Navigating Change

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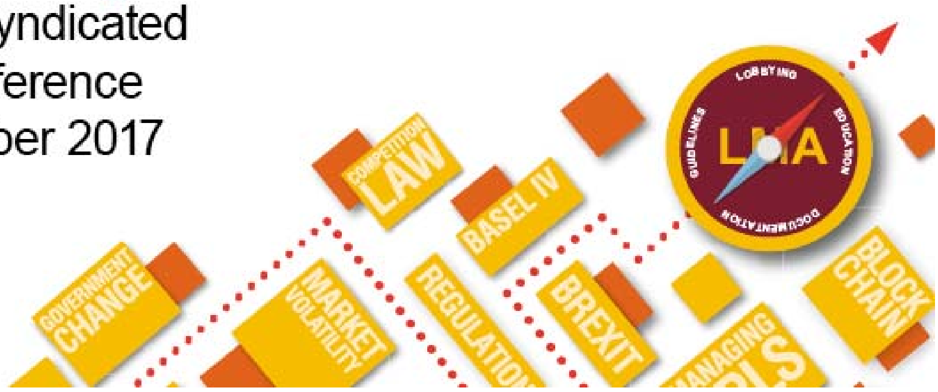

Developing markets: finding the safe harbours

The developing markets panel addressed some of the main opportunities and challenges facing emerging economies within the syndicated loan market.

The panel was chaired by **Edward George**, Country Head, UK Representative Office & Head of Group Research at **Ecobank**; **Lorenz Jorgensen**, Head of Loan Syndications at **EBRD**; **Raouf Jundi**, Managing Director at **MUFG**; **Alper Kilic**, Head of Corporate Finance, Europe & Head of Loan Syndications, Europe & Africa at **Standard Chartered Bank**; and **Constantin von Moltke**, Head of Syndicated Loans at **Afreximbank**.

Changing sentiment towards developing markets

Throughout Q1 and Q2 2017, there has been a surge of investment flowing into emerging markets. This was certainly not the case two years ago, when there was a dearth of inward investment into these rapidly changing economies. Furthermore, in this year's audience vote, over 90% anticipated that lending activity would either increase or remain "rather unchanged" over the next year. The last 12 months have certainly seen an increase in business across the developing markets, with investors expecting yields to increase. As a result, it follows that debt funding in these regions is likely to grow. Whilst there are clearly obstacles to growth which must be overcome, it is anticipated that syndicated loan activity will rise.

Africa, in particular, has faced numerous challenges in the last few years, including declining loan volumes exacerbated by the commodities cycle, dwindling foreign currency reserves, and withdrawal of support by trade finance institutions. Yet the dynamism of the African loan market has bolstered resilience; and participants from across Europe, Asia, and the Middle East are now increasingly looking for opportunities to lend to the continent. Knowledge and growing use of standardised documentation have further resulted in improving, albeit selective, prospects within these markets.

Lending in Turkey

Over the last few years, liquidity in Turkey has benefitted from the decline in availability of liquidity in Russia and, since July 2014, a great deal of displaced Russian capital has found its home in Turkey. However, given the recent improvement in Russian political stability, competition for liquidity between the two jurisdictions is set to rise. In addition, following the coup attempt and subsequent declaration of a state of emergency, accompanied by a drop in tourist revenue, transaction volumes in Turkey fell by 25% in 2016. That being said, Turkey still sees a high volume of completed transactions; and stability is returning to Turkey's political arena, even if it may not fall within the Western definition of 'stable leadership'.

Overall, it is likely to take time before the true impact of Turkish political turbulence becomes palpable; and whilst there are concerns over levels of foreign direct investment, the economy nevertheless grew by 2.9% in 2016, with predictions for 2017-18 being upwards of 5% growth. Turkey, therefore, retains much of its economic strength, and banks are increasing their lending capacity – albeit for short tenors. Work is ongoing by development finance institutions, meanwhile, to increase tenor length and to funnel investment towards smaller corporates.

South Africa & Turkey – comparable markets with distinct features

These two countries have numerous things in common: each has suffered a recent credit downgrade; financial institutions are increasingly cautious about lending to these economies; and political instability remains an issue. Looking to the positives, however, both Turkey and South Africa continue to provide opportunities for investors. That said, there are also obvious differences between the two countries. For example, throughout 2016, in Turkey, syndicated facilities advanced to financial institutions were worth approximately $19bn; in South Africa the same market was worth around $2.5bn. However, in 2016, borrowing by corporates in South Africa was worth in the region of $20bn, whereas the Turkish corporate loan market was only worth about $8.3bn. The difference here is due to South African corporates syndicating their event-driven transactions, whereas in Turkey most non-FI transactions are project finance related.

Another contrast relates to tenors: in Turkey these are predominantly for 12 months, for South Africa they are in the realm of two to three years, on average. However, in terms of investor base, local banks are still providing the majority of lending for domestic corporates in both jurisdictions. Looking to the international sources of bank lending, in Turkey this comes largely from Middle Eastern and Japanese banks; in South Africa, a large chunk of international finance comes from Chinese banks in the form of bilateral loans. As regards the drop in liquidity suffered by both economies, in Turkey, corporates have been hit hardest, with many planned investments being postponed in the short term. The effect of the downgrade for South African corporates has been less noticeable; figures suggest that event-driven financing is still going ahead. Finally, whilst overall transaction volumes are holding in Turkey, it is too early to say how South Africa is faring in this regard.

Shifting appetite within the GCC

In 2016, transaction volumes rose close to their record peak of 2007-08: over $110bn in total. In terms of composition, interestingly, 75% of debt was either purely sovereign, government-related-entity or "sovereign-related" project finance, with the remaining 25% being allocated to financial institutions and the private sector. 2017, however, has seen a monumental shift, with an up to 60% decrease in volumes compared to 2016. Composition has also changed dramatically, with sovereign-related volumes decreasing and the private sector now making up over 60% of all borrowing. As the private sector is largely supported by domestic and regional banks, this shift has had a noticeable impact on the type of lender involved in syndicated loan transactions. Concurrently, the lending appetite of banks within the region has largely shifted inward, as a result of the drop in oil prices.

Following the political standoff in Qatar, appetite has remained the same – mainly due to a lack of outward demand from the jurisdiction, with Qatar satisfying its borrowing needs internally. However, the question remains unanswered as to whether international banks will provide support in the future. By contrast, the rest of the GCC has seen no appreciable negative impact in risk appetite by international lenders thus far.

Africa: opportunities vs. challenges

Africa is easiest to analyse when split into three separate markets: North Africa and Maghreb, Sub-Saharan Africa, and South Africa, since each has its own distinct dynamics. There are also three countries which, historically, have constituted a sizeable portion of African loan volumes; and each of these, at the present time, has its own distinct challenges to overcome: Nigeria, having suffered as a result of dwindling oil prices and a reduction in foreign currency reserves; Egypt, which has gone through substantial political turmoil and is at the tail end of a $12bn IMF rescue package; and finally South Africa, with its aforementioned sovereign credit downgrade.

That said, other African economies have been seen to benefit from the displacement of capital, which has also been leaving the likes of Turkey and Russia – and have been further assisted by their growth in manufacturing, as well as the privatisation of energy and transport. The most active investors are largely pan-African banks, with strong regional players from Nigeria and Kenya participating in cross-border, syndicated transactions. Middle Eastern banks have returned to a certain extent, and the region has also seen renewed interest from Far Eastern (primarily Chinese) investors. Overall, the international financial community has seen Africa's potential, and strategies are being reassessed to engender healthy and competitive market dynamics. The African loan market may be operating from a lower base when compared to other developing markets, but there are clear signs of a recovery.

What's more, encouragingly, development finance institutions and commercial banks have together risen to the task of providing frontier economies with tailored financial solutions. Despite pockets of unrest, many African countries are now benefitting from extensive periods of stable leadership and rapidly diversifying economies. Cote d'Ivoire, Kenya and Ghana are all examples of nations which have faced issues historically, be they political or economic, but have not struggled in recent times to raise money, due to their perceived viability as long-term investments. Challenges within the continent are also being met with creative solutions, and risk appetite, particularly as individual African economies are being evermore understood, is now increasing.

Correspondent banking in Africa: making compliance easier

Looking specifically to correspondent banking, the main obstructions to establishing and continuing cross-border correspondent relationships are that of KYC and AML compliance issues; parallel to this is the fact that many banks feel that the capital flows are not enough to justify the amount of work required. In terms of expense for compliance, the average cost "per customer" has risen from \$10,000 to \$75,000 in Africa; various pan-African banks have therefore been called upon to take over in those instances where existing international banking relationships have been deemed no longer commercially viable.

One recent initiative that is worthy of mention in this context is the African Customer Due Diligence Repository, an online platform intended to make KYC and AML checks faster and more cost-effective. Domestic central banks and registrars are providing much of the data required to populate the repository. This project has received support from the IFC, US Federal Bank, and the African Union.

Within the context of the syndicated loan market, correspondent banking supports liquidity; in markets where much of the effort is still focused on actually establishing an effective marketplace, it can be a useful tool to assist in establishing domestic loan markets. The emerging African markets would also benefit greatly from a standardisation of outward compliance requirements, although participants are now developing means by which compliance information can be shared between different institutions, in order to allow domestic participants to operate effective international relationships.