COVID-19 Impact Assessment: Oil price decline and nascent African exporters

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The COVID-19 pandemic is wreaking havoc on the oil and gas sector with the price of Brent crude having collapsed by more than half during the past month. Virus-triggered disruptions to demand are compounded by a flood of supplies in an historic double demand-supply shock. While a landmark OPEC+ reduction cut deal was recently reached, the short to medium term outlook for the industry remains grim.

Contrary to the 2014-2016 oil price shock, during which production rates remained relatively stable, social distancing measures implemented across the globe are generating significant work delays and production shut-ins. Amid tumbling company share prices, private sector industry players – from junior oil producers to major international oil companies (IOCs) – are slashing spending, deferring final investment decisions for major crude and LNG development projects, and freezing exploration programmes.

The economies of sub-Saharan African oil exporting countries have been caught in the middle of the unfolding oil sector crisis. The impact of the oil price shock on Africa's largest and most established oil exporters – notably Nigeria and Angola – has dominated media headlines. Less attention, however, has been given to exporters in their infancy. In this article, we examine the less obvious, but crucial implications of the oil price decline on one of the fastest growing economies in Africa – Ghana – as it gears up for election season. Taking Ghana as a case study allows us to draw insights into the socio-economic considerations of other smaller exporters in Africa. We conclude with recommendations on how the key stakeholders – exporting governments, oil and gas companies and financial institutions – can best navigate the storm.

Growth cuts and revenue losses

Since taking office in 2017, Ghana's President Nana Akufo-Addo, with strong support from Finance Minister Ken Ofori-Atta, has overseen a marked improvement in the country's macro-economic fundamentals. Owing to the development of its oil and gas sector, the West African country has witnessed stellar growth rates in recent years. Pre-COVID-19 IMF growth forecasts stood at nearly six percent of GDP for 2020 following seven percent in 2019 – one of the highest across sub-Saharan Africa.

The collapse in oil prices, however, has led Minister Ofori-Atta to revise 2020 growth projections down to 1.5 percent – the lowest in over two decades. Ghanaian government's coffers are further bracing for petroleum revenue losses of nearly USD 1 billion this year. The Ministry of Finance had optimistically budgeted 2020 with an oil price benchmark of over USD 62 per barrel, well-above USD 51 used by Equatorial Guinea and USD 57 expected by the Nigerian government; the current sub-USD 40 price environment has raised questions about the Ghanaian government's ability to balance the budget ahead of the December 2020 election.

Public spending dilemma

Ghana is one of about a dozen African countries, including Côte d'Ivoire, Guinea, Tanzania and Burkina Faso, gearing up for presidential elections later this year. All face a public spending conundrum as a result of COVID-19; the United Nations Economic Commission for Africa forecasts up to USD 10.6 billion in unexpected healthcare spending increases to curb the spread of the virus on the continent. Citizens will be watching and noting their governments' responses to the socio-economic impact of COVID-19 and will reward or punish elected leaders at the polls.

Currently, we expect President Akufo-Addo to win the election albeit with a narrower margin than in 2016. His administration's economic achievements and implementation of key policies such as free secondary education should contribute to his party's election victory. The risk he could be punished at polls, if the outbreak of COVID-19 is poorly managed and social protection measures are perceived to be lacking, is low. To date, the government's swift response has been largely praised across Ghana's political spectrum. The Finance Ministry and Bank of Ghana have announced a range of fiscal and monetary measures, including establishing a Coronavirus Alleviation Programme with GHS 1.25 billion (USD 219 million) from its oil stabilisation fund, cutting interest rates and easing reserve requirements to allow banks to increase lending and grant a moratorium on debt payments to local firms operating in the sectors most affected by the crisis.

In the remainder of the year, the government will have to navigate a difficult balance between reducing expenditure in line with falling revenues, ensuring adequate public heath financing and delivering on outstanding election campaign promises. Highlighting the tightrope that all global leaders are facing and signalling the challenges ahead, President Akufo-Addo stated, "We know how to bring the economy back to life. What we do not know is how to bring people back to life", during a widely acclaimed speech announcing the lockdown of Ghana's main economic hubs of Accra and Kumasi. Following his decision on 19 April to lift the lockdown, the dual challenge of protecting lives while reviving the economy will be the central focus of his remaining time in office.

Oil-backed loans and risk of debt distress

The fiscal space is expected to narrow for most African countries as a result of government action against the spread of the pandemic. Across the continent, public debt as a percentage of GDP has doubled in the past decade and debt servicing absorbs over a quarter of government revenues in many major economies. Compared to other regions, African governments – notably oil exporters – find themselves with little space for additional borrowing to finance stimulus packages and mitigate the economic fallouts of the pandemic.

Ghana, whose debt service-to-revenue ratio stood above 40 percent in 2019, with USD 1.44 billion due for repayment this year, is at risk of debt distress as a result of the oil price shock. In a pre-COVID-19 study published in December 2019, the IMF had already categorised Ghana's external debt as "high risk", warning that debt servicing could absorb over 100 percent of 2020 government revenues under a commodity price shock scenario. Such a scenario, aggravated by COVID-19 disruptions, has materialised.

Oil-backed loans – accounting for a significant share of sub-Saharan Africa's debt burden – further complicate matters. Ghana, for instance, obtained in 2010 a USD 3 billion loan from China tied to an offtake agreement for the purchase of crude cargoes from the Jubilee field by the trading arm of China's state oil enterprise, Sinopec Group. Amid falling oil prices and production cuts, Ghana's ability to repay the first USD 1.5 billion tranche of the loan due next year is severely hindered.

Ghana, and other African governments, are urging bilateral creditors to grant them a moratorium on interest payments and the restructuring, or even cancelling, of their debts. As epitomised by Senegal's President Macky Sall in a recent opinion piece in *Jeune Afrique,* "Exceptional circumstances call for exceptional measures… Africa must not be left behind in a global fight against a global peril. That is the whole thrust of my call for the cancellation of Africa's public debt and the restructuring of its private debt based on mechanisms to be agreed upon." Ghana's Finance Minister recently echoed this sentiment, notably calling on China to help ease the debt repayment pressure facing African countries.

Easing debt repayments will be key in determining sub-Saharan African economies' – notably that of oil exporters – ability to tackle the near-term COVID-19 health emergency and minimise the economic fallout. Last week, the IMF agreed to an immediate debt service relief package for the continent's 19 least developed countries, while G20 members agreed to freeze bilateral government debt repayments for low income countries until the end of the year – a move backed by the International Institute of Finance, an association representing hundreds of private creditors. Meanwhile, the IMF has approved USD 1 billion in emergency funding to Ghana under its the Rapid Credit Facility (RCF) – the largest COVID-19 IMF package provided to a sub-Saharan African country to date.

Recommendations for governments, oil businesses and financial investors

Through our analysis of the impact of the coinciding oil price shock and COVID-19 emergency on Ghana, we have identified the following key learnings for sub-Saharan African oil exporting governments, oil businesses and financial investors.

Oil and gas sector

Major IOCs have promptly reacted to the low oil price and global pandemic, cutting capital expenditure plans by an average 20 to 30 percent, suspending share buybacks and freezing divestment programmes as the value of their assets plummet. Some have admitted they will not be able to meet their 2020 business plans, or cover their dividends at USD 30 per barrel. Further belt-tightening measures are expected.

In the short-term, IOCs with a robust balance sheet or well-timed hedging products in place will consider acquisition opportunities that might arise from the crisis – potentially buying struggling junior producers and their asset portfolio in Africa and beyond at lower prices. In this context, gaining a deeper understanding of governments' public and private stances on transfers of ownership and the collection of transactional taxes will be essential. In countries where elections will be held in the next six to twelve months, we recommend developing a robust understanding of the political landscape, identifying key decision-makers and influencers, and gauging their appetite for supporting new foreign market entrants and/or enacting substantive changes to the oil and gas sector.

For existing operators, acquiring a deeper understanding of the host country's response to the unfolding crisis and financial pressure points, while supporting governments initiatives and proactively seeking ways to assist as an industry or a company, will be key in building trust and developing a long-term relationship. For example, downstream entities could make fuel donations to essential service providers such as hospitals.

Exporting governments

The African Union recently projected the loss of nearly 20 million jobs this year across the continent as a result of COVID-19. Rising unemployment will be particularly acute in less diversified economies. In the near term, African oil exporters will face increased pressure to curtail job losses. Although economic crises can prompt adversarial relations between the government and private sector, this does not have to be the case. African governments can work with the private sector and adopt short term measures that protect workers and take into consideration the cost pressures facing companies as a result of the pandemic. Equatorial Guinea, for instance, has given local oil service companies a three-month waiver on corporate taxes to ensure their survival and the protection of their employees through the crisis.

In the medium to long term, supporting job creation outside the hydrocarbon sector and the development of a well-trained labour force for these new sectors will be crucial. Crises can be an opportunity for the acceleration of diversification strategies, but successful implementation of any meaningful structural economic change requires multi-stakeholder support, engagement and involvement. Across numerous countries, including Ghana, we have seen the development of the renewable energy sector impeded by regulatory hurdles and the abrupt revocation of power purchase agreements. For economic diversification strategies to succeed and for robust job creation by the private sector, countries need an enabling investment climate and forward-looking, solutions-driven regulatory environment.

Development finance institutions and commercial banks

In the near term, development finance institutions will need to urgently mobilise to provide budget financing support and cushion oil exporting economies from the catastrophic impact of the double oil price slump and COVID-19 pandemic. The disbursement of limited emergency funding schemes, such as the IMF's RCF, are short term measures. A comprehensive debt-relief plan, notably the write-off of debt repayments to bilateral creditors for oil-backed loans, needs to be devised.

Commercial banks with a high-risk appetite may consider acquiring and restructuring sovereign debt and providing longer-term financing solutions for governments with limited options and mounting near-term debt repayment obligations.

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