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QUARTERLY FRONTIER MARKETS RECAP

Inflation Still High, Debt Trajectories Diverge

The second quarter was relatively quiet in terms of rating actions, with only three frontier markets (FMs) experiencing rating changes compared to eight in 1Q23. Negative rating actions dominated, with two in the Middle East & Africa (MEA) due to weaker economic growth prospects and rising financing concerns, and one in the Americas, where El Salvador was downgraded to 'RD' before being upgraded to 'CCC+'. This contrasts to a largely benign 1Q23, in which positive rating changes outweighed negative ones by 5:3, mostly due to fiscal outperformance in FM Europe and Central America & the Caribbean.

El Salvador's pension-related debt exchange in May was deemed a Distressed Debt Exchange (DDE), as it involved an adverse change in terms given the extension of maturities and the addition of a grace period. The subsequent upgrade of El Salvador's LT FC IDR to a higher rating ('CCC+') than prior to the exchange ('CC') reflects improved fiscal and external liquidity positions after sizeable global bond amortizations and debt buybacks at a discount earlier this year, as well as a significant consolidation effort, which reduced its fiscal deficit to 2.5% of GDP in 2022, from 5.5% in 2021 and 10.1% in 2020.

The actions taken on El Salvador follow three positive rating actions in Central America & the Caribbean earlier this year. The region's positive rating momentum reflects better-than-expected economic, fiscal, and external performance during the twin shocks of the pandemic and the war in Ukraine. Another bright star has been FM Europe, which currently boasts the largest number of sovereigns on Positive Outlook (three out of four), as these continue to benefit from still high energy prices (Azerbaijan) and flows of funds and people triggered by the war in Ukraine (Georgia and Armenia).

On the other hand, rating changes in MEA were all negative in 1H23. Weaker economic growth prospects, higher expected inflation and an increase in government debt/GDP as a result of the sharp depreciation of the kwanza led to Angola's Outlook revision to Stable from Positive in June. Tunisia's downgrade to 'CCC-', also in June, reflects uncertainty around its ability to mobilise sufficient funding to meet its large financing requirements. Ghana's LT FC IDR was downgraded in February to 'RD'. Its LT LC IDR has been in and out of default since then. In EM Asia, the only LT FC IDR change in 1H23 was Pakistan's downgrade in February. The rating was upgraded in July after Pakistan reached a deal with the IMF.

COMMON FRAMEWORK GOT SLOW START IN RESOLVING RECORD DEFAULTS

While two thirds of FMs are on Stable or Positive Outlook, they are generally in a weaker position than they were a few years ago. Half of all Fitch-rated FMs are currently rated 'B-' or less (no Outlooks are assigned below 'B-'), and defaults have reached record levels, with five sovereigns rated 'RD': Zambia, Ghana, Sri Lanka, Belarus, and Lebanon (the latter two are not in JP Morgan's NEXGEM index).

KEY SOVEREIGN RATING ACTIONS

Angola's Outlook Revised to Stable; Affirmed at 'B-'

Tunisia Downgraded to 'CCC-'

Guatemala's USD-Denominated 2036 Bonds Rated 'BB'

Rating Actions Taken on El Salvador Following Local Law Securities Debt Exchange

Ghana's LTLC IDR Downgraded to 'RD'

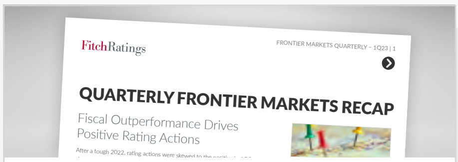
WEBINARS / PODCASTS / VIDEOS

2023 Fitch on Mongolia

Fitch on Banking 2023 CIS, Central & Eastern Europe

Fixed Interest Podcast: Central America's Positive Rating Momentum

Fitch on Africa: Ratings Update Amid Financing Crunch



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QUARTERLY FRONTIER MARKETS RECAP

Fiscal Outperformance Drives Positive Rating Actions

PREVIOUS REPORTS

Frontier Markets Recap – 1Q23

The steady rise in debt over the last decade, combined with a series of shocks from the pandemic, war in Ukraine, global inflation, and subsequent monetary tightening, has weakened many FMs, and those with thinner buffers have struggled to cope. Interest-to-revenue ratios have been rising due to growing government debt, and the trend has been compounded by recent hikes in global interest rates.

Defaults have also been taking longer to resolve than in the past, with the median duration of Fitch-rated sovereign defaults being 107 days since 2020, compared with 35 days for all defaults since 2000. The Common Framework (CF), intended to facilitate creditor coordination, has not been as effective as was hoped in resolving crises quickly over the past two years. A key reason appeared to be weak coordination among Chinese stakeholders, and China's demands that multilateral debt is included in debt restructuring and that there are no haircuts, just maturity reprofiling. However, China is no longer pushing for multilateral debt to be included and Zambia's recent deal with government creditors indicates that some of China's former reservations may have been addressed. Zambia's debt deal, the first reached under the CF, gives hope that FM sovereign restructurings could be resolved more quickly going forward.

HIGH INFLATION STILL A CONCERN FOR MANY FMs

Inflation has started to show signs of abating but is still high for most FMs. The CPI Inflation rate jumped last year due to higher food and energy prices, disruptions to supply chains and, in some cases, exchange-rate depreciation. In Armenia and Georgia, large migrant inflows from the Ukraine war caused exchange rate appreciation but also stoked domestic demand, which has been reflected in high rental inflation.

In FM Europe, headline inflation has declined this year owing to the impact of policy rate increases, strong base effects (notably for lower commodity prices) and exchange rate appreciation in Armenia and Georgia (inflation is now in low single digits in both). However, core inflation remains high across the region. Monetary policy effectiveness is relatively weak in FM Europe, due to high dollarisation (Georgia, Armenia), low credit penetration and prevalence of preferential lending (notably in Uzbekistan), high sensitivity to exchange-rate fluctuations and underdeveloped policy frameworks (mainly in Azerbaijan). A prolonged period of high inflation could destabilise inflation expectations and negate some of the positive gains made in the region, such as robust growth and improved fiscal and external metrics, which led to Georgia, Armenia, and Azerbaijan's Positive Outlooks.

In MEA, inflation remains high and continues to increase in many cases. Fitch now forecasts Angola's inflation to average 14.7% in 2023 and increase to 17.1% in 2024, owing to the depreciation of the kwanza and the country's reliance on imported food.

The government's reduction of gasoline subsidies will also pressure inflation, although to a lesser extent, given the exemptions for taxi drivers, farmers, and fishermen. Nigeria's already structurally high inflation rose to an average 21.9% in 1Q23, from 15.7% in 1Q22. High food price inflation of 24%, naira depreciation, particularly in the parallel market, and deficit monetisation add to pressures. Projected inflation averages of 19.7% in 2023 and 15.4% in 2024 are well above their respective 'B' medians of 6.4% and 4.9%. Despite aggressive policy rate hikes, tightening reserve requirements and the phaseout of credit support schemes, liquidity and credit growth remain strong. The new administration's reform agenda, particularly fuel subsidy withdrawals and the transition to a unified exchange rate could also impact inflation.

In the Americas, inflation pressures are easing, as proactive monetary tightening ahead of the Fed helped to tame inflation and stabilise exchange rates. Costa Rica had one of the strongest declines in inflation, with June inflation at -1.0% versus its August 2022 peak of 12.1%. As a result, Costa Rica, as well as other smaller countries such as the Dominican Republic (formerly a FM) have started to cut rates. A sharper-than-expected economic slowdown or faster disinflation could lead to more sizeable cuts. Higher inflation in some countries has had a positive initial fiscal impact by lifting government revenues, but could turn more negative in coming years as inflation-linked spending (wages, pensions) catches up.

In FM Asia, headline inflation appears to have peaked in certain markets, including Mongolia, where we expect it to average 12% in 2023, versus 15% in 2022, before moderating to 9% in 2024, slightly above the BOM's 4%-8% target. Full normalisation of trade with China and lower global commodity prices should pull down inflation, although international sanctions on Russia are still leading to elevated import costs.

MIXED TRENDS IN GOVERNMENT DEBT/GDP

In Central America & the Caribbean, government debt/GDP is projected to decline in Costa Rica, El Salvador and Jamaica and remain stable at low levels in Guatemala, thanks to continued fiscal prudence. Similar trends are expected for some Asian FMs. In Mongolia, government debt edged down to 60% of GDP in 2022 on strong nominal growth and improved fiscal balances. We expect debt to continue on a downward path broadly in line with the 'B' median, reaching about 55% of GDP by 2024. However, the government has significant potential contingent liabilities, including unguaranteed SOE debt of over 15% of GDP. Vietnam's general government debt/GDP is expected to stabilise at 37% in 2023 and 2024, far below the 'BB' median.

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In FM Europe, government debt/GDP is also anticipated to either stabilise or decline. Azerbaijan and Armenia are expected to reduce their debt by more than 8% of GDP between 2019 and 2025. Uzbekistan's government debt, at 34.4% of GDP at end-2022, is well below the current 'BB' median of 55%, and we expect it to be around 36% to end-2025. While exchange rate risk is high, as about 95% of its government debt is FX-denominated, this is mitigated by a large share of concessional debt, as well as long maturities. Similarly, we project Georgia's public debt/GDP to stay at around 39% to end-2025.

On the other hand, general government debt/GDP is set to rise in many African countries, including Nigeria, Angola, Namibia, and Rwanda. Nigeria's debt ratio is projected to increase to 40.5% by end-2024 but will remain far below the 'B' median of 59%. Nigeria's public debt has relatively long maturities and is mostly LC-denominated, but its interest/revenue ratio is among the highest of Fitch-rated sovereigns at 42%. Angola, Namibia, and Rwanda's debt ratios are all projected to exceed 70% in 2023 - well above their peer medians. Tunisia's debt is anticipated to peak at 80.9% in 2023 and to decrease to 77.3% in 2024, provided the reform path is not derailed.

THE AMERICAS DOMINATE 1H23 DEBT ISSUANCE

There were four debt issuances by Fitch-rated FMs during 1H23, with three taking place in the Americas, where Costa Rica ('BB-'/Stable) led the way in March, issuing a USD1.5 billion bond at 6.55% maturing in 2034. In January, Mongolia ('B'/Stable) issued a USD650 million 5-year bond, allowing the country to refinance its debt maturing in 2023 and 2024 and becoming the first single-B rated sovereign in Asia Pacific to successfully enter the international capital markets in 2023. Guatemala ('BB'/Stable) followed with a USD1 billion note and Paraguay ('BB+'/Stable) with a USD500 million bond issuance, both in June.

ZAMBIA'S DEBT DEAL REVISION CLAUSE COULD SET PRECEDENT

Zambia's agreement in June with the official creditor committee on terms to restructure USD6.3 billion in bilateral debt – the first under the Common Framework - paved the way for the next stage in its restructuring process. The deal extends debt maturities rather than involving any write-downs and contains a unique revision clause that could set a precedent for future cases. The adjustment clause allows for higher interest rates and for the final maturity date to be brought forward if Zambia's economy outperforms the IMF and World Bank's assumptions.

IMF AGREEMENTS NOT ENOUGH TO EMERGE FROM DEFAULT

Zambia's debt deal allowed the country to successfully complete the first review of its IMF Extended Credit Facility (ECF) agreement on 13 July, and to secure the immediate release of USD189 million in IMF funding as part of a 38-month USD1.3 billion loan programme. However, a debt treatment with private creditors is still necessary for Zambia to emerge from its current state of default. If private creditors are able to include conditional adjustment clauses in their debt treatment similar to the ones agreed on with offical creditors, this could smooth the path to an agreement.

Pakistan reached an agreement with the IMF on a new nine-month Stand-by Arrangement (SBA), after the previous Extended Fund Facility (EFF) arrangement expired in late June without conclusion of the final review. The SBA was approved by the IMF board in mid-July, catalysing other funding and anchoring policies around parliamentary elections due by October. Nevertheless, programme implementation and external funding risks remain due to a volatile political climate and large external financing requirement.

The IMF Executive Board also approved a USD3 billion disbursement for Sri Lanka under the new EFF arrangement in March to support the country's economic policies and reforms. However, Sri Lanka's LT FC IDR will not be moved out of 'RD' until the debt restructuring has been completed. On 5 July, Sri Lanka's LT LC IDR was downgraded to 'C', after parliament approved the government's domestic debt restructuring plan. The announcement outlines a domestic debt optimisation strategy that includes treatment of both domestic debt as well as domestically issued FC debt.

On the other hand, the IMF board is anticipated to reach an agreement with Tunisia by year-end, but this is much later than our previous expectation, and risks remain elevated. The IMF board did not approve a new USD1.9 billion 48-month EFF planned in December 2022, as prior actions were not met. This has led to uncertainty around Tunisia's ability to meet its large financing needs.

Newsreel

Initial Reform Steps Positive for Nigeria's Credit Profile

The withdrawal of Nigeria's fuel subsidy and President Bola Tinubu's pledge to move towards a unified exchange rate are positive developments for Nigeria's credit profile. However, the reform agenda continues to face execution risks, and still lacks detail, including measures that might start to address other challenges to Nigeria's credit profile, such as structurally very low non-oil budget revenue.

Vietnam's Banking Sector Liquidity Crunch Eases

Property-sector risks have made operating conditions more difficult for banks in Vietnam in the short term, but the liquidity crunch is easing, and the banking system is likely to avert a sharp slowdown due to the concerted response of policymakers and banks. Tighter monetary policies globally and a domestic crackdown on improper bond-market transactions related to property developers had set off a chill in local credit conditions since 2H22.

Sri Lanka's Domestic Debt Plan a Significant Step for Resolving Bank Uncertainty

The proposal for treatment of domestic debt marks a significant step towards resolving uncertainties around the impact of the sovereign's debt restructuring on the local banking sector. The proposal excludes banks' holdings of Sri Lankan rupee-denominated treasury securities, which will alleviate some of the pressure on their already stressed capital positions from weakening loan quality and the rupee's depreciation.

Peña Win Means Policy Continuity in Paraguay; Consolidation, Reforms in Focus

The victory of Santiago Peña from the ruling conservative Colorado Party in Paraguay's presidential election will result in economic policy continuity. Fiscal consolidation that arrests a rising debt level would be important for avoiding any downward pressure on Paraguay's 'BB+'/Stable rating, and even more so for any potential ratings uplift, along with reforms that brighten economic prospects relative to peers and deepen local-currency funding markets.

Frontier Vision – 2Q23

FMs' exports are slowing as global trade growth falls. Export growth has fallen in recent months in Jordan, Rwanda, Mongolia, Mozambique and Papua New Guinea and has recently turned negative in year-on-year (yoy) terms in Angola, Ethiopia, Ghana, Nigeria, Vietnam, El Salvador and Sri Lanka.

The decline in exports in the two biggest FM economies is particularly pronounced. In Nigeria, predominantly an oil exporter, nominal exports fell by 13% yoy in March, according to latest available data. In Vietnam, which has a large and diversified manufacturing export basket – ranging from mobile phones, electronic products, machine equipment to textiles and garments – nominal exports declined by 11% yoy in June and contracted on a yoy basis in each month since March 2023.

Headline CPI inflation rates continue to fall in: Armenia, Azerbaijan, Costa Rica, El Salvador, Georgia, Guatemala, Honduras, Iraq, Jamaica, Jordan, Maldives, Rwanda, Sri Lanka and Vietnam, among others.

GDP outturns for 1Q23 present a fairly gloomy picture by and large, with yoy GDP growth weakening relative to 4Q22 in Angola, Armenia, Azerbaijan, El Salvador, Georgia, Honduras, Nigeria, Uzbekistan and Vietnam, while in Sri Lanka GDP fell by 11.5% in 1Q23, the fifth consecutive yoy contraction. However, GDP in 2Q23 in Vietnam – the earliest FM to report quarterly GDP outturns – showed a slight recovery in growth at 4.1% yoy, up from 3.3% yoy in 1Q23.

Fitch's quarterly 'Frontier Vision' chart pack tracks high-frequency macroeconomic data for the countries included in J.P. Morgan's Next Generation Markets (NEXGEM) Index. The charts cover five years of historical data and the choice of data series has been harmonised as far as possible across all countries to facilitate comparisons. The index comprises countries representing sub-Saharan Africa, Latin America & the Caribbean, the Middle East & North Africa, Europe, Asia and Oceania.

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Regional Commentary

EUROPE

Sovereigns Dashboard: Debt/GDP to Resume Upward Trend in Emerging Europe

CEE and CIS+ Banking Presentations

Uzbek Bank Privatisations Will Depend on Business Model Changes

Inflation in Caucasus, Central Asia to Remain Above Rating Peers

Strong Government Links Key for Most GREs in CIS and Ukraine

ASIA PACIFIC

Pakistan Upgraded to 'CCC'

Sri Lanka's Government Debt Plan Tempers Funding Risk for NBFIs

Sri Lanka's LT LC IDR Downgraded to 'C'

Vietnam Sovereign Presentation - June 2023

Vietnam's PDP8 Roadmap for Energy Transition Sets Ambitious Medium-Term Targets

Vietnam Affirmed at 'BB'; Outlook Positive

Mongolia Affirmed at 'B'; Outlook Stable

LATIN AMERICA & THE CARIBBEAN

Paraguay's 2033 USD Bond Rated 'BB+'

Central American Corporate Credit Indicators: 1Q23 (Corporates Resilient Amid an Uncertain Environment)

El Salvador Sovereign Upgrade Leads to National Rating Scale Recalibration

Costa Rica

MIDDLE EAST & AFRICA

Action Taken on Tunisian NBFIs' National Ratings Following Sovereign Downgrade

Zambia's Debt Deal Paves Way for Next Stage of Restructuring

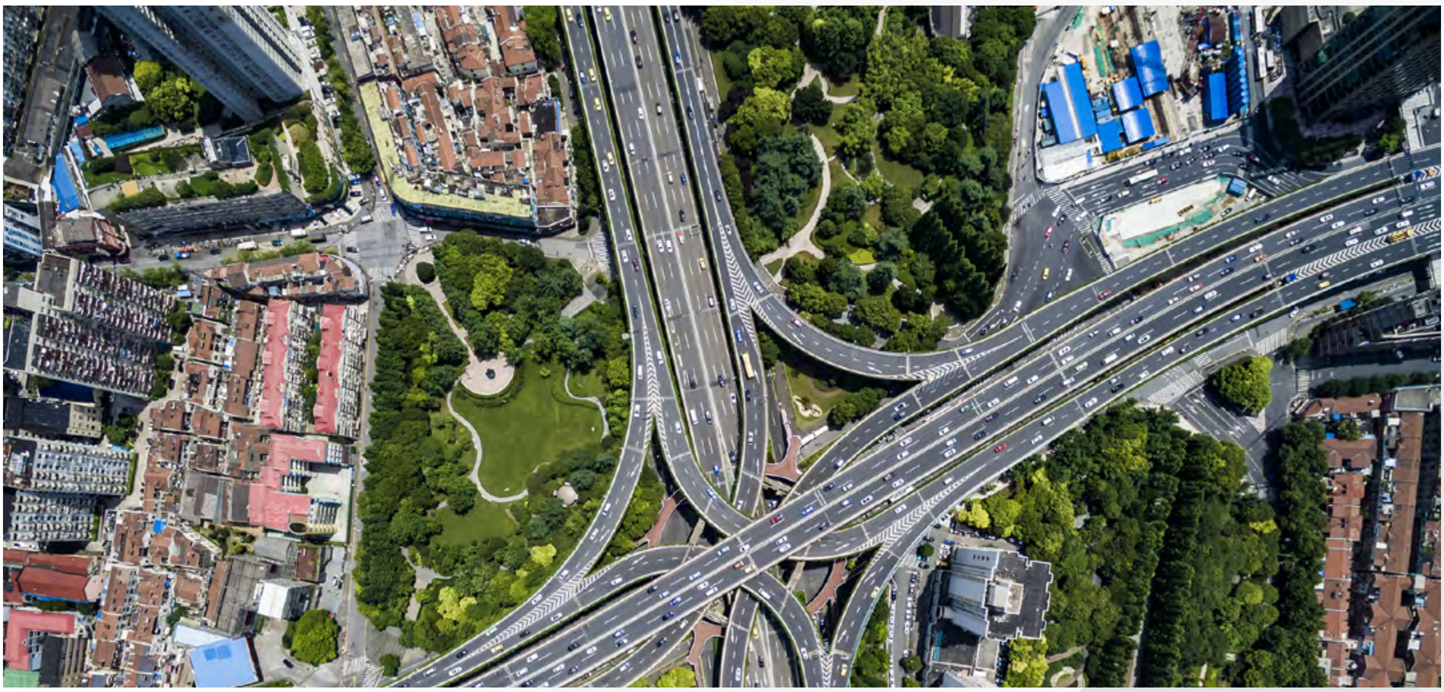
Presentation: Nigeria: Sovereign Rating Drivers and Credit Developments

Namibia Affirmed at 'BB-'; Outlook Stable

Jordan Affirmed at 'BB-'; Outlook Stable

Nigeria Affirmed at 'B-'; Outlook Stable

Rwanda Affirmed at 'B+'; Outlook Negative



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Regional Commentary

Country	Current Ratings	Last Rating Action	Outlook	Rating Action Type
Middle East & Africa				
Angola	B-	23-Jun-2023	►	Affirmation
Cote D-Ivoire	BB-	24-Feb-2023	►	Affirmation
Ethiopia	CCC-	20-Dec-2022	-	Downgrade
Gabon	B-	10-Feb-2023	▲	Affirmation
Ghana	RD	21-Feb-2023	-	Downgrade
Iraq	B-	21-Dec-2022	►	Affirmation
Jordan	BB-	12-May-2023	►	Affirmation
Kenya	B	14-Dec-2022	►	Downgrade
Mozambique	CCC+	17-Feb-2023	-	Affirmation
Namibia	BB-	02-Jun-2023	►	Affirmation
Nigeria	B-	05-May-2023	►	Affirmation
Rwanda	B+	14-Apr-2023	▼	Affirmation
Tunisia	CCC-	09-Jun-2022	-	Downgraded
Zambia	RD	06-Dec-2022	-	Affirmation
Latin America & The Caribbean				
Bolivia	B-	14-Mar-2023	▼	Downgrade
Barbados	B	20-Oct-2022	►	New Rating
Costa Rica	BB-	11-Mar-2023	►	Upgrade
El Salvador	CCC+	05-May-2023	-	Upgrade
Guatemala	BB	16-Feb-2023	►	Upgrade
Jamaica	B+	07-Mar-2023	▲	Affirmation
Paraguay	BB+	22-Nov-2022	►	Affirmation
Asia				
Maldives	B-	13-Oct-2022	▼	Affirmation
Mongolia	B	15-May-2023	►	Affirmation
Pakistan	CCC	10-Jul-2023	-	Upgrade
Sri Lanka	RD	05-Jul-2023	-	Affirmation
Vietnam	BB	31-May-2023	▲	Affirmation
Europe				
Armenia	B+	10-Feb-2023	▲	Affirmation
Azerbaijan	BB+	31-Mar-2023	▲	Affirmation
Georgia	BB	27-Jan-2023	▲	Affirmation
Uzbekistan	BB-	03-Mar-2023	►	Affirmation

Legend

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

Source: Fitch Ratings

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