



FINANCE IN AFRICA

Unlocking investment in an era
of digital transformation and climate transition



Chapter 1

Financial markets and financing conditions

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European
Investment Bank

Finance in Africa

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Chapter 1

Financial markets and financing conditions



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Chapter 1

Financial markets and financing conditions

This opening chapter of the 2024 report provides an overview of financial markets and financing conditions in Africa. Stock markets, bond markets and private capital markets are examined at continent, regional and country levels. The second half of the chapter focuses on financing conditions in Africa, and describes the data obtained with an updated version of the financial conditions index for Africa, which was first introduced in last year's report.

Like elsewhere in the world in 2023, African financial markets felt the effects of tightened global financial conditions, a growth slowdown, heightened inflation, exchange rate depreciation and declining foreign exchange reserves. However, African stocks faced a more pronounced decline compared with those of emerging markets and developing economies, reflecting the greater risk aversion of global investors to Africa. The tightening of interest rates resulted in lower stock valuations and prices in Africa, with total returns (net of dividends) declining at the onset of the interest rate hiking cycle in 2021 until mid-2022 and oscillating around zero in 2023. The fall in stock prices was mirrored by a decrease in market capitalisation as a percentage of gross domestic product (GDP) across most regions, except for North Africa, where it marginally increased compared with the previous year.

Government bond issuance stagnated as yields rose significantly for more risky sovereigns in 2022 and 2023. As developed economies tightened their monetary policies, international investors assumed a more risk-averse stance and shunned debt securities from more indebted government debt issuers, especially in Africa. Consequently, Eurobond issuances by African sovereigns stagnated in 2023, except for Egypt and Morocco. Moreover, as governments became more indebted, yields started rising to reflect increased sovereign risk, and the pressure on yields was compounded by higher inflation expectations. The increase in yields was most pronounced in North and West Africa, followed by East, Central and Southern Africa. Nevertheless, with the easing of global financial conditions in 2024, four countries (Benin, Côte d'Ivoire, Kenya and Senegal) successfully tapped the international bond market after a hiatus of approximately two years, indicating that investor confidence in African economies is growing but at elevated interest rates.

African private capital markets had a resilient but difficult year in 2023. A surge in private capital fundraising in Africa, to \$3.7 billion in 2023 from \$2.5 billion in 2022, meant fundraising eclipsed the record of \$3.5 billion set in 2019. However, private capital investments fell by 24% to \$5 billion in 2023 from \$6.5 billion in 2022, making it the lowest amount of capital deployed since 2020. Among the asset classes, private equity (\$1.24 billion) and venture capital (\$1.14 billion) experienced annual declines of 39% and 59%, respectively, relative to 2022. Private credit fell by 70% to \$0.33 billion in 2023, while there was a sharp increase in infrastructure spending, which almost quadrupled from \$0.55 billion in 2022 to \$2.18 billion in 2023. Private capital investment has become more concentrated at the country level, with South Africa leading and accounting for half of all African investment in 2023 (20%), followed by Kenya (11%), Côte d'Ivoire (7%) and Morocco (6%). The renewables sector accounted for the largest share at 37% of investment, surpassing financial services, which had dominated in the previous year.

Financial integration increased across most African regions until the shocks caused by the COVID-19 pandemic and Russia's invasion of Ukraine stalled or even reversed the growth. From the latest available data for 2022, financial integration ranged from 84% of GDP in West Africa to 362% in Southern Africa, with values between 104% and 116% for the other African regions. In this 2024 edition of the Finance in Africa report, the sample for calculating the financial conditions index in Africa has been expanded to

ten countries from the four employed in 2023,¹ further enhancing the representativeness of the index. The financial conditions index reveals a severe tightening in financial conditions over the course of 2023, as in 2022, and this tightening is driven by policy rate increases, exchange rate depreciation and the fall in stock markets. The pressure exerted by these factors started decreasing around mid-2023, particularly for the stock market, but weaker private sector credit growth and wider lending spreads maintained tightening pressures.

African governments faced increasing financing needs as international investor appetite declined, strengthening the connection between governments and banks and increasing crowding-out effects (when banks channel their financial resources to sovereign instruments at the cost of limiting lending to the private sector). African bank holdings of domestic sovereign debt have increased sharply (to 17.5% in 2023 from 10.3% in 2010), raising the potential for bank losses in the event of a debt default or restructuring. At the same time, there is a decreasing trend in banks' private sector lending (to 38% in 2023 from 42% in 2010), posing concerns about the severity of crowding out. The severity of crowding out index reveals that before easing in 2024, crowding out significantly tightened to record levels in 2023, driven by higher public debt issuance and a rebound in private credit demand which created intense competition for banks' funding. Furthermore, the severity of crowding out was particularly high in 2023 in over half of the African countries examined, and regionally the highest levels of crowding out were seen in East, Southern and West Africa.

Financial markets in Africa

Stock markets

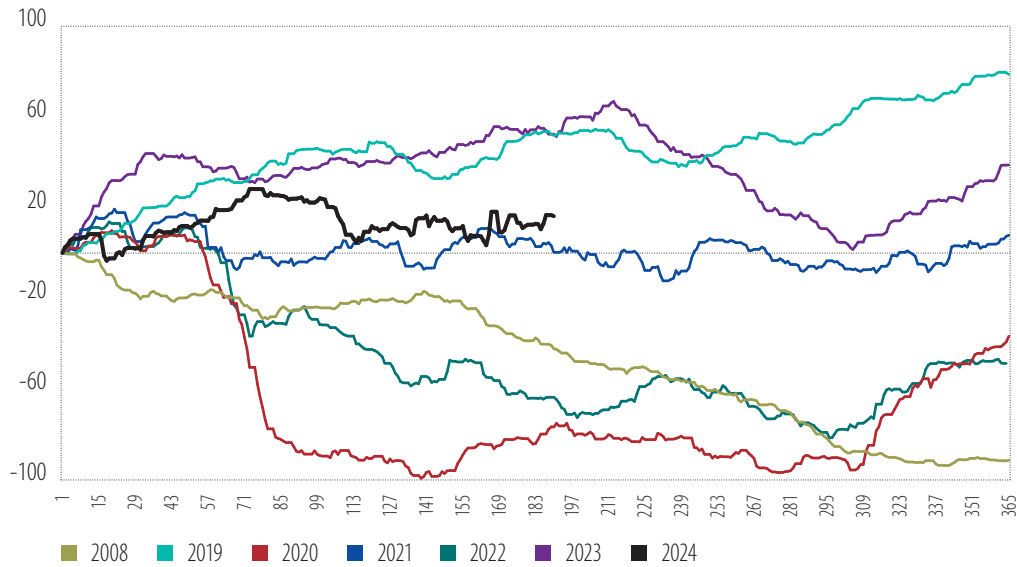
The tightening of monetary policy following the COVID-19 pandemic was the most synchronised in the past half a century. Higher inflation triggered by the COVID-19 pandemic and Russia's invasion of Ukraine was more persistent than initially expected. Higher prices that were at first limited to commodities such as food and energy spread to inflation and became more engrained and highly correlated globally. On the African continent, inflation increased to 13% in 2022 and 19.3% in 2023 from 9% in 2019, with the most pronounced increase in West Africa (to 17.1% in 2022 and 20.4% in 2023 from 8.2% in 2019). The ensuing global monetary tightening was the most synchronised in the past 50 years.

Higher interest rates triggered considerable portfolio outflows from emerging markets. As advanced economies raised interest rates, international investors shied away from the riskier assets of emerging markets, favouring the safer and higher quality assets offered by advanced economies. With 90% of central banks raising interest rates by the end of 2022, emerging market assets experienced portfolio outflows totalling \$49 billion in 2022, which was higher than the \$36 billion outflows seen during the first year of the COVID-19 pandemic in 2020 (Figure 1). Portfolio inflows resumed in 2023, and although net portfolio inflows were almost stagnating year-to-date by the third quarter of 2023, the year closed with net inflows of \$39 billion, backed by more accommodative monetary policies by central banks. However, net portfolio inflows in 2023 were half of those recorded in 2019, the year before the COVID-19 pandemic erupted. In 2024, the US Federal Reserve maintained its monetary policy tightening bias to support the US dollar, dragging inflows to emerging markets.

¹ Morocco, Côte d'Ivoire, Ghana, Tunisia, Senegal and Zambia are now included in the index in addition to the four countries (Egypt, Nigeria, Kenya and South Africa) employed in computing the financial conditions index in 2023. These ten countries now account for approximately 60% of the continental GDP as of the end of 2023.

Figure 1

Year-to-date portfolio flows to emerging markets (Y-axis: \$ billion; X-axis: Days passed since the beginning of the year)



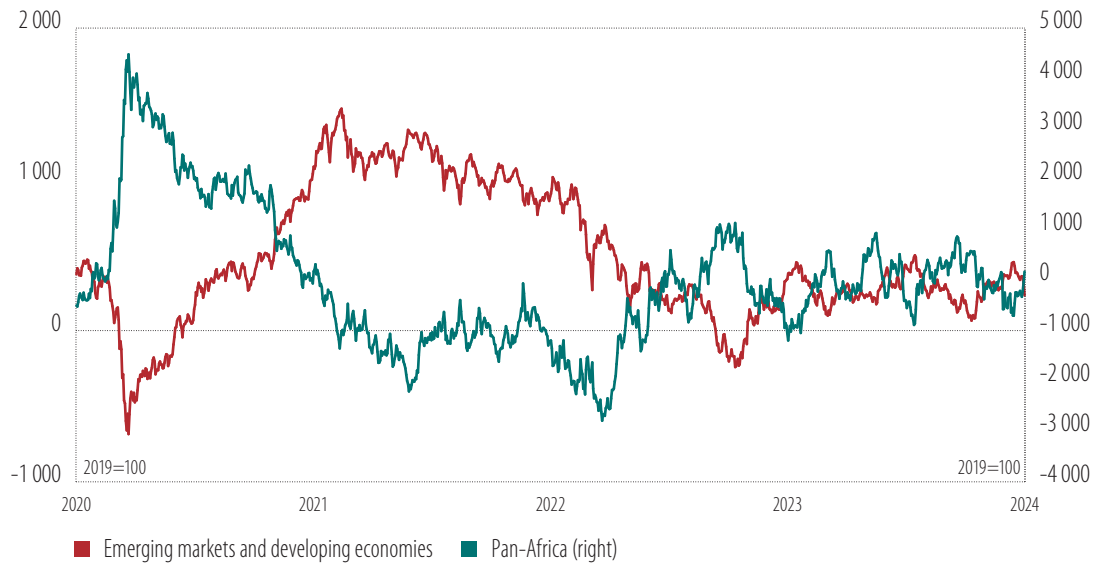
Source: Institute of International Finance and EIB staff calculations.

In response to monetary policy tightening, returns on African stocks declined more compared with those of emerging markets and developing economies. Higher interest drove lower stock prices globally, but the decline was more pronounced in Africa relative to emerging markets and developing economies. The authors of this chapter proxy the African stock market indices using the Standard and Poor's Pan Africa Benchmark Market Index (Bloomberg ticker: STEIPADP Index), which is a comprehensive benchmark including stocks from 12 African emerging and frontier markets.² We proxy stock prices in emerging markets and developing economies using the MSCI Emerging Markets Investable Market Index (Bloomberg ticker: MXEF Index), which captures large-, mid- and small-cap representation across 24 emerging markets. All stock market indices used are US dollar based. Pan Africa's total returns (net of dividends) started declining at the onset of the interest rate hiking cycle in 2021 until mid-2022, oscillating around zero thereafter (Figure 2). The drop in returns was more pronounced for Pan African stocks than for those of emerging markets and developing economies, reflecting the greater risk aversion of global investors to Africa. The returns for Pan Africa remained negative for most of the policy rate hiking cycle, whereas returns for emerging markets and developing economies were mostly positive during this period.

Utility and energy sectors outperformed the stock market in Africa. Figure 3 depicts the returns by sector and shows that the energy and utilities sectors followed by the materials sector performed better than the overall market. The materials sector had the third highest excess returns, relative to the market, in the Pan Africa and Africa Frontier stock market indices. These excess returns most likely stem from the marked increase in international commodity prices, including oil and construction material prices, recorded at the same time. For the other sectors, excess returns were either stagnant or negative.

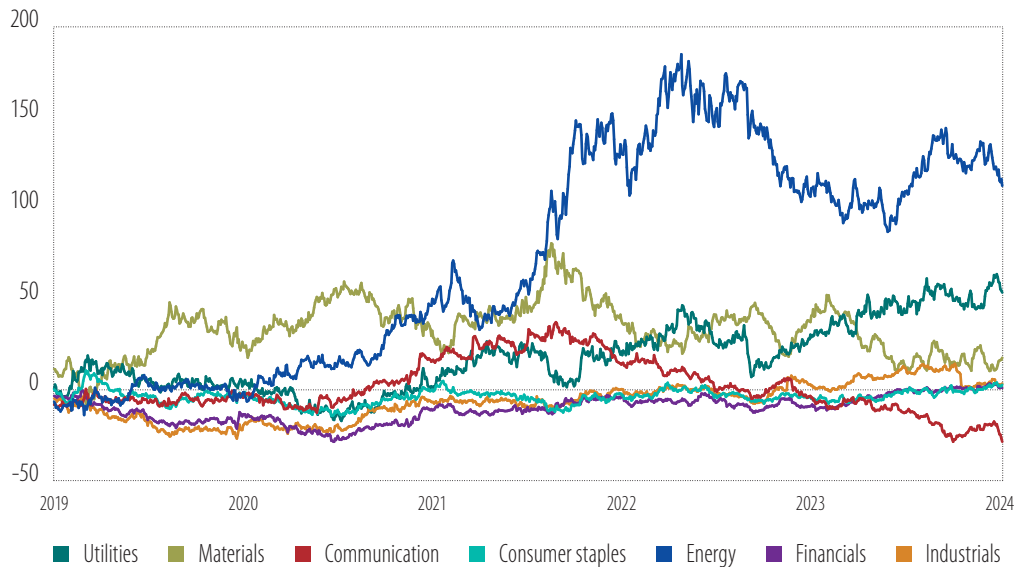
² Botswana, Côte d'Ivoire, Egypt, Ghana, Kenya, Mauritius, Morocco, Namibia, Nigeria, South Africa, Tunisia and Zambia.

Figure 2
Cumulative total return (net dividends) in emerging markets and developing economies and in Africa



Source: Bloomberg and EIB staff calculations.

Figure 3
Return indices of African stocks by industry minus pan-Africa (percentage points)



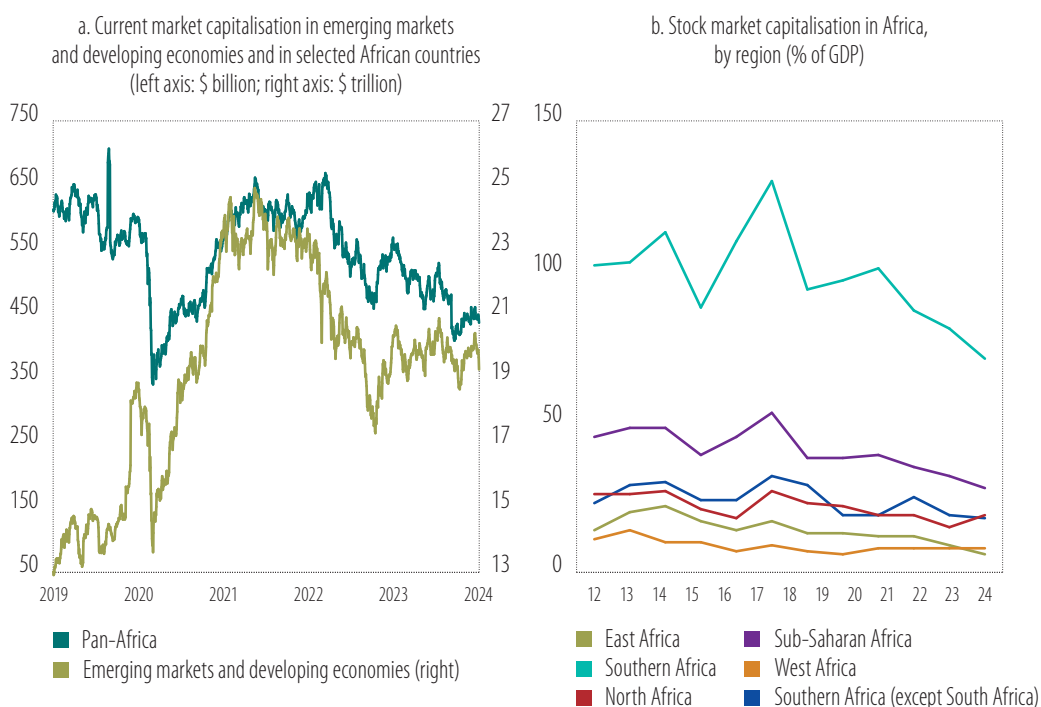
Source: Refinitiv and EIB staff calculations.

Note: >0: The return of the specific industry stock index outperforms that of the overall market.
<0: The return of the specific industry stock index underperforms that of the overall market.

Falling stock prices were also reflected in the fall in market capitalisation. Stock prices declined initially in 2020 due to the outbreak of COVID-19 but rebounded in 2021 as markets were buoyed through central bank support. However, when inflation became a problem, central banks reversed course and tightened

monetary policy, leading to a fresh decline in stocks. The market capitalisation of the stock price indices fell across the board from the start of the policy rate hiking cycle in 2021. Although this market capitalisation has been improving in emerging markets and developing economies since mid-2022, it is still falling in Pan Africa (Figure 4a). Currently, stock market capitalisation is highest in emerging markets and developing economies (\$19.3 trillion), overshadowing that in Pan Africa (\$437 billion). While Figure 4a shows that stock market capitalisation in Africa and emerging markets and developing economies followed the same trend in the two years after the pandemic, total returns experienced diverging trends during the same period (Figure 2), and this difference in behaviour is explained by the inclusion of dividends in total returns. By African region, stock market capitalisation as a percentage of GDP is falling across all regions except North Africa (Figure 4b), where it increased marginally in 2023 compared to the previous year. Southern Africa has the largest stock market capitalisation followed by North Africa, while stock market capitalisation in West Africa and East Africa are similar.

Figure 4
Stock market capitalisation



Source: Bloomberg and EIB staff calculations.
 Note: **Country aggregations:** **Central Africa:** Cameroon; Central African Republic; Chad; Democratic Republic of the Congo; Equatorial Guinea; Gabon; Congo; and São Tomé and Príncipe; **East Africa:** Burundi; Djibouti; Ethiopia; Kenya; Rwanda; Tanzania; and Uganda; **North Africa:** Algeria; Egypt; Morocco; and Tunisia; **Southern Africa:** Angola; Botswana; Comoros; Eswatini; Lesotho; Madagascar; Malawi; Mauritius; Mozambique; Namibia; Seychelles; South Africa; Zambia; and Zimbabwe; **West Africa:** Benin; Burkina Faso; Cabo Verde; Côte d'Ivoire; Ghana; Guinea; Guinea-Bissau; Liberia; Mali; Mauritania; Niger; Nigeria; Senegal; Sierra Leone; The Gambia; and Togo.

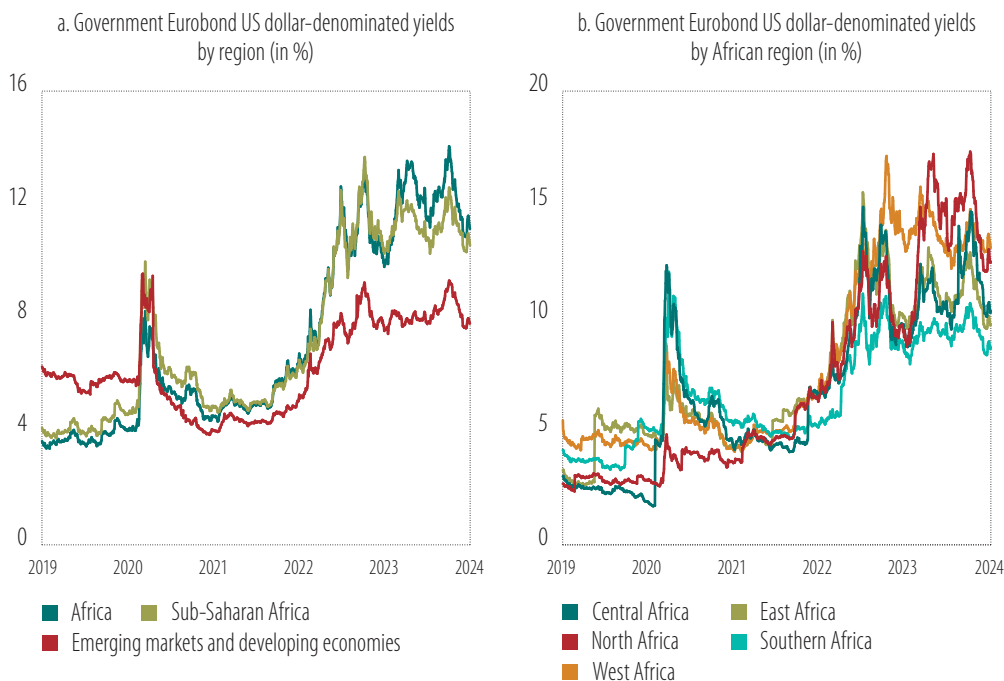
Bond markets

Africa's indebtedness has increased significantly in the last decade. The mix of ample liquidity available after the 2008 global financial crisis and governments' resorting to bilateral and market-based lending fuelled indebtedness in sub-Saharan Africa. The upward trend in indebtedness steepened as governments had to incur considerable fiscal spending to support economic activity and the health system during the COVID-19 pandemic. According to the World Bank (2023), the stock of sub-Saharan Africa's (sub-Saharan Africa excluding high-income countries in the region) external debt more than doubled to \$833 billion

in 2022 from \$340 billion in 2010 (+145%), and a similar trend was observed in North Africa, with an increase to \$275 billion from \$105 billion (+162%) over the same period. For comparison, the stock of debt in emerging markets and developing economies (low- and middle-income economies) increased from \$4.3 trillion in 2010 to \$9 trillion in 2022 (+107%).

Yields increased to a greater extent for more risky sovereign bonds in 2022 and 2023. As governments became more indebted, yields began to rise, reflecting increased sovereign risk, and the pressure on yields was compounded by higher inflation expectations. Governments issuing US dollar bonds in 2023 faced greater yields than those seen before the COVID-19 pandemic (Figure 5). Yields on US dollar sovereign debt in Africa increased to an even greater extent, leading to wider spreads relative to the bonds of emerging markets and developing economies. This rising cost of debt has contributed to fiscal problems. In nominal terms, interest payments on long-term external debt stock by emerging markets and developing economies have doubled since 2010 to an all-time high of \$210 billion in 2022. In sub-Saharan Africa interest payments multiplied to \$20 billion in 2022 from \$4 billion in 2010. By African region, the increase in yields was most pronounced in North Africa and West Africa, followed by that in East Africa and Central Africa then Southern Africa. Despite a reduction in yields from late 2023 to mid-2024, they remain above pre-pandemic levels, meaning debt service costs will continue rising for African governments. For example, in sub-Saharan Africa, spending on government debt interest is expected to exceed 14% of fiscal revenues in 2024 to 2025, up from 13% in 2023 and 6% in 2014, signalling large liquidity needs (Fitch Ratings, 2024).

Figure 5
Government Eurobond yields

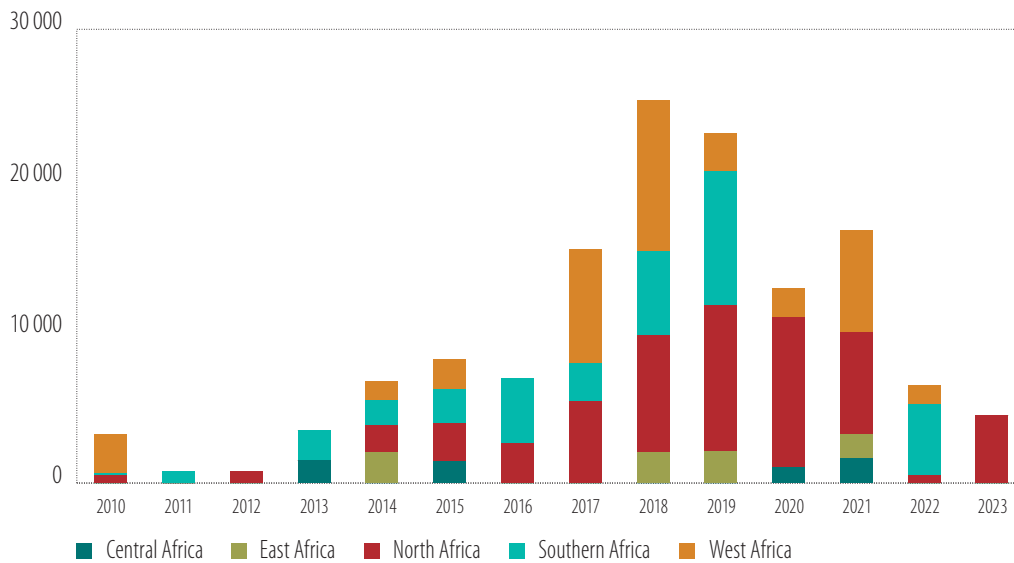


Source: Bloomberg and EIB staff calculations.

Gross issuances of government bonds in Africa stagnated in 2023, following a sharp decline in 2022 (Figure 6). Sub-Saharan African governments were effectively locked out of international capital markets for almost two years, following a Eurobond issuance in April 2022. The only countries that issued government US dollar-denominated Eurobonds in 2023 were in North Africa (Egypt and Morocco). However, Côte d'Ivoire, which is the world's largest cocoa producer, succeeded in tapping international capital markets in January 2024 for a \$2.6 billion bond, selling \$1.1 billion via a sustainable bond maturing in 2033 and \$1.5 billion in

conventional bonds due in 2037. Benin followed in February 2024, selling \$750 million of 14-year bonds at an 8.4% yield, matching Côte d'Ivoire's rate for its 2037 notes. Demand for Benin's issuance exceeded the offering by over six times, signalling strong investor interest in emerging market assets. In February 2024, Kenya sold a new \$1.5 billion Eurobond maturing in 2031, which it will use to buy back a large portion of a \$2 billion international bond due in June 2024 via a tender offer. Thus, market access is being restored but at elevated interest rates.

Figure 6
Government Eurobond issuances in Africa by region (\$ million)



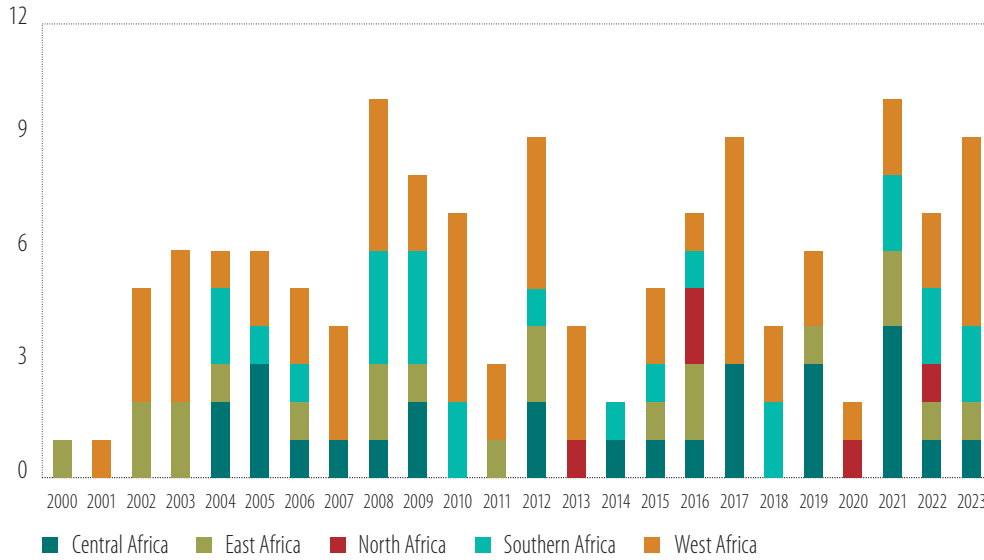
Source: Bloomberg and EIB staff calculations.

The lack of access to international capital markets in 2022 to 2023 meant many African governments resorted to the International Monetary Fund (IMF) for financing in the form of a programme with attached conditionality (Figure 7). The number of approved new International Monetary Fund arrangements remained elevated in 2023, marginally higher than in 2022 and close to the levels observed in 2021 when two years of the COVID-19 pandemic started weighing on governments' public finances. New International Monetary Fund arrangement approvals in 2023 were skewed towards West and Southern Africa, while approvals dropped in North Africa between 2022 and 2023.

Contrary to government debt, the issuance of non-sovereign international debt securities increased in 2023 in sub-Saharan Africa, driven by Southern Africa. Total international debt securities issued in sub-Saharan Africa in 2023 were at the highest level since 2019 (Figure 8). This was mainly due to issuers in Southern Africa, with a smaller contribution from those in Central Africa. With sovereign issuance falling in 2023, as mentioned above, international debt securities issued by non-sovereign sectors of the economy must have been responsible for the increase in total issuance of international debt securities.

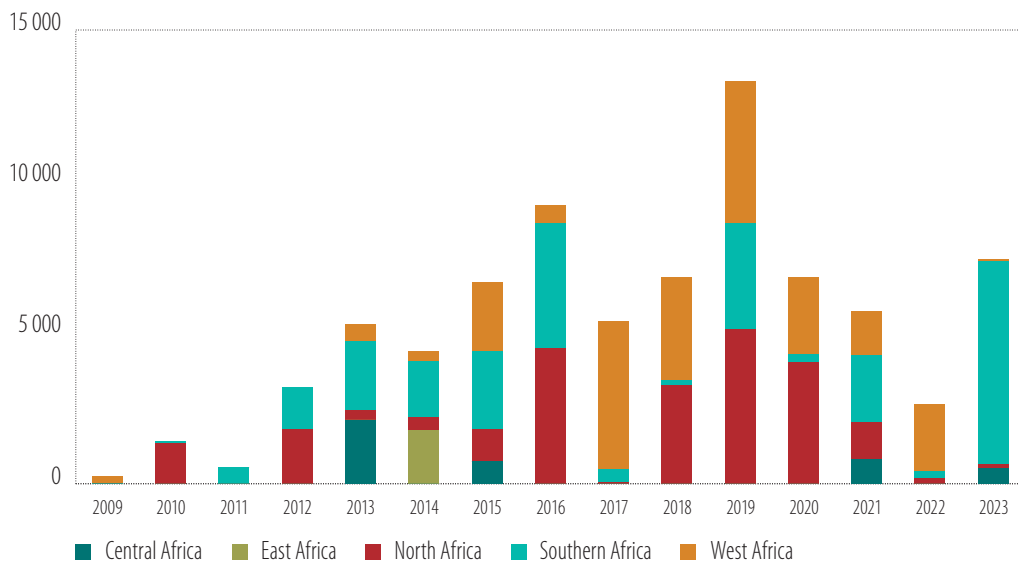
Turning to stocks rather than flows, the value of outstanding international debt securities as a percentage of GDP, issued by all African sectors, almost plateaued in 2023. The stock of international securities reached 11.6% of GDP in 2023, up from 11.2% in 2022 and 11.3% in 2021 (Figure 9). The debt stock is greatest in Southern Africa and has been on a consistent upward trend over recent decades. However, since about 2013, other African regions have seen their debt stock ratios increase, particularly West and North Africa.

Figure 7
Number of new International Monetary Fund arrangements approved (Extended Credit Facility, Extended Fund Facility, Stand-by Arrangement)



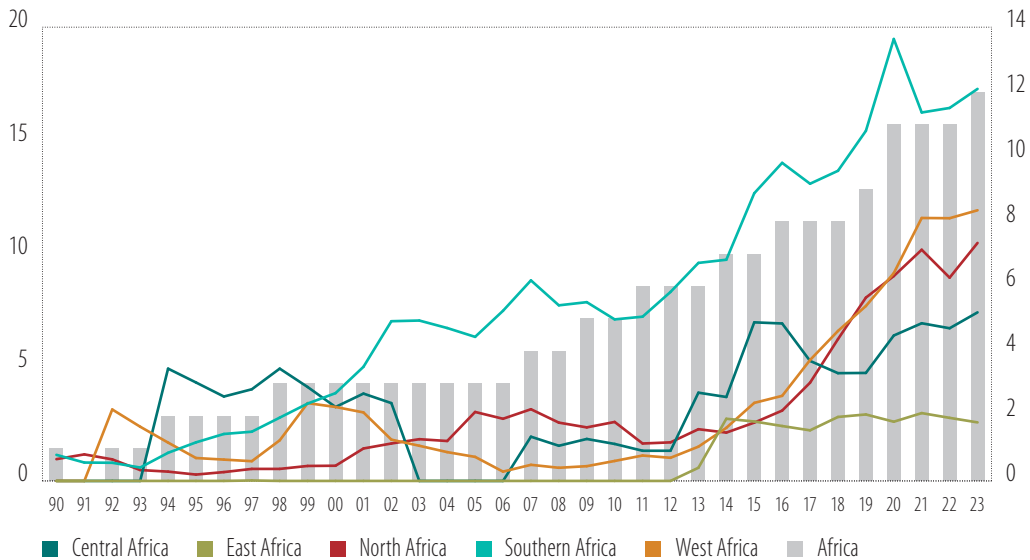
Source: IMF and EIB staff calculations.

Figure 8
Gross issuances of all international debt securities in Africa by region (\$ million)



Source: Bank for International Settlements and EIB staff calculations.

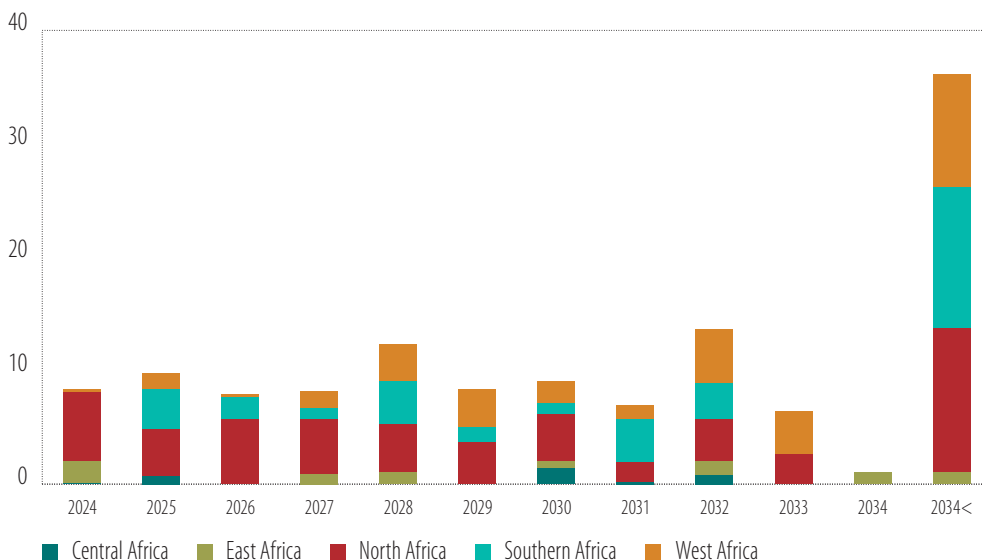
Figure 9
Outstanding international debt securities issued by all sectors in Africa by region (% of GDP)



Source: Bank for International Settlements and EIB staff calculations.

North and Southern Africa account for the bulk of debt redemptions in the medium term. Looking at the debt redemption schedule of government hard currency Eurobonds for Africa, debt redemptions in the next five years will be dominated by those of North and Southern Africa (Figure 10), with North Africa especially exposed to rollover risk in the short term.

Figure 10
Government Eurobond debt redemptions in Africa by region (\$ billion)



Source: Bloomberg and EIB staff calculations.

Southern Africa is the greatest contributor to sustainable debt issuances in Africa, but accurate understanding of the uses of sustainable debt relies on issuance by the country of risk. The country of risk is the country where the proceeds of the sustainable debt will be used and does not need to be

the country of domicile.³ Box 1 provides an overview of sustainable debt. Grouping the different African regions by the country of risk shows that, until 2016, Southern Africa and supranationals,⁴ in that order, dominated sustainable debt issuances on the African continent (Figure 11). North Africa is the next contributor for such issuances, while from 2019 onwards, West Africa also issued non-negligible volumes of sustainable debt. Within Southern Africa, the main issuers of sustainable debt are South Africa and Mauritius, in North Africa the predominant issuer is Egypt, and in West Africa the principal issuers are Côte d'Ivoire, Benin, Togo and Nigeria in that order. Meanwhile, the main issuer of sustainable debt in East Africa is Kenya and in Central Africa it is Cameroon.

Box 1

Sustainable debt

Sustainable debt refers to the issuing of bonds or loans to invest in projects or businesses that promote social or environmental causes. This definition has become more granular in meeting the evolving scope and complexity of the sustainable debt market. Sustainable debt issuance involves six main types of debt instruments that are classified based on how the funding is raised (from the investor market through bonds or from banks through loans) and the use of the proceeds. These instruments are:

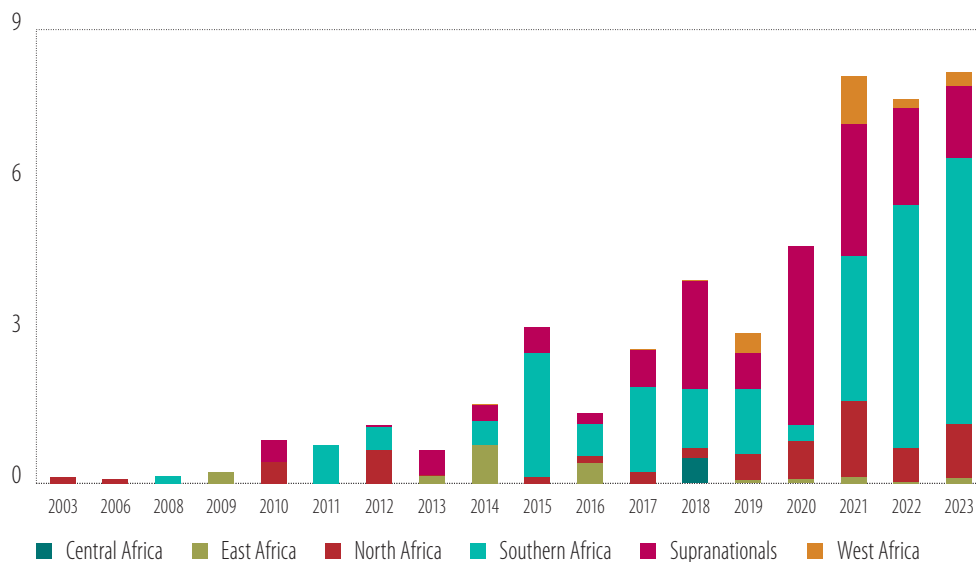
- **Green bonds:** The funds from these bonds are earmarked for environmental or climate projects, such as investing in renewable energy.
- **Social bonds:** The proceeds from these bonds are used for social impact projects, such as investing in low-cost housing for people with restricted access to the housing market.
- **Sustainability bonds:** The funds here are committed to a mix of social and green impact projects that may be aligned with the UN Sustainable Development Goals.
- **Green loans:** The proceeds from these bonds are used for financing environmental or climate projects, such as investment in improving the energy efficiency of buildings.
- **Social loans:** The funds here finance social impact investments, like training people with disabilities to improve employability.
- **Sustainability-linked loans (or bonds):** These loan (bond) proceeds are used for supporting various green and social impact projects.

Green bonds, social bonds, sustainability bonds and green loans are activity-based debt instruments because their proceeds are used for financing new – or refinancing existing – specific projects with strict reporting requirements where uses of the proceeds are recorded. Sustainability-linked loans and bonds are behaviour-based debt instruments as the proceeds are not expected to finance specific projects but are used in financing behavioural change(s) of the debt issuer as the issuer becomes more aware of the environment and climate change. An example of such behavioural change is a reduction in greenhouse gas emissions. However, behaviour-based debt instruments are more prone to greenwashing concerns owing to the lack of explicit and mandatory reporting on whether the proceeds were indeed used for financing improvements in a debt issuer's environmental behaviour. Moreover, increasing scrutiny means issuers must ensure their sustainability targets are suitably ambitious to avoid greenwashing allegations. In the United States, for example, the volume of sustainability-linked loans in 2023 was 77% smaller than in 2022 and 85% lower than in 2021 amid growing greenwashing concerns.

³ Using the country of domicile could be misleading for the importance of a country in sustainable debt markets. For example, the African Development Bank is the largest African sustainable debt issuer and is domiciled in Côte d'Ivoire, but the proceeds from this institution are mainly deployed elsewhere.

⁴ Supranational financial organisations are institutions created through international finance agreements. These organisations pool the financial resources of the participating countries to solve certain problems in developing the world economy and international economic relations. Supranational financial institutions domiciled in Africa include the Africa Finance Corporation, the African Development Bank, Banque ouest-africaine de développement, and the Eastern and Southern African Trade and Development Bank.

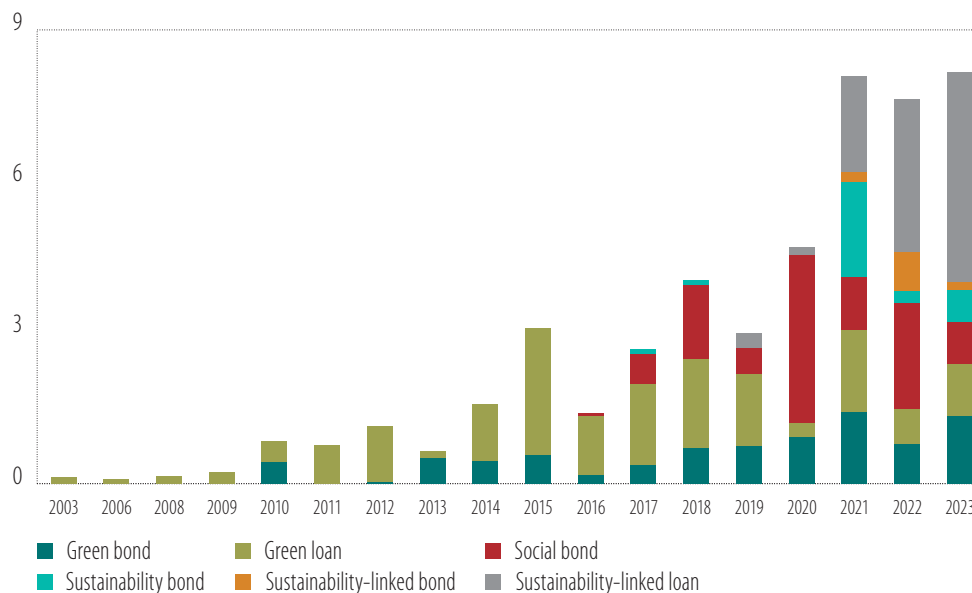
Figure 11
Sustainable debt issued by African countries and African supranationals for use in Africa
by issuer (\$ billion)



Source: Bloomberg and EIB staff calculations.

Sustainable finance has grown rapidly since 2020 (Figure 12). Before the COVID-19 pandemic, financial markets were focused on green issuance and climate change. However, the pandemic brought a new perspective to sustainable financing. Social finance increased as the healthcare sector expanded and strengthened in response to the high public health risk, and the education sector needed reinforcing to support remote schooling. In addition, more flexible working arrangements and remote working had to be introduced while safeguarding small businesses from closing. The necessary financing of these policy initiatives was supplemented by the issuance of additional sustainable debt, evident in the significant increases in social bonds and sustainability-linked loans seen after 2020. Subsequently, Russia’s invasion of Ukraine has shifted energy discussions and underlined the urgency of energy transition. The ensuing global energy crisis dictated that energy supply should be diversified towards cleaner sources, thereby supporting green debt issuances. The significant increase in global sustainability-linked loans in the last three years implies that debt issuers prefer to have flexibility in using the proceeds not for specific projects, but to support greater environmental awareness without the reporting requirements on the use of the proceeds (Box 1).

Figure 12
Sustainable finance in Africa by debt instrument (\$ billion)

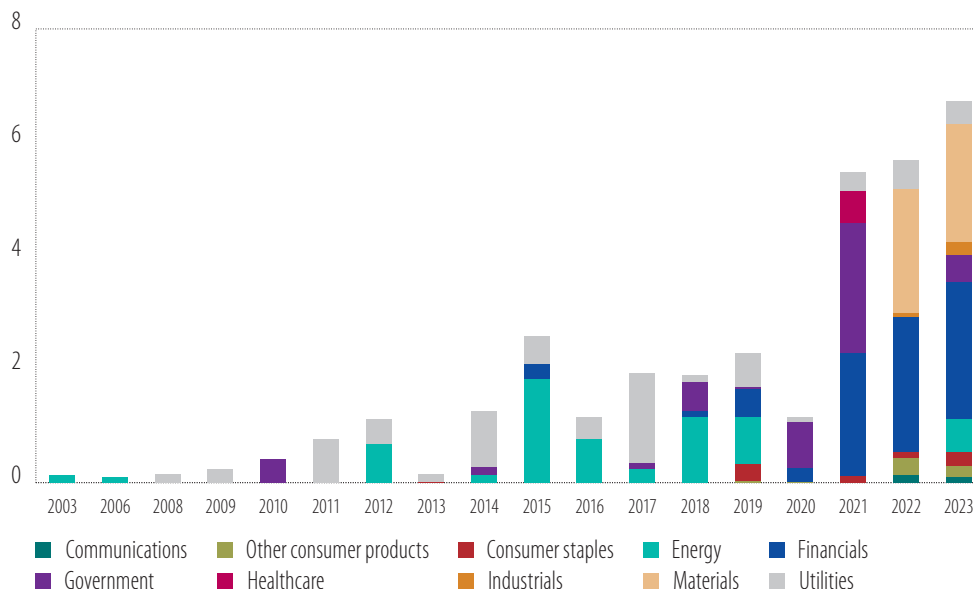


Source: Bloomberg and EIB staff calculations.

The financial sector has dominated sustainable debt issued in Africa since 2003. Disregarding issuances by supranationals reveals that the financial sector leads sustainable debt issuances in Africa. The utilities (non-energy) sector is the second most important sector issuing sustainable debt in Africa, having issued almost what the government sector has issued since 2003 (Figure 13). The energy sector trails the sustainable debt issued by the utilities sector in Africa over the same period. African regions show some differences in the leading sectors for sustainable debt issuances. The sectors issuing the largest amount of sustainable debt since 2003 are government, energy and utilities in North Africa, financials, energy and utilities in Southern Africa, utilities and communications in East Africa, government in Central Africa, and the government and financial sectors in West Africa.

There is a greenium, or green premium, in African debt of approximately 7 basis points over longer horizons. The EIB analysed bonds issued over the past couple of years by supranationals domiciled in Africa to explore whether a greenium existed. A greenium exists when the price of a green debt instrument is higher, or its yield is lower, than that of a comparable non-green debt instrument. This situation occurs when investors are willing to pay a higher price to hold a green instrument because they anticipate a higher demand in the future. We focused on supranationals because their debt has better credit quality than that of individual sovereign and corporate debt issuers in Africa. For example, the credit rating of the African Development Bank is AAA. In addition, supranationals issue ordinary and sustainable debt securities in the same hard currency with comparable maturities. If we had used sovereign debt issuers for this exercise, it would have been very difficult to find green and non-green bonds of comparable characteristics (coupon type, currency of issuance, type of payment, maturity, etc.) and compare their yields to see if there is a difference and, consequently, a greenium.

Figure 13
Sustainable finance in Africa issued by institutional sector (\$ billion)



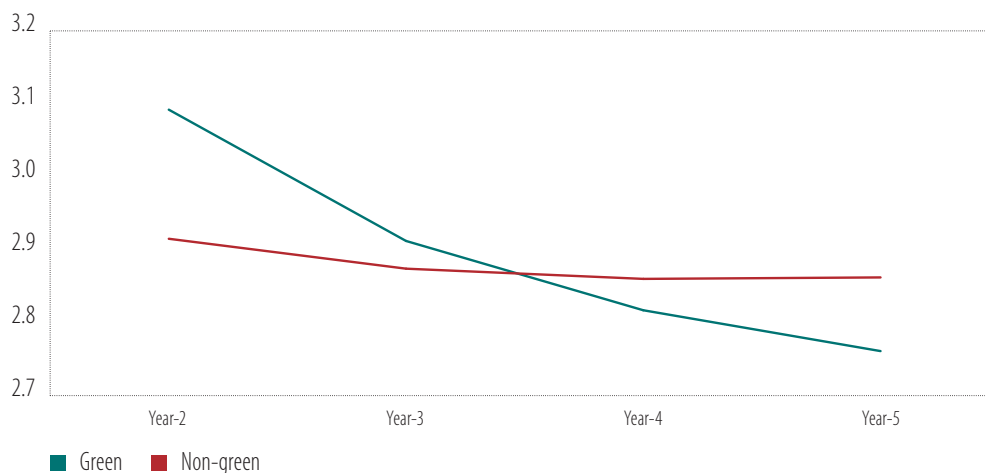
Source: Bloomberg and EIB staff calculations.

We chose green and non-green bonds issued by supranationals in Africa with comparable debt characteristics and constructed two groups. The green group includes bonds with Bloomberg’s Green Bond Instrument indicator, meaning the proceeds of the debt will be used for green purposes. In contrast, the non-green group includes bonds without the Green Bond Instrument indicator. For each of the two groups, we fitted a yield curve for the daily yields using the Nelson-Siegel method to construct a parametric term structure of interest rates.⁵ The yield of green bonds is higher than that of non-green bonds at shorter maturities implying that at short horizons there is no greenium (Figure 14). We attribute this finding to the markets’ position that the greening of economic activity will take time to materialise and is more likely to occur in the longer term than in the medium term. As bond maturity lengthens, the yield of green bonds is lower than that of non-green bonds, implying that there is an average greenium of 7 basis points for tenures of four to five years. In the European Union, an average greenium of 10 basis points has been reported for sovereigns and 6 basis points for corporates (Alper et al., 2022).

Deeper capital markets do not necessarily mean higher credit penetration. Banks in Africa fund their credit expansion predominantly by resorting to their deposit base, as highlighted in Chapter 3. Yet, part of the credit expansion may be supported by capital market sources. We proxy capital market depth by two different metrics: stock market capitalisation and the volume of outstanding debt securities issued by all sectors of the economy, as a percentage of GDP. The higher these two metrics are, the deeper capital markets are. We proxy credit penetration by using domestic credit to the private sector as a percentage of GDP. Credit to the private sector in Africa declined between 2013 and 2022 (the latest available data for domestic credit to the private sector), with the decline being most pronounced in sub-Saharan Africa (Figure 15). This decline coincided with a drop in stock market capitalisation in Africa despite an increase in international debt securities observed over the same period.

⁵ The method is based on Nelson, C. and Siegel, A.F. (1987). It uses a long-term yield rate, curve slope, curvature and time-decay factors to generate a standard best-fit model widely used in academia and by central banks for calculating yield curve constant maturity points.

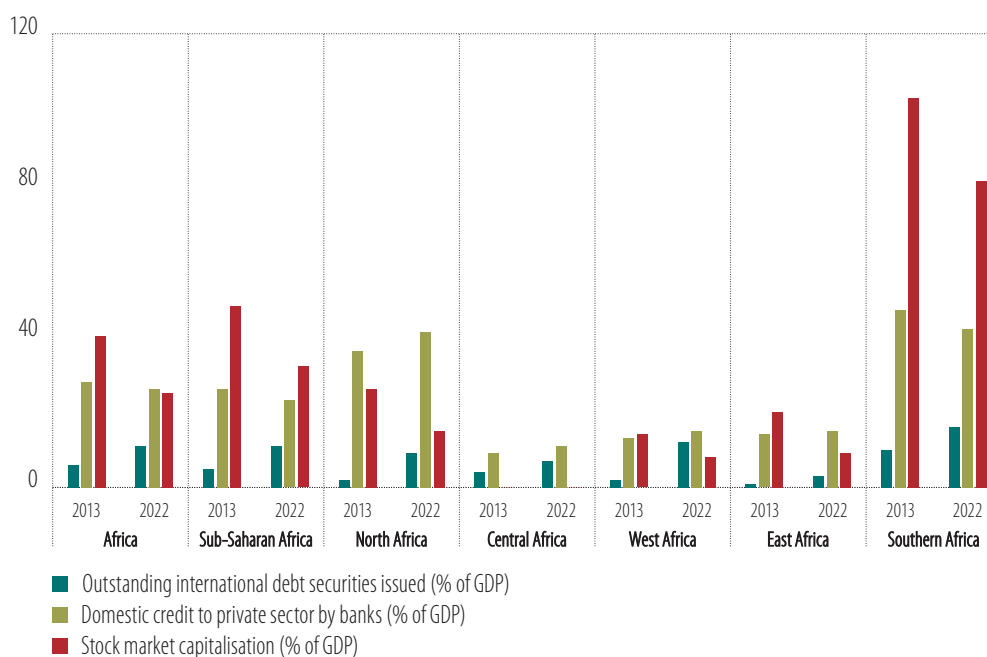
Figure 14
Sub-Saharan African supranationals' yield curves (in %)



Source: Bloomberg and EIB staff calculations.

In Southern Africa, the bond market grew between 2013 and 2022, but the decline in the country's much larger stock market capitalisation may have contributed to lower credit penetration in the same period. In North and West Africa, where an increase in credit penetration was observed, outstanding international debt instruments increased and stock market capitalisation decreased, implying that banks in these regions are more likely to source market liquidity for financing credit growth from the bond market rather than the stock market. In all of the regions except West Africa, the stock market capitalisation is higher than the stock of outstanding international debt securities issued, suggesting that there is room for the debt market to catch up with the depth of the stock market.

Figure 15
Capital market depth and banking sector penetration (% of GDP)

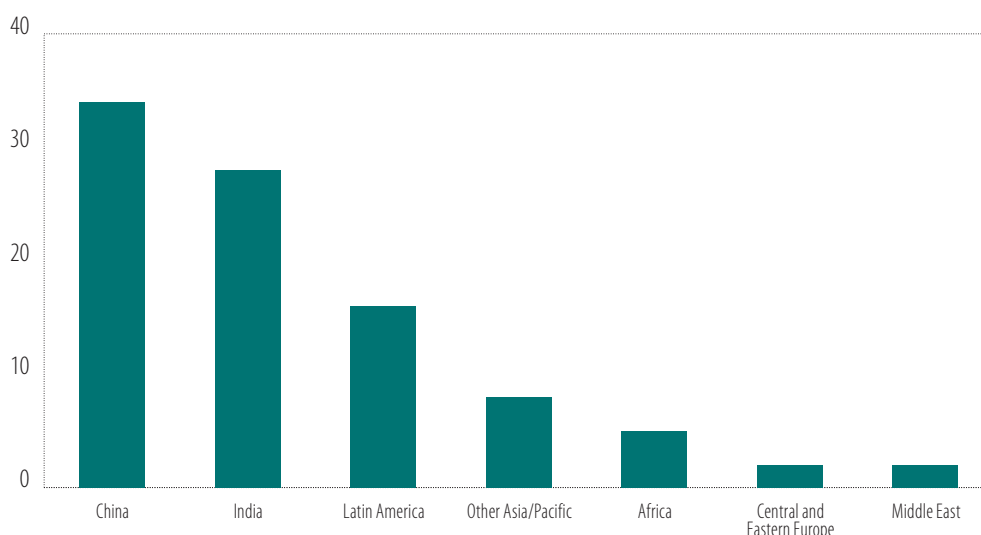


Source: Bloomberg, Bank for International Settlements, World Bank, IMF and EIB staff calculations.

Private capital markets

Africa has a 5% share in private capital investment in emerging and developing economies, up from 3.5% in 2022, and its largest share of global capital investment since 2016. Asia remains the largest market for global private capital, with China, India and other Asia-Pacific countries accounting for three-quarters of private capital investment in emerging and developing regions in 2023 (Figure 16). Latin America accounts for about 17% of investment, while Africa is at 5% (Figure 16). Globally, private investment spending in emerging and developing regions halved from \$188 billion in 2022 to \$94 billion in 2023, and is down from a peak of \$251 billion in 2021. The fall in African private capital investment was 23% between 2022 and 2023, which was lower than other regions and helped boost Africa’s share of the global total.

Figure 16
Private capital investment by region in 2023 (\$ billion)



Source: Global Private Capital Association.

A surge in private capital fundraising in Africa to \$3.7 billion in 2023 from \$2.5 billion in 2022 meant fundraising surpassed the record of \$3.5 billion set in 2019 (Figure 17). Although the amount of capital raised annually in Africa has varied in the last three years, the number of funds has been quite stable, meaning the variation is mainly in fund size. About three-quarters of the capital raised on the continent is for pan-African investments, rather than investments focusing on a specific country or region. Private capital funds are raised for different asset classes, including private equity, venture capital and infrastructure, which are various subcomponents of the data underlying Figure 17. In 2022, there was a sharp decrease in funds raised for private equity, falling to \$0.78 billion from \$1.76 billion in 2021. In contrast, funds raised for venture capital almost tripled, to \$0.77 billion in 2022 from \$0.27 billion in 2021, putting venture capital and private equity on an equal footing in 2022. In 2023, despite the tough market conditions, private equity fundraising rebounded to \$1.63 billion, almost matching the high of 2021, whereas venture capital fundraising fell to \$0.68 billion, thereby restoring the dominance of private equity in fundraising. Over the last two years, there has been sustained growth in infrastructure fundraising, to \$0.78 billion in 2023 from \$0.48 billion in 2021, accounting for a fifth of the total private capital funds raised. See Figure A1 in the appendix for detailed data on the components of private capital fundraising.

Figure 17
Private capital fundraising in Africa (\$ billion)

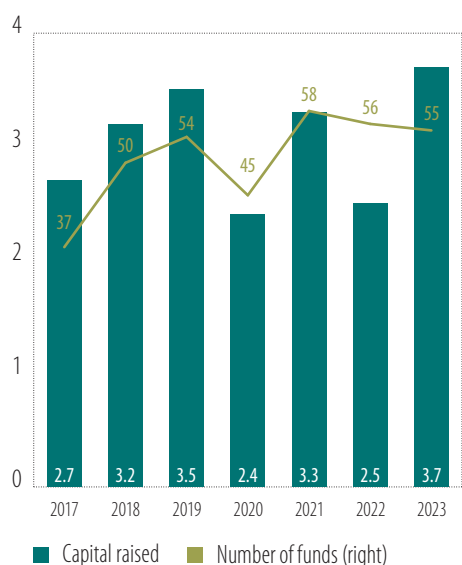
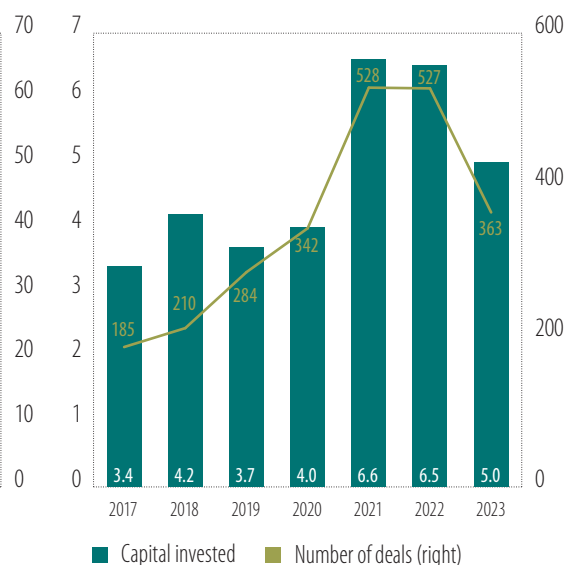


Figure 18
Private capital investment in Africa (\$ billion)

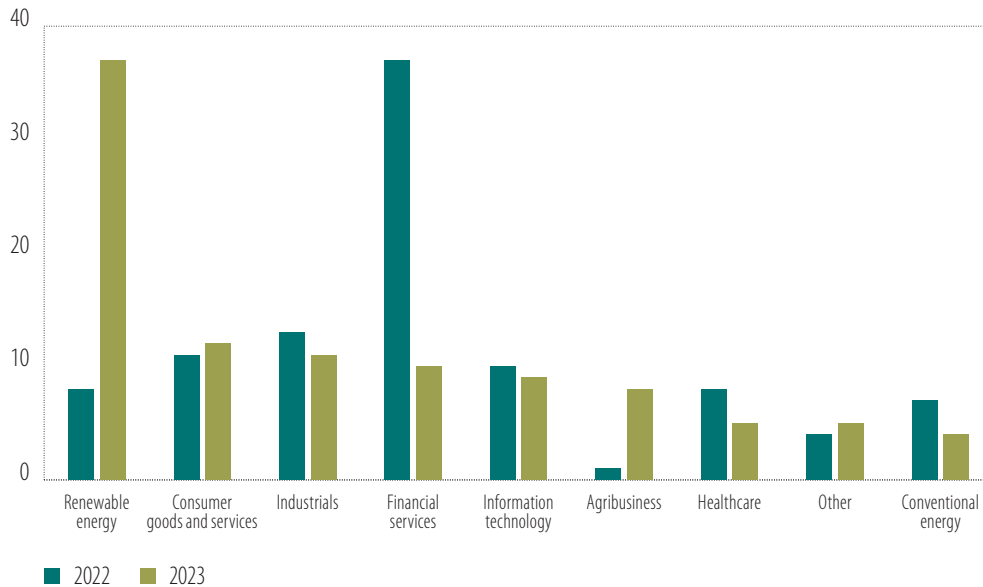


Source: Global Private Capital Association.

Private capital investment in Africa fell by 24% to \$5 billion in 2023 from \$6.5 billion in 2022, making it the lowest amount of capital deployed since 2020 (Figure 18). There were significant falls in investment across most major asset classes, except for infrastructure. Of the capital deployed in 2023, private equity (\$1.24 billion) and venture capital (\$1.14 billion), which are typically the two core asset classes in private capital, saw an annual decline of 39% and 59%, respectively, from 2022. Private credit, which had surged in 2022, fell by 70% to \$0.33 billion. Thus, it was a sharp increase in infrastructure spending – almost quadrupling to \$2.18 billion in 2023 from \$0.55 billion in 2022 – that allowed Africa to record a more modest decrease in overall capital investment compared to other regions. See Figure A2 in the appendix for detailed data on the components of private capital investment.

Renewable energy became the industry receiving the largest share of private capital investment in 2023, replacing the financial industry which had led investment in 2022 (Figure 19). The renewables sector accounted for 37% of investment in 2023, with financial services receiving 10% of total investment. This large increase for the renewable energy sector effectively reversed the share of investment of these two industries in 2022, when the financial sector attracted 37% of total investment. This volatility in industry share is partly related to the markets being relatively small. However, industry shares have been steadier in other sectors, including consumer goods and services, industrials, and information technology, with each typically receiving 10-13% of the total private investment annually. The agribusiness sector saw its share of investment increase to 8% in 2023 from 1% in 2022. Agriculture is a critical sector for Africa and the benefits of supporting the agribusiness sector to increase industrialisation in Africa is discussed in Chapter 2. One of the largest sectoral declines in private investment observed in 2023 was for conventional energy, which attracted only 4% of total funding, further highlighting the relative appeal of renewables seen recently.

Figure 19
Industry shares of total private capital investment in Africa in 2023 (in %)



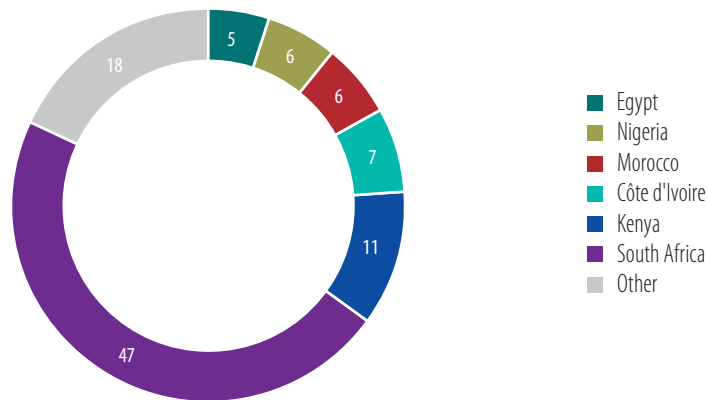
Source: Global Private Capital Association.

Private capital investment has become more concentrated at the country level, with South Africa accounting for half of all African investment in 2023 (Figure 20). In 2022, South Africa accounted for 20% of private investment on the African continent, up from 17% in 2021. The marked increase in concentration in the latest data might be driven by greater investment in larger, more liquid markets when financial conditions are tight. Kenya is the next biggest individual country market (11%), followed by Côte d'Ivoire (7%) and Morocco (6%). However, except for Morocco, most other large economies saw their share of capital investment decline in 2023 compared with their average for the previous two years. Nigeria, which was the largest individual market with a 20% share in 2021, has seen a sharp decrease in its share to 6% in 2023 as venture capital financing of the fintech sector slowed.

Exit values for private capital investments decreased by 39% to \$4.6 billion in 2023, from \$7.5 billion in 2022, but the value of exits remained robust by historical standards (Figure 21). Exit value is the return on an investment or asset at the time of sale. Although financial conditions were tight in 2023, private capital funds achieved a high value for exited assets relative to the historical average. However, there was a more pronounced decline in the number of exit deals, falling to 42 from 80, meaning that the average value of individual exited investments increased to \$110 million in 2023 from \$94 million in 2022. In 2022, strategic sales accounted for 79% of the total exit value, secondary sales made up a further 13% and private exits comprised just 6% of the total.⁶ In 2023, the composition of buyers changed significantly, with secondary sales surging to 61% of the total exit value, strategic sales falling to 34% and public markets dropping to a meagre 1%. The low share of public exits reinforces a long-standing issue whereby shallow public equity markets in Africa are a constraint on exiting investments compared with other regions. Increased country concentration was also evident in the private capital exit data, with South Africa accounting for 52% of the total exit value in 2023, compared with 41% in 2022. Côte d'Ivoire (8%) was the next largest contributor, owing to two deals worth a total of \$350 million in the second quarter of 2023.

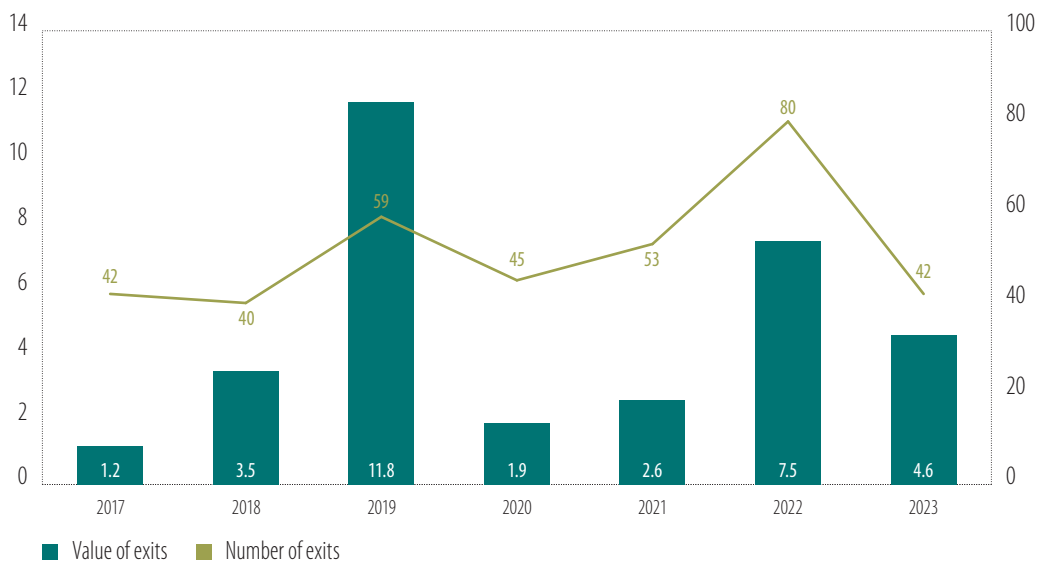
⁶ Strategic sales are when the private equity/venture capital firm sells its investment in a company to another company in the same industry, with the buyer typically trying to expand or build capability within its own industry. A secondary sale is when the investment in a company is sold to another private equity/venture capital firm, keeping the company in the hands of private capital investors. Note that the percentages do not total 100 because some smaller exit categories are not discussed in this report.

Figure 20
Country shares of total private capital investment in Africa in 2023 (in %)



Source: Global Private Capital Association.

Figure 21
Private capital exits in Africa (left axis: value in \$ billion; right axis: number of deals)



Source: Global Private Capital Association.

Financing conditions in Africa

Financial integration

Financial integration measures the degree to which a country or a region is connected financially with the rest of the world. This metric is calculated as the total external assets and liabilities of a country relative to the GDP of that country, and encompasses the assets and liabilities of the public and private sectors. As countries become more financially integrated, they have access to more financial resources. Such access is crucial for developing countries as they typically have large financing needs for development

that cannot be met using domestic resources alone. Thus, greater financial integration can lead to higher consumption and investment when domestic resources are limited. However, increased financial connectivity to global markets increases the exposure of a country to global financial shocks. The effects of global financial tightening in recent years, caused in part by an aggressive monetary policy tightening cycle in the United States, are an example of the perils of this increased connectivity. The 2022 edition of our Finance in Africa report (EIB, 2022) began tracking financial integration and contains a more detailed review of the pros and cons of increased financial integration, based on the External Wealth of Nations dataset (see Lane and Milesi-Ferretti (2018)).

Financial integration varies substantially across African regions and is particularly high in Southern Africa compared with other regions. The latest available data for 2022 show that financial integration ranged from 84% of GDP in West Africa to 362% in Southern Africa, with values between 104% and 116% for the other three regions (Figure 22). West Africa has the lowest level of financial integration, partly because this region is large with a significantly higher GDP than East Africa or Central Africa. In absolute US dollar terms, the total amount of external financial assets and liabilities is in fact much larger than that of either Central or East Africa. In Southern Africa, financial integration is boosted by the large external financial position of South Africa and, to a lesser extent, Mauritius. Financial integration in other developing regions in Asia or Latin America is typically around 150-180% of GDP. In this sense, most African regions are less integrated in global markets than regional peers.

Figure 22
Financial integration by region (% of GDP)

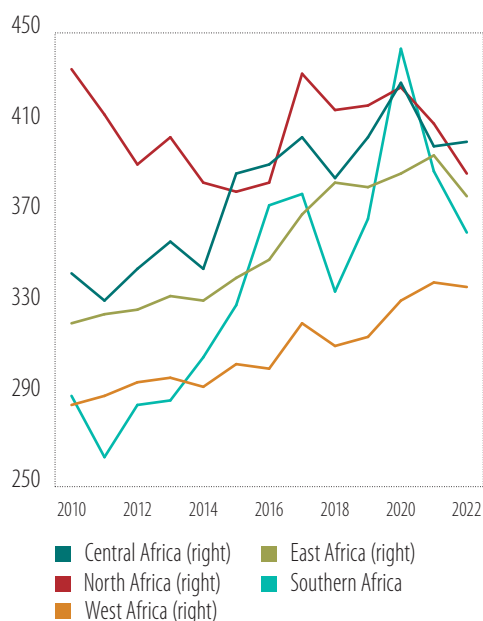
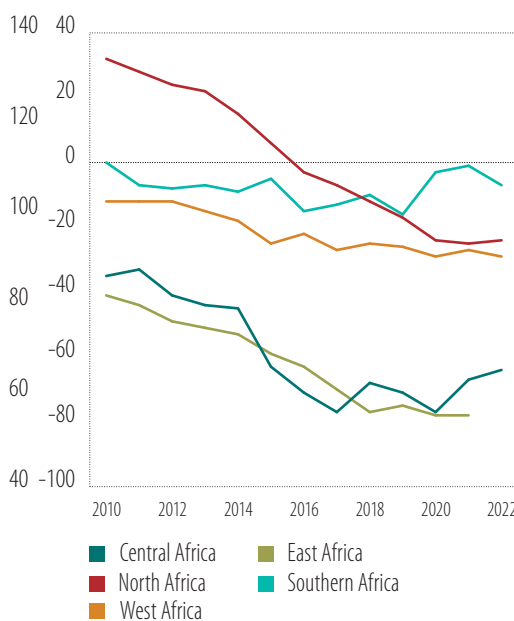


Figure 23
Net international investment position (% of GDP)



Source: [External Wealth of Nations database](#).

Financial integration increased across most regions between 2010 and 2020 until the shocks caused by the COVID-19 pandemic and Russia’s invasion of Ukraine stalled or even reversed the growth. The typical pattern observed over the last ten to 15 years is that external assets in nominal terms have been flat or growing slowly and external liabilities have increased more quickly. However, even for liabilities, their growth rate has slowed over the last five years. These patterns are reflected in the net international investment position, which subtracts external liabilities from external assets, aiming to show the external solvency of a country or regions. According to the net international investment position, net external liabilities grew across most regions until 2015 or 2016 but have been relatively stable since then as liability

growth slowed and aligned with asset growth (Figure 23). The volatility in financial integration measures compared with the net international investment position is mainly due to variability in the growth rate of nominal GDP. In 2020 and 2021, there were some large changes – positive and negative – in nominal GDP across the African regions, impacted by volatile real growth rates, high inflation and changes in US dollar exchange rates. As inflation slows and GDP growth settles over the coming years, financial integration metrics are also likely to be more stable.

Among bond and equity portfolio flows, bond market flows are typically more important for African regions. As mentioned above, a drawback of increased financial integration is the potential for global shocks to have a bigger impact on domestic financing. Such effects can be seen using the financial conditions index (see the next section in this chapter). However, the financial conditions index is a high frequency indicator using monthly data, but there is a shortage of timely indicators available on changes in portfolio flows to include in that index. Instead, now that annual data are available until 2022, the data on external assets and liabilities can provide an overview of how equity and debt flows behaved between 2019 and 2022. Focusing on the liability side, which represents foreign financing of domestic regions, Figure 24 shows that portfolio debt/bond liabilities are higher than equity liabilities for all African regions except Southern Africa. Debt liabilities range from 2.4 times larger than equity liabilities in East Africa to eight times larger in West Africa.

Figure 24
Portfolio equity and bond liabilities
(% of GDP)

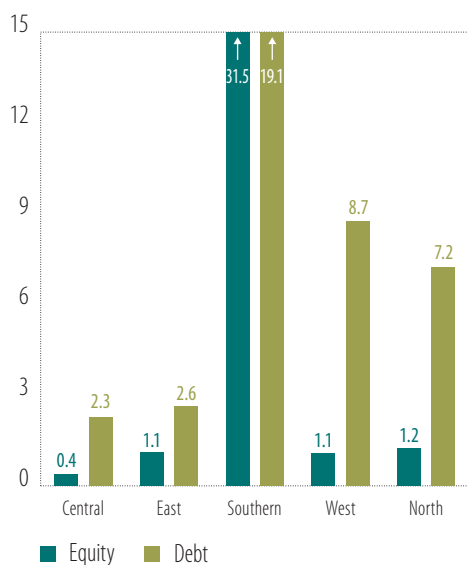
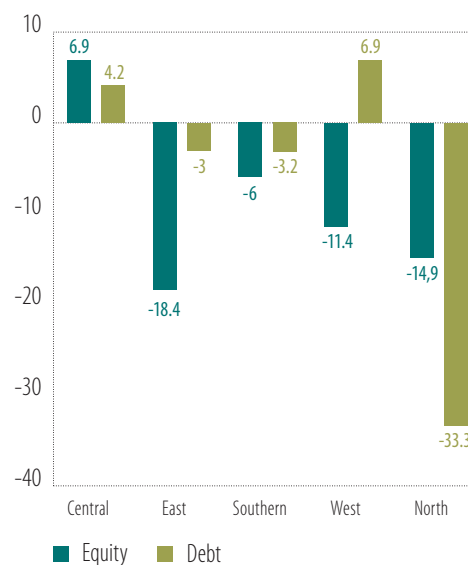


Figure 25
Change in nominal portfolio liabilities
2022 vs. 2021



Source: External Wealth of Nations database and EIB staff calculations.

The tightening in global financing conditions in 2022 is reflected in changes in portfolio liabilities. As the flows remain small relative to GDP in most African regions, and nominal GDP was volatile between 2021 and 2022, it might be more useful to focus on the changes in outright US dollar liabilities. Global markets were buoyant in 2021 but experienced a souring in sentiment in 2022. In terms of equity portfolio liabilities, there is a general tendency of declining liabilities across regions, ranging from a 6% fall in Southern Africa to an 18% fall in East Africa (Figure 25). In stark contrast is the 7% increase in equity portfolio liabilities in Central Africa but, as seen in Figure 24, the size of equity liabilities is extremely small in Central Africa as a share of GDP. Furthermore, the market in Central Africa is also smaller than other markets in absolute terms, with total portfolio liabilities of about one-third of the size of East Africa, which is the next smallest market in absolute terms. In this sense, the trend in terms of volumes was for exits from equity liabilities across Africa. However, for debt liabilities, which are generally more

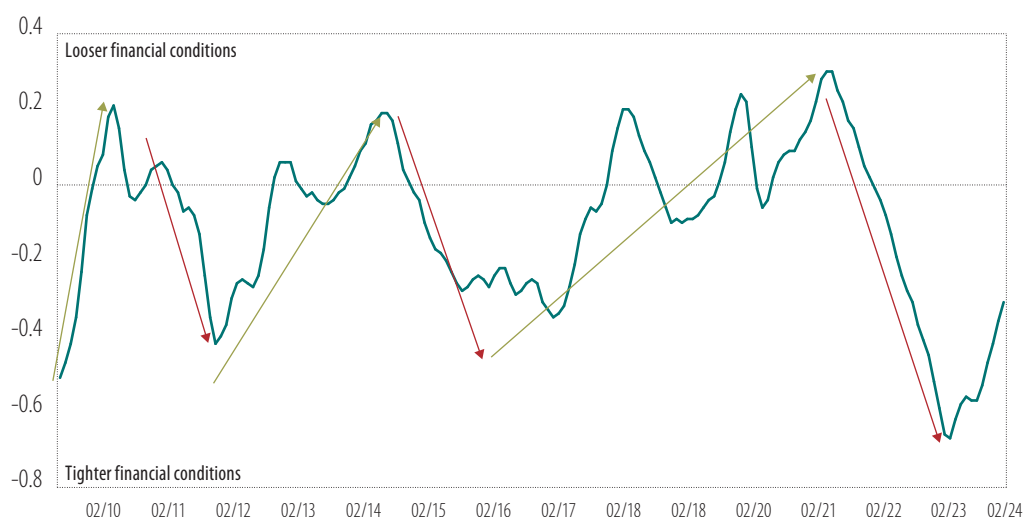
important for African regions, the situation was mixed. There were small reductions in debt liabilities in East and Southern Africa but increases in Central and West Africa. North Africa experienced a sharp drop in portfolio liabilities that was driven by the financial problems in Egypt, which included devaluation of the currency, thereby reducing the value, in US dollar terms, of the debt liabilities held by overseas investors. Overall, portfolio liabilities point to outflows in 2022 following a buoyant 2021 but, apart from North Africa, these outflows were more concentrated in equity rather than debt.

Financial conditions index for Africa

A financial conditions index for Africa was introduced last year in the Finance in Africa report (EIB, 2023). The motivation was to create an indicator capable of reflecting the ease with which the private sector can secure financing. The analysis was based on monthly data for four countries in sub-Saharan Africa from February 2009 to February 2023. Egypt, Nigeria, Kenya and South Africa were chosen because they are among the region's major economies, accounting for about half of the continent's GDP, and the regional heterogeneity permits an approximation of financial trends at the continent level. Seven country-level variables were included: credit growth (private and public sectors), corporate lending spread,⁷ 12-month change in the nominal exchange rate vs. the US dollar, 12-month policy rate change, 12-month change in the stock market, and annual rate of inflation. More details on the methodology are available in the 2023 Finance in Africa report (EIB, 2023).

The financial conditions index has been expanded to ten countries in this edition of the report, adding Morocco, Côte d'Ivoire, Ghana, Tunisia, Senegal and Zambia. These ten countries accounted for approximately 60% of GDP on the African continent in 2023, further enhancing the representativeness of the index. The sample has been extended to February 2024, compared to February 2023 last year. The index shows three periods during which financial conditions have loosened since 2009, and three periods of tightening (Figure 26). For a detailed description of the drivers of financial conditions during these historical periods, please consult the 2023 Finance in Africa report (EIB, 2023).

Figure 26
Financial conditions index for Africa



Source: European Investment Bank.

⁷ This is the difference between corporate interest rates and the policy rate.

The extended financial conditions index reveals a severe tightening in financial conditions over the course of 2023. A broad loosening in financial conditions began in 2016 but there was some volatility, caused by stock market changes and, to a lesser extent, exchange rate movements. The onset of the COVID-19 pandemic in early 2020 led to a tightening of financial conditions initially due to weakness in the stock market and exchange rates. However, swift reductions in policy rates by central banks quickly reversed the sentiment on stock markets and strengthened currencies, loosening financial conditions until mid-2021. Subsequently, accelerating inflation following the onset of Russia's invasion of Ukraine rapidly reversed the situation again. Policy rates were increased, and exchange rates and stock markets fell, causing tightening in the financial conditions index over 2022 and 2023. The period after the invasion represents the most severe peak-to-trough tightening episode since 2009. The tightening pressure exerted by the variables comprising the financial conditions index started to wane around mid-2023, particularly for the stock market, but weaker private sector credit growth and wider lending spreads maintained tightening pressures. Since then, financial conditions have started easing again, reversing approximately one-third of the peak-to-trough tightening.

The new countries added to the index have driven the recent rebound in financial conditions, recovering from the shocks caused by the COVID-19 pandemic and the spike in food and energy prices stemming from Russia's invasion of Ukraine more quickly than the four original countries in the index (Figure 27). As the financial conditions index is GDP-weighted, Morocco (35%), Côte d'Ivoire (19%) and Ghana (18%) account for about three-quarters of the weight of the index for new countries. In Morocco, the tightening exerted by the currency had begun reversing by the final quarter of 2022, while inflation started falling from the first quarter of 2023, accompanied by improving stock market performance and tightening spreads on corporate lending rates. In Côte d'Ivoire, the situation was similar, with inflation, foreign exchange pressures and stock markets all improving by the final quarter of 2022, although this improvement was partially offset by fresh policy rate tightening. Ghana had weathered the financial impact of global shocks relatively well but then faced a severe tightening in financial conditions owing to its sovereign debt default in late 2022. However, by mid-2023, financial conditions were starting to loosen again through inflation, foreign exchange and stock prices, but tightness continued in private sector lending. Among the remaining three new countries in the index, financial conditions had also started improving in Zambia and Tunisia but less so in Senegal. Although the recovery was quicker for the six new countries, the scale of the peak-to-trough tightening in financial conditions was similar for the original and the new countries.

Economic and financial conditions remained strained among the original four countries in the index. Nigeria saw inflation rise and currency weaken in 2023 as the new government tried enacting economic policy reforms that will bear fruit in the long term. South Africa saw financial conditions hit a low point in the final quarter of 2022 and improvement since then has been weak, impeded by unfavourable developments in credit markets. In addition, stock market performance in South Africa has trailed other large economy commodity exporters in global emerging markets. In Egypt, the economic problems confronting the country led to a sharp deterioration in financial conditions from the final quarter of 2021, hitting a low point in the second quarter of 2023, although there has been some recovery since then, helped by a rebound in the stock market. Kenya saw continued tightening of financial conditions throughout 2023 due to a weaker currency, falling stock prices and policy tightening.

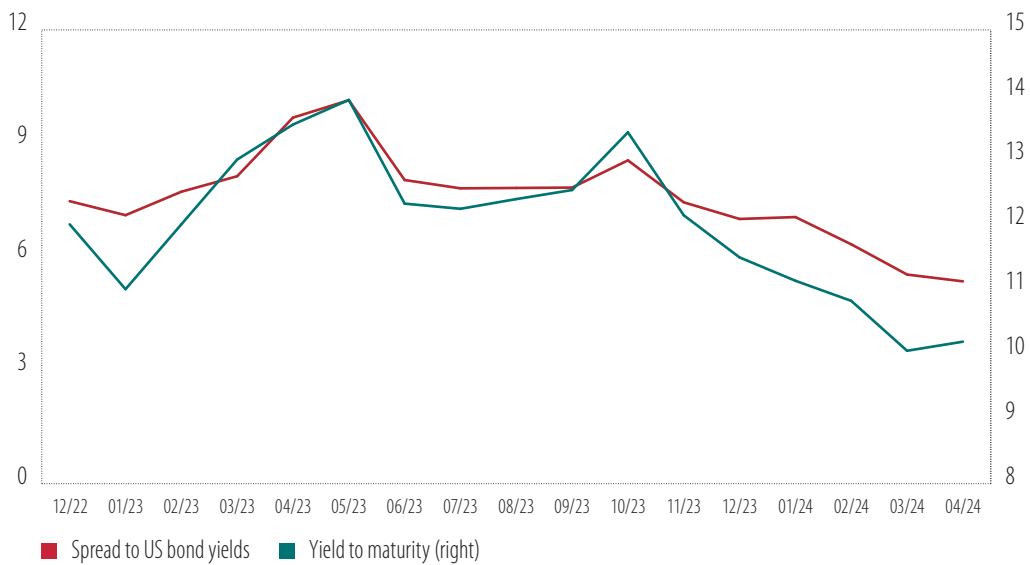
The conditions experienced recently by the new countries more closely reflect the loosening of conditions on international bond markets. Figure 28 shows the GDP-weighted average yield for 14 African countries and their spread relative to US Treasury yields. These yields fell to 10.2% in April 2024 from 13.9% in May 2023, a reduction of 373 basis points. Over the same period, the yields on US Treasuries increased by 106 basis points, meaning the risk-free rate was rising. Accordingly, the fall in African yields was entirely due to spread tightening, with spreads narrowing by 479 basis points. This reflects an improvement in market sentiment towards African governments since late 2023, at least partly linked to perceptions that risks are receding. Even though major fiscal issues persist and financing options remain narrow, there are now signs that the worst of the sovereign debt crisis has passed, although, as seen earlier in the chapter, yields remain above pre-pandemic levels.

Figure 27
Financial conditions indices by country groups



Source: European Investment Bank.
 Note: New countries are Morocco, Côte d'Ivoire, Ghana, Tunisia, Senegal and Zambia while existing countries are South Africa, Nigeria, Egypt and Kenya.

Figure 28
Hard currency bond yields and spread to US bond yield, GDP-weighted average for 14 African countries (in %)



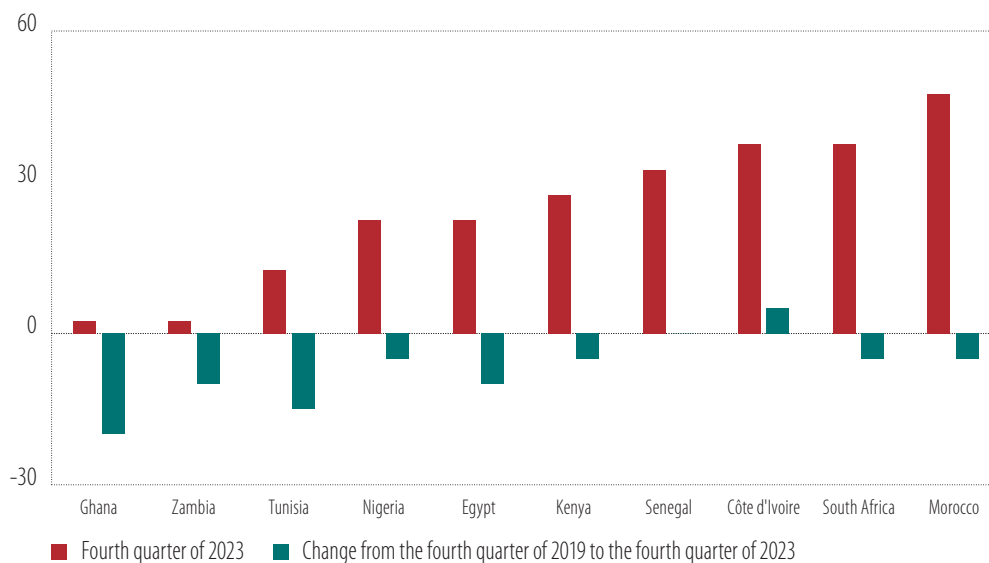
Source: Bloomberg and EIB staff calculations.

Middle-income rather than low-income countries present the biggest sovereign debt risk in terms of impact. There are 13 low-income countries at high risk of debt distress in Africa, according to the International Monetary Fund, but their share of continental GDP is only 13%. This group includes Ethiopia, even though this country is effectively still finalising its debt restructuring. If Ethiopia is excluded, the GDP share of low-income countries in debt distress falls to just 8%. At present, middle-income countries such

as Egypt and Tunisia probably represent the greatest risk, while Angola is also considered at fairly high risk of debt distress. These three countries account for almost 19% of GDP on the African continent. Egypt is by far the largest of these three economies (14% of Africa's GDP) and while risks remain, the situation has improved, and bond yields have fallen for this country. Among the 13 low-income countries at high risk of debt distress, nine have International Monetary Fund programmes in place and three more are in pre-programme negotiations, leaving just Burundi without a programme. While a programme does not preclude sovereign debt distress, the Economist Intelligence Unit (2024) highlights that Ethiopia, Ghana, Malawi and Zambia did not have a programme in place when they fell into debt distress. Among the middle-income countries, Egypt has a programme, but Tunisia and Angola do not.

There is significant variation in the creditworthiness of the countries included in the financial conditions index. For the countries in the index, the EIB conducted an analysis comparing their sovereign creditworthiness in the fourth quarter of 2019, just ahead of the onset of the pandemic, to that in the fourth quarter of 2023, using the median sovereign credit rating of the three main rating agencies – Fitch, S&P and Moody's.⁸ Credit rating agencies use a rating scale (from Aaa to D, for example) to classify sovereign creditworthiness. These detailed scales typically have roughly 20 different notches on the rating scale. For each country, a numerical score is created for the rating by translating the credit rating to a number on a points scale between 0 and 100, meaning that each notch on the scale is equivalent to five points. For example, the highest rating of Aaa is equivalent to 97.5,⁹ Aa1 is equivalent to 92.5, continuing all the way down the scale in increments of five to a score of 2.5 for a country in default.

Figure 29
Sovereign creditworthiness (numerical rating scale)



Source: European Investment Bank, Fitch, S&P and Moody's.

Note: The red bars show sovereign creditworthiness (median credit rating) in the fourth quarter of 2023, and green bars show the change since the fourth quarter of 2019.

The deterioration in sovereign creditworthiness was most pronounced for countries that already had weaker fundamentals. Figure 29 shows the sovereign creditworthiness in the final quarter of 2023 and how that credit rating has changed since the final quarter of 2019. Starting credit ratings (that is, those in the fourth quarter of 2019) ranged from a high of Baa3 for Morocco to a low of Caa2 for Zambia. The largest declines in creditworthiness were for Ghana and Zambia, both of which went into default during

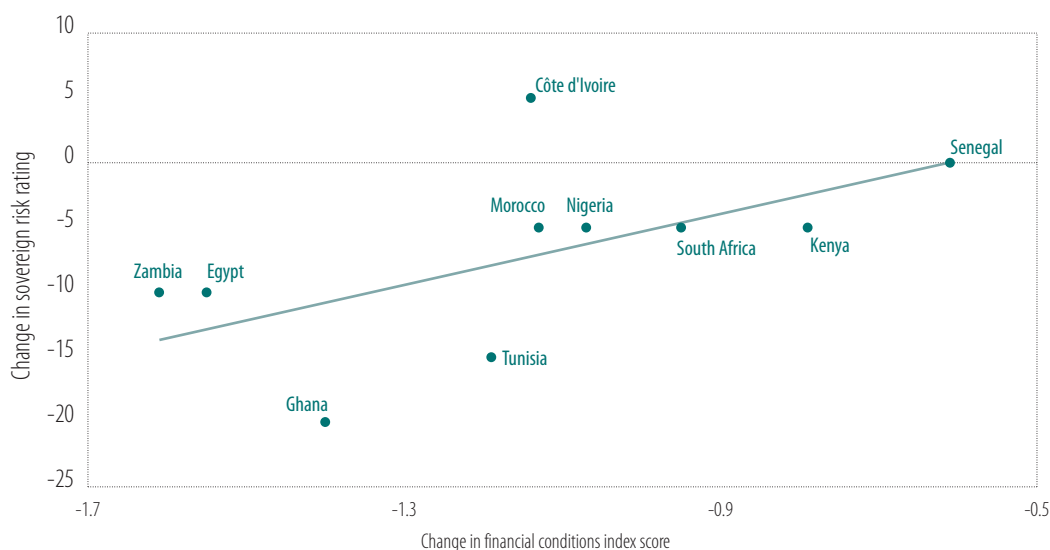
⁸ If there is no sovereign credit rating available for a country from all three rating agencies, which would preclude the use of the median rating, the best rating is used instead.

⁹ This is the mid-point of the 95-100 range.

the period. The very low starting rating for Zambia limited the scale of its subsequent fall. Tunisia had the next weakest credit rating before the COVID-19 pandemic and saw a median downgrade of three notches during the four-year period analysed. This suggests that recent global shocks particularly affected countries with weaker initial fundamentals. At the higher end of the rating scale, Morocco and South Africa saw a median one-notch downgrade, while Côte d'Ivoire was the only country that benefited from an upgrade.

The degree of tightening in financial conditions may reflect changes in sovereign creditworthiness. Comparing the change in sovereign creditworthiness from Figure 29 to the peak-to-trough decline in the financial conditions index for each country, Figure 30 points to a loose relationship between the size of the decline in the financial conditions index at the country level and the corresponding change in credit rating. This is not surprising given that the financial conditions index and the sovereign credit rating capture some of the same broad macrofinancial trends. Moreover, as sovereign borrowing costs are affected by sovereign credit ratings, changes in credit ratings have implications for financing of the private sector. This highlights the importance of sound public finances for the well-being of the private sector and the wider financial system in a country. For countries that have found themselves in debt difficulties, such as Ghana and Zambia, progress on their debt restructuring has coincided with improvements in their respective financial conditions index.

Figure 30
Changes in sovereign creditworthiness and financial conditions index scores



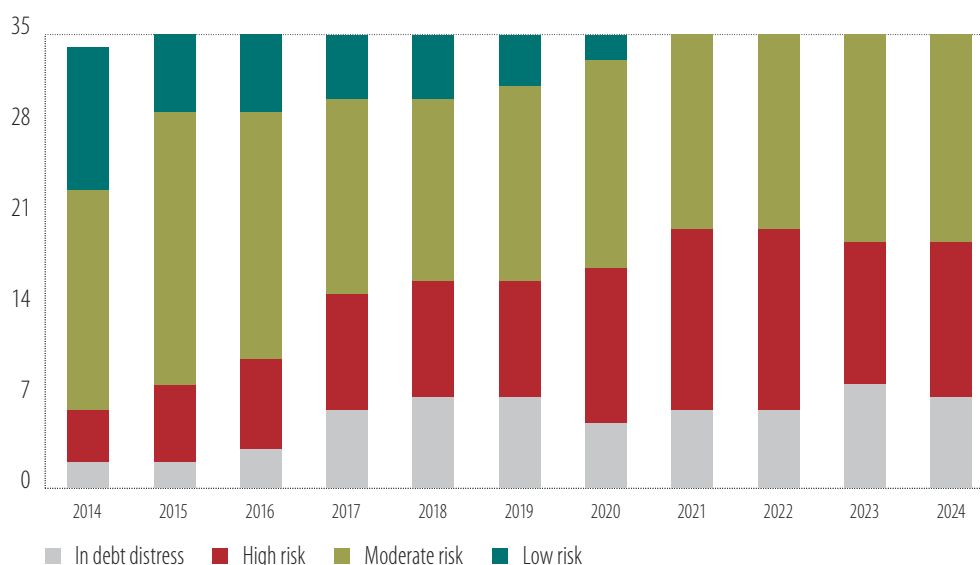
Source: European Investment Bank, Fitch, S&P and Moody's.

Public debt and private sector credit in Africa

Over the past four turbulent years, bank holdings of domestic sovereign debt have increased sharply across Africa. To help finance the widening fiscal deficits in the wake of multiple shocks – the COVID-19 pandemic, the cost-of-living crisis stemming from Russia's invasion of Ukraine, and the global economic slowdown – African banks absorbed a sizeable share of the new issuance of domestic sovereign debt. This has created a stronger connection between governments and banks with two key consequences: (i) it reduces resources available for financing private investments (crowding out) and (ii) it exposes the banking sector to sovereign risks at a time of elevated concerns over sovereign debt distress (Figure 31). For instance, two of the largest banks in Ghana suffered their first loss following the country's decision to restructure its local currency and overseas debt at the end of 2022 (Bloomberg, 2023). Ghana Commercial

Bank – the largest bank in terms of assets – posted a net loss of GHS¹⁰ 593.4 million (\$50.5 million) in 2022 for the first time since 1993, and Ghana’s Standard Bank – the largest bank by market value – registered a loss of GHS 297.8 million (\$25.4 million). In the neighbouring country of Nigeria, banks also reported suffering a loss (about \$1.4 billion) following Ghana’s public debt restructuring.

Figure 31
Risk of debt distress in debt risk status for low-income countries in Africa



Source: *Low-Income Countries Debt Sustainability Analysis Comprehensive List, February 2024; IMF REO (2024).*

Note: *As per the joint IMF-World Bank Debt Sustainability Analysis of Poverty Reduction and Growth Trust in Eligible Low-Income Countries. 2024 data cover up to the end of February. Constant sample of 35 African countries.*

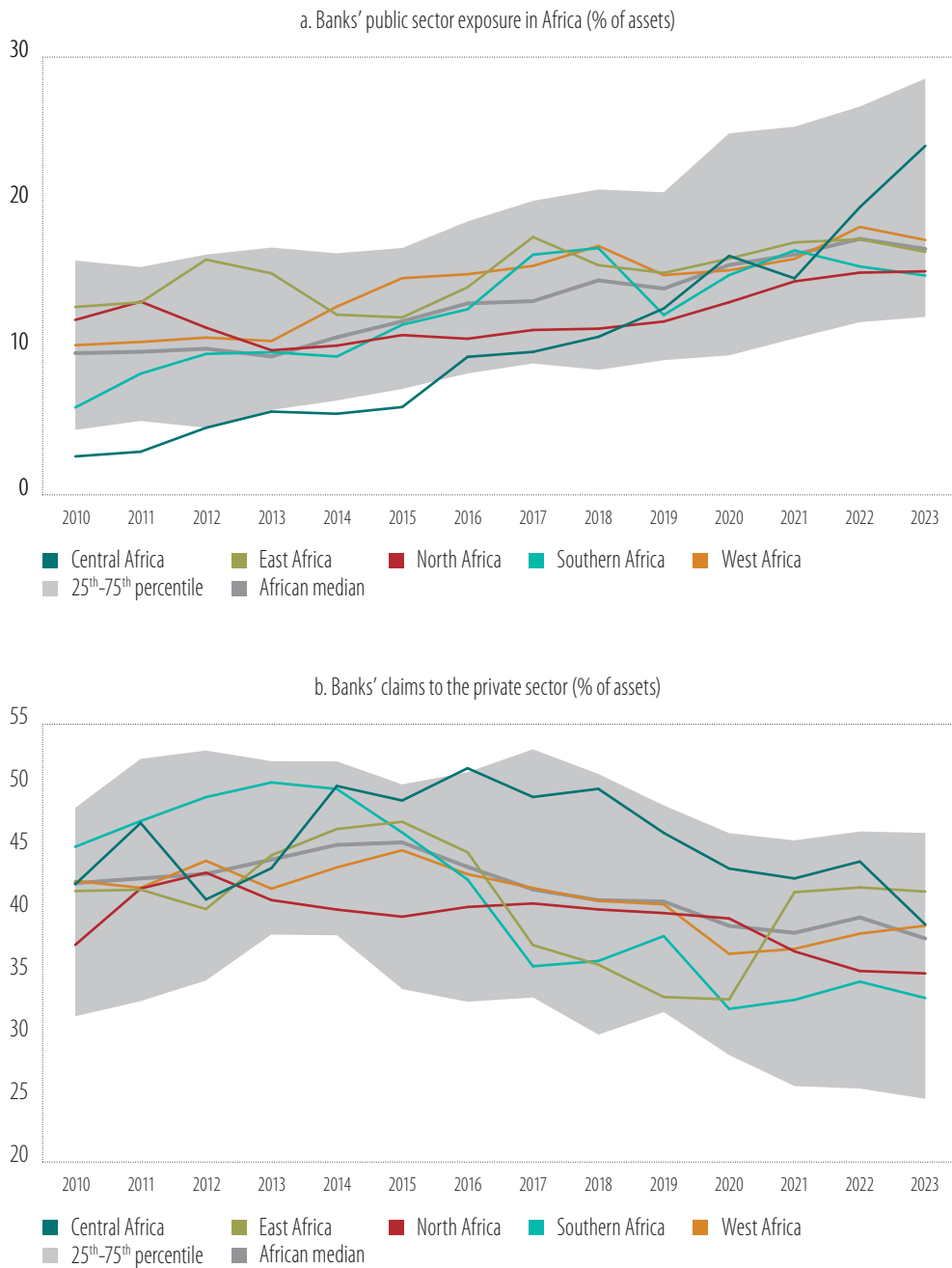
The continued exposure of banks to government borrowings poses concerns about the severity of crowding out. Domestic sovereign debt exposure of banks increased in Africa to 17.5% in 2023 from 10.3% in 2010 (Figure 32a). In parallel, Figure 32b shows a decreasing trend in banks’ private sector lending (the sample median declined from 42% to 38% during the same period). At the regional level, public sector exposure of banks increased, particularly in Central Africa, from 2.6% to 24% of total assets. In West and Southern Africa, public sector exposure of banks increased by 7-9% of assets, whereas in North and East Africa, it increased by around 3% of assets. In contrast, the most marked decline in banks’ private sector lending was observed in Southern Africa, with a decline of about 12.1% of assets, whereas that in Central, North and West Africa declined by about 2-3% of assets. Although private sector lending of banks in East Africa hardly declined from 2010 to 2023, it exhibited the highest volatility over the sampled period. This increasing exposure was the result of additional government financing needs met mostly by domestic banks as foreign holders in local currency bond markets receded and the domestic investor base remained limited.

Empirical evidence shows that crowding out has been an issue in many African countries even before the recent increase in public debt (Attout et al., 2022; EIB, 2023). The high liquidity of sovereign instruments, their high yields and the fact that they are perceived as less risky and cheaper (in terms of capital charges) make them more attractive to financial intermediaries than lending to the private sector. Furthermore, sovereign instruments require no due diligence or monitoring compared with private sector lending. In Africa, where financial systems are less developed, government securities dominate the financial markets, offering higher rates – sometimes higher than private sector lending for banks – while attracting zero capital charges. Crowding out is one factor explaining the structurally low level of bank

¹⁰ GHS denotes Ghanaian cedi.

lending to the private sector in many African countries, and this becomes even more of a bottleneck when demand for private sector credit increases. Moreover, banks prefer lending to a safe borrower than a risky private business, especially in times of uncertainty and high inflation and interest rates, which have been witnessed in Africa in recent years (International Monetary Fund, 2024).

Figure 32
Banks' public sector exposure and private sector lending



Source: International Financial Statistics data and EIB staff calculations.

Note: Banks' public sector exposure and private sector lending correspond to claims on central government debt and banks' claims to the private sector, respectively all divided by total banking sector assets. The figure shows aggregated data for 52 African countries.

In this edition of the report, we measure crowding out using a severity of crowding out (SOCO) index. The severity of crowding out index was initially developed by Schmidt and Zwart (2018) and recently refined by Attout et al. (2022), and is updated annually to capture trends in the crowding out of private sector lending in African countries. In addition, the severity of crowding out index provides insights on bank lending conditions under different economic cycles while allowing for comparisons between countries and over time. The index comprises three sub-indices that facilitate understanding of the key factors at play: the supply of public debt, demand for private sector credit, and banks' lending decisions towards the private sector (Box 2).

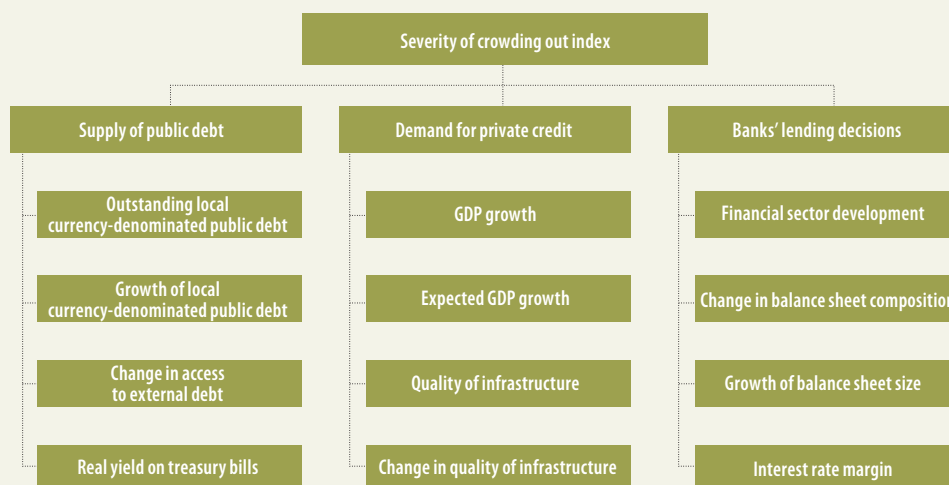
Box 2

The severity of crowding out index, sub-indices and underlying variables

Construction of the severity of crowding out index allows for comparisons between countries and over time. The index was developed by assessing each country using 12 indicators categorised into three sub-indices. The first sub-index estimates the supply of public debt and includes the local currency debt-to-GDP ratio (level and change), changes in the composition of debt (foreign currency vs. local currency), and the real yield on Treasury bills. The second sub-index captures the demand for private credit by examining GDP growth rates for the current year and the forecast for the following year. It also includes the Africa Infrastructure Development Index (level and change), which is a structural indicator of economic development. Finally, the third sub-index explicitly explores banks' behaviour towards lending to the private sector and considers financial sector development, balance sheet developments (growth and composition), and pricing. Figure 33 presents an overview of the index, the three sub-indices, and the underlying indicators.

Figure 33

The severity of crowding out index aggregates three sub-indices, each with four underlying variables

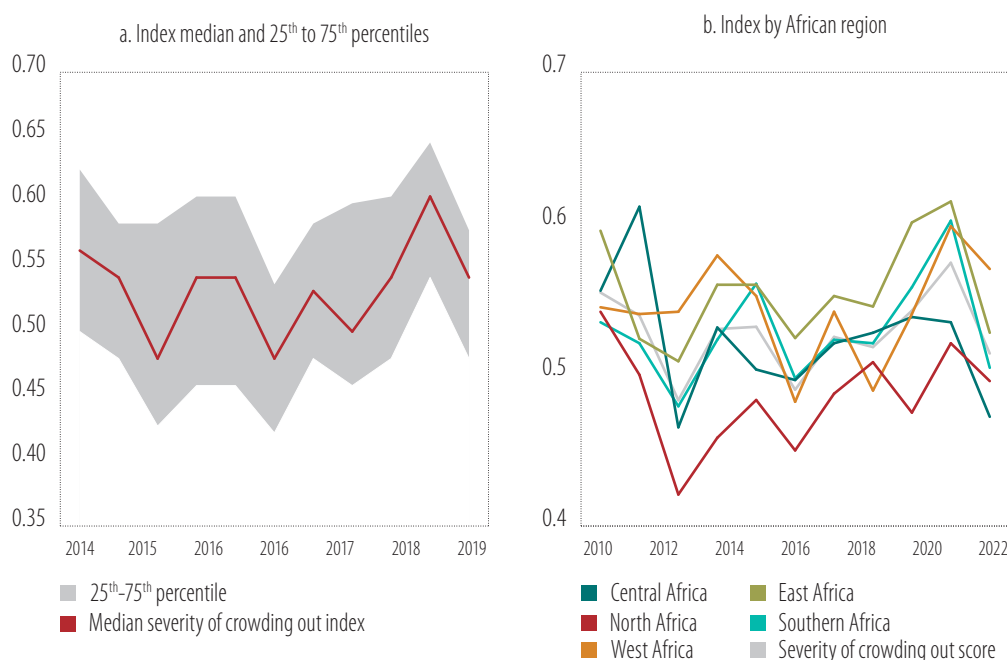


Source: Attout et al. (2022).

As shown in Figure 34, crowding out significantly increased to record levels in 2023 before easing in 2024. The sharp increase in the severity of crowding out index from 2021 until the peak reached in 2023 was driven by higher public debt issuance and a rebound in private credit demand, creating intense competition for banks' funding. The limited supply of external funding in African countries amid the souring fiscal deficits means domestic borrowings by governments have intensified. However, the severity of crowding out index shows signs of easing in 2024 due to the loosening of global financial conditions,

allowing African countries to access international markets for financing. As shown in Chapter 3, there is also an increase in the share of banks expecting to issue hard currency bonds in the next 12 months compared to the past 12 months. Figure 34a, which shows the median and the 25th to 75th percentiles (shaded band) for the severity of crowding out index, depicts the distribution of the index across African countries. The evolution of the index shows episodes of volatility over the entire sample. For example, the index declined between 2014 and 2016 as an economic slowdown reduced demand for private sector credit. However, when economic activity recovered in 2017 and 2018, the index picked up with a rise in loan demand from the private sector. The index dropped in 2019 as public finances improved, before sharply increasing in 2020 in the wake of the COVID-19 pandemic, remaining elevated until 2023.

Figure 34
Severity of crowding out in Africa: 2014-2024



Source: *International Financial Statistics data and EIB staff calculations.*
 Note: 0 and 1 indicate low and high severity, respectively. The severity of crowding out index median is computed across 41 countries in Africa. The shaded band depicts the 25th to 75th percentiles, showing the heterogeneity of the whole sample. 2024 values are estimates.

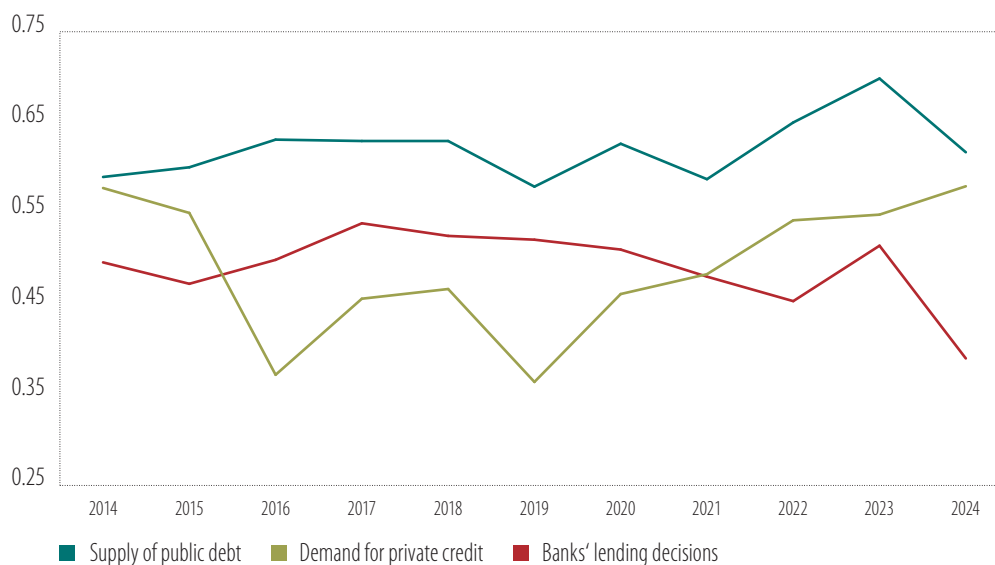
Although all the African regions show high levels of crowding out, the East, Southern and West African regions have the highest levels, especially after 2021 (Figure 34b). These observations are explained by increases in government financing needs as economic recovery measures from the shocks intensified, leading to increased government borrowing from banks and further crowding out of the private sector. The severity of crowding out index for North Africa declined in 2022 due to favourable bank lending decisions driven by increased bank private sector credit and improved financial sector development in Egypt, Morocco and Tunisia, which reduced the crowding-out effects.¹¹ However, the index deteriorated markedly in 2023, in parallel with an increased supply of public debt. Sustainability of the high debt levels in Egypt and Tunisia (96% and 77% of GDP, respectively) remains a source of concern as these countries are at high risk of debt default. Central Africa is projected to have the lowest severity of crowding out in 2024, mostly explained by structurally favourable bank lending decisions.

11 See the yearly severity of crowding out index for each African country presented in Appendix B, where 0 indicates low severity and 1 indicates high severity.

The severity of crowding out was particularly high in 2023 in over half of the African countries in the index. Although pressures had considerably increased across the continent, the severity of crowding out index was above 0.6 in these countries and even above 0.7 in Mozambique. The increased supply of public debt was the main driver of higher severity of crowding out scores and was especially high for Ghana, Gabon, Mali, Burkina Faso, Uganda, Mozambique and Kenya. Credit growth has been expanding considerably since 2019 (highest in Benin and Côte d'Ivoire in 2023), broadly reflecting the risk aversion of financial institutions. The lending decisions of banks in Africa deteriorated in 2023, reflecting the tightening of financial conditions, but are projected to start easing in 2024 with the tepid recovery of the economy.

Overall, all the indicators contributed to an increase in the severity of the crowding out index in 2023, but public debt issuance and private sector credit needs were the most significant contributors (Figure 35). Apart from 2023, banks' lending decisions have steadily reduced crowding out, reflecting the continuous growth in banks' balance sheet size and financial sector development. The improvement in bank lending conditions implies that private sector lending is still growing, and this offsets the effect of the crowding out (Figure 35). The decline in the severity of crowding out index in 2024 implies that banks' appetite for sovereign debt is gradually diminishing and risk aversion to the private sector is improving.

Figure 35
Evolution of the severity of crowding out sub-indices



Source: EIB staff calculations based on publicly available data.

Note: 0 and 1 indicate low and high severity, respectively. The values for 2024 are estimates.

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Appendix A: Components of private capital

Figure A.1
Components of private capital raised
(\$ billion)

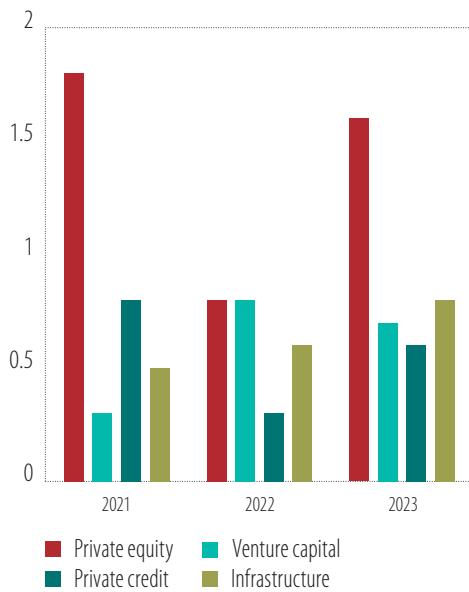
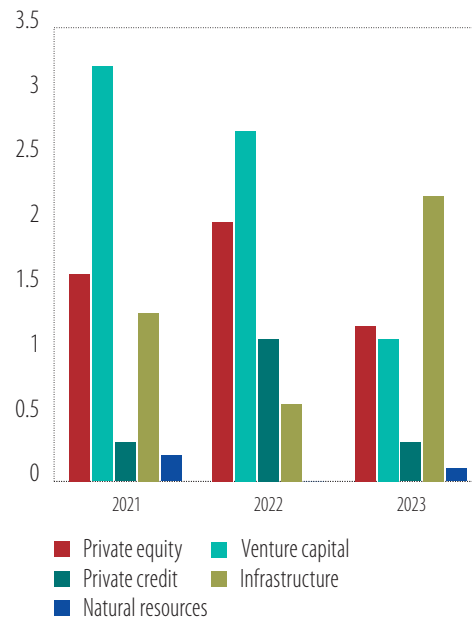


Figure A.2
Components of private capital investment
(\$ billion)



Source: [External Wealth of Nations database](#) and EIB staff calculations.

Note: The components of private capital in Figure A1 are the constituent elements of private capital fundraising in Figure 17 in this chapter. Similarly, the components of Figure A2 are the constituent elements of private capital investment in Figure 18.

Appendix B: The severity of crowding out index over time by country

Country	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Algeria	0.46	0.48	0.40	0.44	0.54	0.56	0.46	0.54	0.52	0.52	0.48
Angola	0.54	0.42	0.40	0.46	0.56	0.42	0.50	0.38	0.46	0.60	0.48
Benin	0.50	0.54	0.54	0.60	0.44	0.44	0.60	0.50	0.58	0.63	0.60
Botswana	0.58	0.48	0.54	0.52	0.46	0.48	0.56	0.63	0.63	0.67	0.50
Burkina Faso	0.33	0.52	0.46	0.60	0.56	0.48	0.50	0.56	0.48	0.60	0.60
Burundi	0.50	0.50	0.50	0.56	0.54	0.46	0.50	0.42	0.44	0.50	0.46
Cabo Verde	0.54	0.67	0.60	0.60	0.60	0.58	0.63	0.65	0.60	0.54	0.56
Cameroon	0.56	0.67	0.46	0.58	0.40	0.44	0.48	0.50	0.54	0.50	0.54
Central African Rep.	0.50	0.54	0.46	0.56	0.44	0.48	0.44	0.46	0.44	0.35	0.31
Chad	0.50	0.63	0.38	0.50	0.65	0.65	0.58	0.52	0.52	0.50	0.42
Comoros	0.54	0.50	0.29	0.46	0.44	0.38	0.54	0.40	0.58	0.58	0.54
Congo, Dem. Rep. of	0.63	0.58	0.40	0.46	0.50	0.40	0.48	0.67	0.54	0.60	0.42
Congo	0.50	0.60	0.50	0.58	0.58	0.52	0.60	0.42	0.56	0.63	0.56
Côte d'Ivoire	0.63	0.42	0.58	0.50	0.50	0.42	0.58	0.48	0.60	0.63	0.56
Egypt	0.56	0.48	0.38	0.38	0.40	0.44	0.44	0.40	0.42	0.40	0.42
Eritrea	0.67	0.56	0.44	0.42	0.42						
Eswatini	0.35	0.50	0.35	0.54	0.52	0.60	0.54	0.46	0.44	0.48	0.44
Gabon	0.65	0.65	0.60	0.50	0.46	0.50	0.54	0.60	0.63	0.63	0.58
Ghana	0.52	0.48	0.65	0.85	0.88	0.58	0.71	0.60	0.54	0.65	0.60
Guinea-Bissau	0.63	0.58	0.60	0.35	0.44	0.42	0.48	0.33	0.50	0.60	0.56
Kenya	0.42	0.52	0.60	0.65	0.63	0.52	0.56	0.60	0.63	0.63	0.50
Lesotho	0.56	0.54	0.44	0.46	0.63	0.46	0.40	0.60	0.60	0.60	0.50
Madagascar	0.48	0.56	0.50	0.42	0.60	0.38	0.54	0.42	0.50	0.67	0.60
Mali	0.44	0.52	0.56	0.56	0.54	0.52	0.54	0.35	0.54	0.65	0.60
Mauritania	0.65	0.56	0.58	0.50	0.50	0.44	0.48	0.48	0.54	0.65	0.54
Mauritius	0.63	0.60	0.54	0.54	0.63	0.50	0.46	0.56	0.63	0.65	0.56
Morocco	0.54	0.58	0.46	0.54	0.56	0.38	0.52	0.58	0.46	0.58	0.54
Mozambique	0.65	0.54	0.48	0.54	0.54	0.44	0.52	0.48	0.69	0.71	0.63
Niger	0.56	0.48	0.46	0.58	0.58	0.42	0.44	0.46	0.50	0.58	0.65
Nigeria	0.54	0.58	0.40	0.52	0.58	0.52	0.46	0.48	0.60	0.65	0.52
Rwanda	0.63	0.56	0.56	0.65	0.60	0.52	0.58	0.54	0.60	0.65	0.54
São Tome & Príncipe	0.48	0.42	0.48	0.46	0.56	0.54	0.50	0.46	0.48	0.58	0.56
Senegal	0.56	0.52	0.48	0.60	0.38	0.33	0.50	0.52	0.44	0.56	0.58
Sierra Leone	0.67	0.71	0.63	0.67	0.56	0.60	0.60	0.48	0.58	0.58	0.60
South Africa	0.46	0.54	0.42	0.54	0.52	0.52	0.54	0.48	0.48	0.50	0.46
Tanzania	0.65	0.46	0.60	0.60	0.60	0.60	0.60	0.63	0.63	0.65	0.56
The Gambia	0.67	0.69	0.71	0.67	0.63	0.50	0.58	0.46	0.60	0.56	0.48
Togo	0.56	0.44	0.44	0.52	0.48	0.40	0.46	0.52	0.50	0.56	0.48
Tunisia	0.50	0.40	0.29	0.44	0.42	0.44	0.54	0.54	0.44	0.46	0.50
Uganda	0.77	0.56	0.56	0.58	0.69	0.67	0.52	0.69	0.73	0.69	0.56
Zambia	0.56	0.50	0.65	0.69	0.58	0.69	0.65	0.69	0.60	0.54	0.38
Average	0.55	0.54	0.50	0.54	0.54	0.49	0.53	0.51	0.54	0.58	0.53

Note: The table presents the severity of crowding-out index over time by country where 0 and 1 indicate low and high severity, respectively. The different shading denotes the severity of crowding out index where dark shades indicate intensified crowding out.

FINANCE IN AFRICA

Unlocking investment in an era
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Chapter 1 Financial markets and financing conditions



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