase with consolidation, reduction in competitors and a shift in competitive dynamics to qualitative factors such as brand and technology in various sectors in East Africa.

Kenya recorded 13 M&A deals out of the total 17 deals in 2021, Uganda recorded 2, Rwanda and Tanzania each recorded 1 deal with none in Ethiopia. This was a decline from 2020 when Kenya recorded 15 deals, Uganda 4, Rwanda 3, Tanzania 2 and Ethiopia 1 deal. The financial sector was the predominant sector in 2020 and 2021.

The technology sector's number of M&A deals increased in 2021 to 4 deals from 1 in 2020 largely attributed to the increased technology and telecommunication use during COVID-19, innovations that arose out of the gaps realised in the technology used in East Africa and the willingness of investors to invest in the sector. With several tech unicorns sprouting across the African continent, the East African region and predominantly Kenya (the 'Silicon Valley of the region) is set not to miss out on the growth with an increasing number of tech start-ups already witnessed.

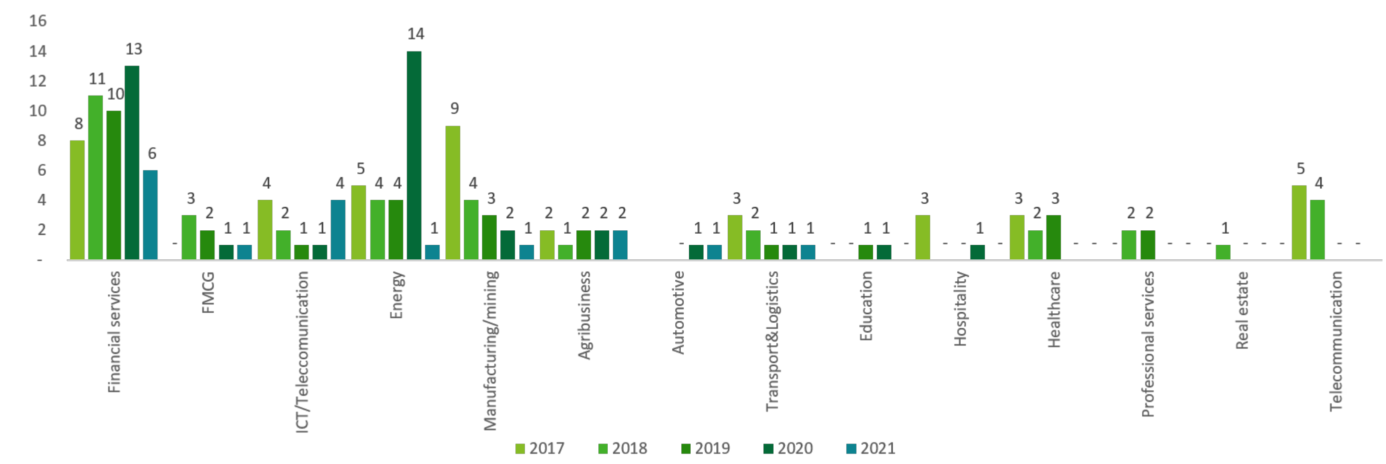
While a robust transaction environment is expected, the global impact of the Russia-Ukraine conflict is expected to lead to an increase in inflation and a generally bearish market in the region in response to increased oil prices and food prices. M&A deals are thus likely to decrease, citing market uncertainties with most companies taking a 'wait and see approach as they assess the impact of rising energy prices.

M&A deals per East African Country



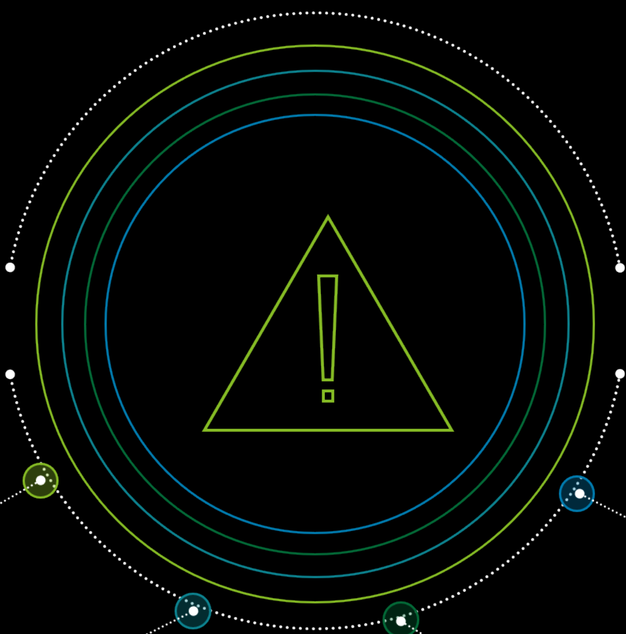
Source: Thomson Reuters, Deloitte research

M&A deals per sector in East Africa



Source: Thomson Reuters, Deloitte research

Challenges facing M&A in East Africa



Challenges in conducting due diligence on target companies

A critical part of the M&A deal process, due diligence ("DD") plays a pivotal role in assessing the financial soundness of potential targets. This involves an analysis of historical performance and an evaluation of the operating environment to infer future performance. Key challenges experienced in DDs comprise tight deadlines, inadequacy in the skills in the finance function and low quality of financial information. Inadequate due diligence presents the risk of mis-assessment of the going concern of the target, resulting in an uninformed merger or acquisition.

Under-developed potential targets

Most of the deal flows in East Africa are originated from foreign investors who prefer targets within certain bands of revenue and profitability. With few of these targets available, this causes an over-emphasis on a few sectors. Data shows that the energy and natural resources, fast-moving consumer goods and financial services sectors made up an average of 45% of total deal volume in East Africa between 2015 and 2019.

Difficulty in pricing deals in an uncertain market

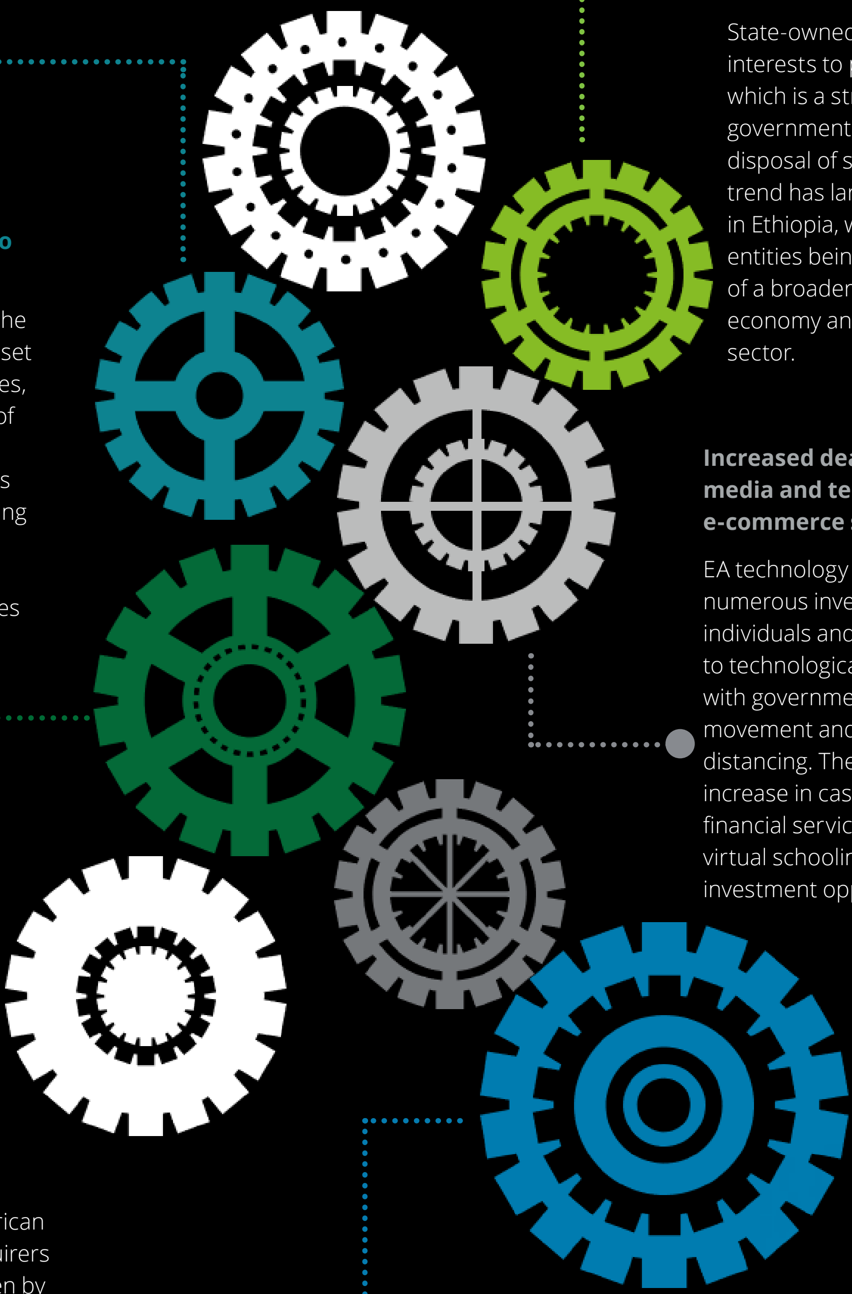
Most investors looking to deploy capital in the East African region have expressed concerns about the quality of assets, the reasonableness of their valuation asking prices and the fairness of market pricing. This growing concern comes in the wake of uncertainty in the political environment in Kenya and Ethiopia and is likely to affect deal volumes.

Regulatory framework

Although the East African region through the economic bloc EAC, has been trying to implement a harmonised approach to regulation of M&A through the EAC competition regulations of 2010, the countries have yet to fully implement the regulation. This poses a challenge, particularly to cross-border deals.

Source: Deloitte research

Key trends in M&A in East Africa



Increased state privatisation activity

State-owned enterprises are reviving interests to privatise their assets, which is a strategic tool to generate government revenue through the disposal of state-owned assets. This trend has largely been witnessed in Ethiopia, with key state-owned entities being privatised as part of a broader effort to reform the economy and expand the private sector.

Move towards asset and business sale as opposed to share sale

A recent trend witnessed is the shift towards business and asset sales as opposed to share sales, largely due to the protection of the acquirer from the target's past liabilities. This shift places huge importance on conducting adequate tax and financial due diligence to get sufficient protection as regulatory bodies continue to impose stringent conditions on transactions.

Increased deal activity in technology, media and telecommunication and e-commerce sectors

EA technology start-ups are attracting numerous investments attributed to individuals and companies shifting to technological solutions to comply with government directives, restricting movement and encouraging social distancing. The pandemic drove the increase in cashless transactions, digital financial services, remote work and virtual schooling, stimulating technology investment opportunities.

Rise of African acquirers

M&A deals have historically been dominated by non-African multinationals. African acquirers have been on the rise, driven by the African Continental Free Trade Area (AfCFTA) which is expected to promote economic integration, accelerate economic growth, and attract foreign investment - a potential development for not only revitalising the region's M&A market but also for its overall economic recovery.

Rise of distressed M&A transactions

Buyers with strong market positions and an appetite for risk are expected to seek to capitalise on the opportunities available in the most challenged sectors such as retail, transport, energy, hospitality and leisure. The oil and gas industry and non-core infrastructure sectors are also facing significant stress, presenting opportunities for buyers.

Source: Deloitte research

The ESG Imperative

Introduction

As emphasis continues to be laid on business responsibility, Environmental, Social and Governance (ESG) has become a critical consideration globally for mergers and Acquisitions.

This has further been motivated by coming to the fore, the concern of climate change, whose effects have become more palpable in recent years.

Authorities have continued to create frameworks on which companies will rely to make disclosures about the ESG activities.

Global scene

A survey conducted by Deloitte in March 2022 on 300 finance, accounting, sustainability and legal executives revealed that only 21% of respondents had an ESG council or working group.

Access to reliable and accurate data remained the biggest challenge for organisations.

57% however indicated that they were actively working to establish ESG functions within their organizations.

Investment in green solutions has however grown to make up USD 39tn in the 5 major global markets in 2022, up from USD 26tn in 2020.

Africa scene

Significant progress has been made towards adopting ESG practices in Africa.

In 2018, the Africa Securities exchanges Association set up a sustainability working group with the aim of creating a sustainability roadmap for exchanges in Africa.

Despite this initiative, however, the world bank estimated that less than 0.1% of the USD 1tn green bonds were raised in Africa in 2022. The level of disclosure on sustainability practices by listed companies also remained low, averaging at 30% excluding South Africa, which had 70%.

East Africa scene

The East African region still lags behind regional peers in ESG practices. According to the Sustainability Stock Exchanges Initiative, of the four exchanges in the region, only the Nairobi Securities Exchange published an annual sustainability report and required listed companies to have ESG reporting.

Similarly, both the regional and country competition authorities, which are responsible for oversight of mergers and acquisitions, do not have an elaborate ESG framework guiding the deal process.

The lack of a regulatory framework in the region prevents organizations from disclosing and undertaking ESG practices.

Source: Deloitte research

The ESG Imperative

1 Accelerate ESG goals & assess opportunities

Combining strategy, transaction and ESG experts from across the globe, we build the right team to explore potential ESG M&A strategies, aligning ESG ambition with wider long-term growth strategies.

Our target screening approach is customised to the client's impact preferences, incorporating regulatory, technological, megatrend and investor sentiment considerations into target selection and valuation, and producing an impact thesis that outlines the client's contribution to a specific sustainability challenge.

2 Prepare for the transaction. Identify & mitigate transaction & closing risks

To facilitate our client's ability to make fully informed transaction decisions, we use our extensive deal, industry and ESG experience to highlight key issues and navigate blockers in valuations; deal structure; execution efforts and integration or separation planning.

Throughout the ESG Diligence process we assess and quantify target ESG impact and performance focused on key areas of risk including supply chain, sector/asset level physical climate risks and social impact; then identify and quantify opportunities to enhance ESG performance and credentials.

3 Set-up up for success from transaction close

Whether integrating or separating an entity, our team develops a plan to deliver on the anticipated ESG synergies. This can include the design of ESG target reporting and market engagement programs, workshops to assess how to reverse integrate sustainable practices of the target and ensuring all regulatory and compliance obligations are met.

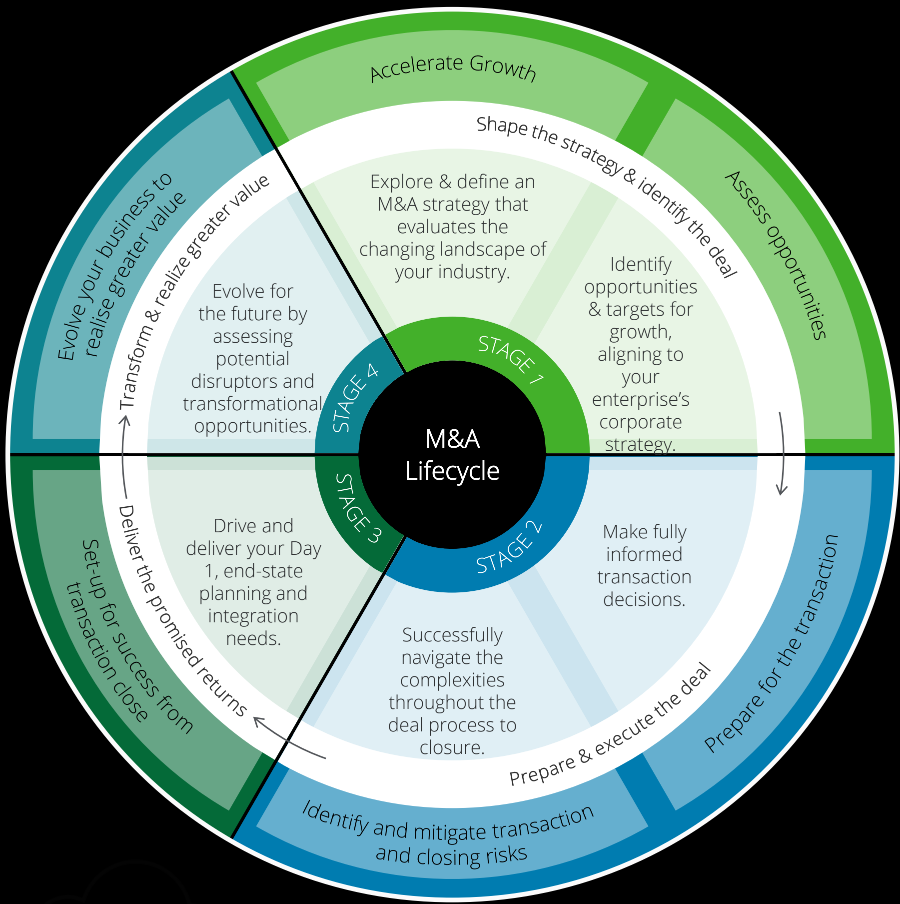
To unlock the full value of the transaction, we can jointly develop a comprehensive and integrated company-level ESG strategy with the new owners to drive a smooth and successful transaction.

4 Evolve your business to realise greater value

The complex nature of an M&A deal will often prompt our clients to seek a more in-depth and robust understanding of potential disruptors and transformational opportunities to evolve and advance the sustainability of their business.

This might include driving impact through value creation from sustainable assets, setting targets and delivering change related to the company's performance, and tracking progress made towards these goals through quantifiable KPIs.

The role of Deloitte as a transaction advisor



1 Accelerate ESG goals & assess opportunities

Combining local and global expertise, we build the right team to explore potential growth strategies, assessing how emerging tech can accelerate inorganic and organic growth opportunities. Our target screening approach and experience help identify attractive and plausible acquisition targets, encompassing options to diversify or increase market differentiation

2 Prepare for the transaction. Identify & mitigate transaction & closing risks

To facilitate our client's ability to make fully informed transaction decisions, we use our extensive deal and industry experience to highlight key issues and navigate blockers in valuations; deal structure; execution efforts and integration or separation planning.

Throughout the diligence process, we impartially interrogate the deal, provide solutions to any risks, and identify and quantify potential upsides. An Executive briefing plan and board paper help ensure senior stakeholders understand the deal rationale and its implications, including closing risks.

3 Set-up up for success from transaction close

Whether integrating or separating an entity, our team develops a plan to deliver on the anticipated business synergies. This can include running workshops to assess how sales teams, suppliers, employees, systems and processes will integrate; developing a customer retention plan, and ensuring all regulatory and compliance obligations are met.

To unlock the full value of the transaction, we can also create and design talent retention programs, and help manage change and communication initiatives to drive a smooth and successful transaction.

4 Evolve your business to realise greater value

Transform While You Transact. The complex nature of an M&A deal will often prompt our clients to seek a more in-depth and robust understanding of potential disruptors and transformational opportunities to evolve and advance their business.

This might include assessing avenues for value creation, exploring performance improvements, or reviewing readiness for disruptive technologies or events that may impact the future stability and success of the business.

The role of Deloitte as a transaction advisor

With Deloitte M&A Services, your ability to source one advisor across the transaction lifecycle becomes a reality.

Shape the Strategy & Identify the Deal

Our advisors help define an M&A strategy that evaluates the changing landscape of your industry to identify opportunities and targets for growth, while aligning to your enterprise's corporate strategy.

Strategy Review

Can we use inorganic strategies to accelerate the implementation or realization of our growth ambitions?

Opportunity Assessment

How should I evaluate and capture the growth opportunities i.e. buy / invest/ collaborate?

Portfolio Rebalance

What is the optimal portfolio structure? Which assets to divest and which ones to acquire?

Growth Capital

How do I deploy growth capital strategically by investing in emerging trends and opportunities?

Prepare & Execute the Deal

From financial, tax, commercial and operational, HR/benefits, ESG and IT due diligence to structuring advice and financing options, we bring deep capabilities to help clients successfully navigate the complexities of a closing process.

Preparation & Negotiation

How do I best prepare for the transaction?

Due Diligence

Do I have a comprehensive diligence process that identifies financial, commercial, cyber, ESG, tax and legal risks?

Deal Structuring

Are we paying / receiving the right multiples and structuring the deal in a tax efficient manner?

Completion

How do I address transaction closing risks?

Deliver the Promised Returns

Integrating or divesting involves an additional set of challenges – costs, timelines and disruption to business as usual. Our lead advisors drive and deliver your Day 1, end-state planning and integration needs.

Set for Success

Do I have a clear view on what is required to deliver on Day 1, Day 30 and Day 100?

Skills & Resources

Do I have the right people, skills and tools to deliver optimal deal returns?

Synergies

How do I identify, track & report synergies?

Carve-out

How do I protect the retained business from the carve-out?

Transform & Realise Greater Value

Evolve for the future by assessing potential disruptors and transformational opportunities. Often pursued in parallel with the transaction the energy of a deal can be harnessed to redefine your organization – Transform While You Transact.

Value Creation

How do I evolve my business to realise greater value?

Disruptive Innovation & Transformation

Am I prepared for disruptive innovation & digital transformation?

Be your own Activist

How do I conduct a rigorous company examination to pre-empt investor activists?

Business Continuity

Is my company protected against disruption eg supply chain alternatives?

Contact us

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