

LMA Developing Markets Conference – 27 April 2022

Panellists discussed key topics relevant to developing market jurisdictions at the present time. These included:

The war in Ukraine

The Russia-Ukraine conflict had already taken 1% off global growth (reducing it from 4.4% to 3.4%) and had further contributed to a large hike in the price of fuel, particularly in African countries such as Nigeria and Kenya. The Ukrainian economy itself was likely to face a 35% real GDP drop in 2022. The situation was also already having a noticeable impact on supply chains in respect of goods exported from Ukraine – this was likely to lead to problems in Sub-Saharan Africa, for example, as it received about 28% of its wheat from Russia and 12% from Ukraine. Overall, the situation had the potential to have a negative impact on the world economy, though much would depend on how quickly the situation was resolved.

Impact of Covid-19

African countries had rebounded much faster than the western market in response to COVID-19 lockdowns - various things (including increased consumer spending) had helped with this, but the fact that governments had chosen not to take advantage of debt service suspension initiatives had also cemented trust and encouraged greater long-term investment in those countries. For example, Sub-Saharan Africa had already benefitted from bond investors moving into South Africa in both the local currency and US dollar bond market. Its rebound from the pandemic was hoped to promote trust in the continent, and its resilience should serve as an example to Western countries. That said, ongoing lockdowns in China could have an adverse impact on the continent if they continued for much longer due to the country's role as a long-term investor on the continent.

Outside of Africa, most developing market regions outside the eurozone had recovered to 2019 levels due to fiscal and monetary injections by governments and central banks.

ESG

Panellists discussed the importance of Green, Social and Sustainability Linked Loans and the nuances differentiating the three: 'Green' and 'Social' loans focused on the use of the proceeds for 'green' and 'social' purposes, whereas 'Sustainability-linked' loans were focused upon incentivising a borrower to comply with certain KPIs and performance targets. Sustainability linked loans took up the largest part of the market, and common metrics included CO2 emissions and employee management, with margin-ratchets being offered when targets were met.

The main borrowers seen thus far in a developing markets context had been banks, as such loans did not require a change to their underlying business models; corporate borrowers, by contrast, had been smaller in number and were focused on Turkey and the Middle East. Green and social loans had been seen in Turkey and other frontier markets (ESG loans had increased sixfold in the course of the last year) with the most notable example being Credit Suisse and Standard Chartered Bank financing a railway project in Turkey. The broader market had witnessed social loans but at a government level.

African countries still lagged behind slightly in their approach to ESG, with tension being seen regarding the approach which should be taken in respect of “less-ESG friendly” sectors such as oil and gas, which African economies were still very much dependent upon.

Inflation

Inflation continued to have an impact on the market more broadly, with central Banks hiking interest rates as inflation remained high. This, for example, had led to a detrimental impact on the consumer price index of food and non-alcoholic beverages in developing market economies.

The impact of LIBOR's demise and Risk-Free Rates

The impact of the demise of LIBOR and the transition to RFRs in developing markets was a diverse and multi-faceted picture. This was mostly due to the prevalence of the US dollar in these countries, as a result of which different approaches were being seen in terms of whether to transition using a compounded in arrears methodology or by using term SOFR. So far there had been progress, with larger borrowers engaging in the process early. However, difficulties had arisen with less sophisticated borrowers still demonstrating a lack of awareness regarding the transition process and therefore transitioning at a slower speed. However, with inflation and interest rates on the rise, this stance had started to change.

Nevertheless, transition had its challenges for developing countries: for example, how to deal with credit adjustment spreads, look back periods (particularly relevant for countries with exchange controls) and fallbacks. The Islamic Finance market had also had difficulty with transition due to compounded SOFR not complying with Sharia law, and so the market would possibly have to move forward using term SOFR instead. That said, lenders in these countries were aware of the need to transition, and fortunately due to the presence of some sterling-based deals in, for example, South Africa, internal systems were set up to deal with the transition in the context of the dollar.

Risk Mitigation

Panellist discussed risk mitigation strategies taken by DFIs, ECAs, and Insurers when lending and driving deals in developing markets. The outlook was positive in this context but challenging, although the market had continued to expand. However, whilst there had been an increase in confidence, this has not yet increased to meet pre-COVID levels.

Traditional origination of loans was however happening again, which meant a likelihood of increased demand for local currency loans and diversification of that risk moving forward. Healthcare, green energy and infrastructure were the key areas of growth seen to date. However, with political risk increasing and inflationary pressures ongoing, there could be domestic issues within certain regimes. This meant that pricing from a political risk perspective was likely to be affected.

Focus: Sub-Saharan Africa

Panellists discussed syndicated lending in the Sub-Saharan market. GDP growth in Sub-Saharan Africa had remained flat in comparison to Europe's 3% decline, and average loan volumes had recovered somewhat since 2021. This demonstrated that the loan market had been extraordinarily resilient, as there had been appetite for credit despite a slowdown in growth and capital expenditure.

Most loan volumes currently in the market were for well-structured deals which were fully underwritten, with the insurance market also being tapped into quite effectively. There had been increasing competition for banks looking to invest in and identify leads on the continent. Typically, new investors to the continent would deal with sovereigns and financial institutions as well as the oil and gas sector, before then branching out into project finance and corporates. However, it should be recognised that sovereigns were now focusing much more on ESG and sustainability linked loans to draw in pockets of liquidity.

Focus: MENA and Turkey

Panellists discussed loan volume and transactions in Turkey and MENA. Loan volumes had not been the same as in previous years, with transactions not underwritten due to the lack of liquidity in the market. In the Middle East, banks were flush with US dollars due to high oil prices and were seeking ways to deploy excess funds. Moving forward it would be therefore necessary to consider the large amount of market liquidity and the consequent pressure to release capital.

Due to geopolitical tensions in Eastern Europe and Africa more deals were likely to be seen in MENA going forward, for example in countries such as Oman and Bahrain.