INVESTMENT STRATEGY

Despite being home to 17% of the world’s population, Africa is an underinvested market. Indeed, 72% of investors surveyed do not currently invest there. We believe that despite near-term challenges, the continent offers compelling long-term opportunities vis-à-vis private markets and infrastructure.

We are mindful that as recently as our July 21 Global Insights “Some EMs Are Not Like the Others,” we explored the limits of making broad conclusions at the asset class level. While we are especially sensitive to the generalizations herein, we think it is critical to introduce our readers to the continent’s myriad investment opportunities.

This edition of Global Insights examines infrastructure investment in Africa and policies aimed at building economic ties.

- Africa is poised to benefit from demographic tailwinds.
- The setup for strong consumption should make the continent more appealing to investors.
- The Africa Development Bank estimates that Africa’s infrastructure will need billions of US dollars in annual investment.
- China has invested heavily in the continent over the past two decades.
- Investors interested in private market opportunities should focus on Nigeria, Kenya, Egypt, South Africa and Ghana.
Africa is the second most populous continent, with around 17% of the world’s inhabitants. Based on current forecasts, its population will likely double by 2050, and it is poised to benefit from demographic tailwinds vis-à-vis its relatively young population. For starters, Africa’s median age, at 19.7, is considerably lower than those of Asia and South America, at 32.0 and 32.1, respectively. Furthermore, according to the World Economic Forum, Africa is expected to have the world’s largest working-age population by 2034. The expected increase in the working-age population will likely promote middle class growth, building on trends already in place. For example, according to the Brookings Institution, the dollar value of household consumption will have increased by nearly 50% in the 10-year period ending 2025 (see Exhibit 1). Furthermore, internet penetration has started to take hold. The International Data Corporation, an independent advisory firm focusing on information technology, telecommunications and consumer technology markets, has reported that smartphone shipments to Africa grew 13.2% year over year in the second quarter of 2021. Notably, Chinese tech giant Huawei has fallen out of the continent’s top five providers in the smartphone space.

The setup for strong consumption should make the continent more appealing to investors, and we see long-term growth opportunities given the continent’s projected infrastructure needs. For example, although Africa is home to approximately 17% of the world’s population, it accounts for only 4% of global power supply investment, according to the International Energy Association. Furthermore, according to the same agency, around 560 million people in sub-Saharan Africa will lack access to reliable electricity in 2030.

There is no question that the continent offers numerous opportunities. The Africa Development Bank estimates that Africa’s infrastructure will need at least $170 billion in annual investment. According to private market data provider Prequin, however, 72% of investors they surveyed do not currently have allocations to the continent. We are reasonably confident that a majority also do not invest in Africa’s public markets considering the continent’s muted foreign direct investment flows (see Exhibit 2). Africa’s infrastructure supply-demand imbalance should draw in new investment over time, as indicated by a McKinsey & Company forecast calling for its electricity demand to quadruple between 2010 and 2040. It’s hard to know for sure if Africa’s opportunities will attract more investment, but data suggests China’s involvement has grown quickly, exceeding that of the US since 2014 (see Exhibit 7).

The Chinese government and private sector have lent billions of dollars to Africa. According to the American Enterprise Institute, the continent was the recipient of $305 billion in total assistance over the nearly two-decade period ending in 2021 (see Exhibit 3).

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**Exhibit 1: Household Consumption in Africa Is Poised for Significant Growth**

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Regional % 2015</th>
<th>US $ Billion 2015</th>
<th>Regional % 2025</th>
<th>US $ Billion 2025</th>
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</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>26</td>
<td>369</td>
<td>22</td>
<td>454</td>
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<tr>
<td>Egypt</td>
<td>16</td>
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<tr>
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<td>199</td>
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<td>310</td>
</tr>
<tr>
<td>North Africa</td>
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<td>185</td>
<td>13</td>
<td>269</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>18</td>
<td>256</td>
<td>21</td>
<td>434</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>1,420</td>
<td>100</td>
<td>2,065</td>
</tr>
</tbody>
</table>

Note: North Africa excludes Egypt; Sub-Saharan Africa excludes Nigeria, South Africa and East Africa.

**Exhibit 2: Africa Captures a Small Slice of Foreign Direct Investment Flows**

- Foreign Direct Investment Flows
  - Africa
  - Developing Economies
  - Developed Economies

<table>
<thead>
<tr>
<th>Year</th>
<th>Africa</th>
<th>Developing Economies</th>
<th>Developed Economies</th>
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<tr>
<td>2019</td>
<td>600</td>
<td>400</td>
<td>500</td>
</tr>
<tr>
<td>2020</td>
<td>650</td>
<td>450</td>
<td>600</td>
</tr>
</tbody>
</table>

Note: Developing Economies excludes financial centers in the Caribbean, namely: Anguilla; Antigua and Barbuda; Aruba; Bahamas; Barbados; British Virgin Islands; Cayman Islands; Curaçao; Dominica; Grenada; Montserrat; Saint Kitts and Nevis; Saint Lucia; Saint Vincent and the Grenadines; Sint Maarten; and Turks and Caicos Islands.
Source: UNCTAD, Morgan Stanley Wealth Management Global Investment Office as of Dec. 9, 2021

The Chinese government and private sector have lent billions of dollars to Africa. According to the American Enterprise Institute, the continent was the recipient of $305 billion in total assistance over the nearly two-decade period ending in 2021 (see Exhibit 3).
Exhibit 3: China Has Invested Substantially in African Infrastructure

Notably, investment in energy, transportation and metals dominated the project pipeline. While some might characterize China’s interest in the continent as global posturing, its motivations are actually more nuanced. In 2017, Beijing set up its first overseas military base roughly six miles from the largest American base in the small nation of Djibouti off the Horn of Africa. On the surface, it would seem that China is protecting its overseas economic, political and security interests. For example, according to China’s State Council Information Office, China has helped African countries build and upgrade 10,000 kilometers of railways, tens of thousands of kilometers of highways and transmission lines, 80 large-scale power facilities and 130 medical facilities, and trained more than 160,000 personnel. Furthermore, according to senior researchers at the South African Institute of International Affairs, tech giant Huawei has constructed 70% of Africa’s 4G networks and most recently launched the first 5G networks in South Africa and Kenya. The 5G rollout in the US, meanwhile, will be delayed until at least Jan. 19, 2022 over airplane safety concerns.

Despite generally troubling progress (only 9.5% of the population is fully vaccinated), Africa has experienced some positive developments on the COVID-19 vaccination front. Chinese President Xi Jinping has pledged to supply 1 billion vaccine doses to the continent as it struggles with the more transmissible Omicron variant (see Exhibit 4). According to Chinese officials, 600 million doses will be donated, while 400 million will come from other sources, such as investments in production sites.

Looking at investment in Africa beyond just China, several policies designed to lower the hurdle for doing business on the continent are in place. The US government’s Prosper Africa initiative intends to increase trade and investment between African nations and the US. According to the organization coordinating its activities, the initiative has already led to over 800 investments and $50 billion in exports and investments in 45 of the continent’s 54 countries. Among other things, it should help reinvigorate the US’s trade relationship with Africa. (see Exhibit 5). Notably, the decline in US-Africa trade in the last decade was driven in part by the US shale boom.

The European Union has also launched its own development initiative, Global Gateway. Global Gateway aims to raise €300 billion of investment in digital, climate and energy, transportation, health care, and education and research by 2027. We would not be surprised if global infrastructure investment were addressed at the sixth European Union-African Union summit next month.
Finally, Jan. 1, 2021 marked the first day African countries opened their markets under the African Continental Free Trade Agreement (AfCFTA). AfCFTA drops 90% of tariffs and aims to eliminate barriers to imports and exports between participants. While its scope is wide, it will help limit cross-border conflicts and generate economic growth. This could not come soon enough; according to the UN Conference on Trade and Development, intra-Africa trade (the average of exports and imports to and from specific African nations) was around 2% of total African exports and imports from 2015 to 2017.

The UN anticipates that Africa’s aggregate GDP will expand by 3.6% in 2021. In fact, although the continent has been hit particularly hard by the global pandemic, we expect per capita income to recover to pre-crisis levels by 2024 and are encouraged by the healthy rebound from 2020’s doldrums (see Exhibit 6). We note that in the near term the continent will likely struggle to control outbreaks until its vaccination progress improves.

**Exhibit 6: IMF Economic Outlook for Select African Countries**

[Graph showing Real GDP Growth Forecasts for various African countries from 2004 to 2022.]

Note: 2021 and 2022 are estimates. 2022 is not available for Ethiopia.
Source: International Monetary Fund, Morgan Stanley Wealth Management Global Investment Office as of Oct. 21, 2021

**Investment Implications**

While the outlook for African investments is promising, according to McKinsey & Company, 80% of infrastructure projects fail at the feasibility and business plan stage. Despite this, 26% of fund managers surveyed by Prequin said that Africa will present one of the best regional investment opportunities. While we are mindful that African nations account for nearly 60% of the bottom quartile names in the World Bank’s Ease of Doing Business ranking, the continent has already started on the road to recovery. We see opportunities for qualified investors to make allocations to the region’s infrastructure through private investments or public companies that stand to benefit from stronger and more sustainable consumption. In our view, investors interested in private market opportunities should focus on Nigeria, Kenya, Egypt, South Africa and Ghana, which captured over 80% of venture capital funding in 2020, according to Partech, a San Francisco-based global venture capital firm.
Exhibit 7: Flows From China to Africa Have Recently Outpaced Those From the US


Exhibit 8: Transsion Maintains Commanding Lead of African Smartphone Market


Exhibit 9: Africa Sovereign Bonds Offer Attractive Yields But Carry Elevated Risks

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Jan. 6, 2022

Exhibit 10: African Private Equity Robust Despite COVID-19 Backdrop

Note: 2021 is an estimate. Source: African Private Equity and Venture Capital Association, Morgan Stanley Wealth Management Global Investment Office as of October 2021
Exhibit 11: Africa Is Experiencing High Levels of Food Inflation

Note: CPI Indexed to 2014, not seasonally adjusted.

Current Readings From Our Quantitative Framework

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<thead>
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<th></th>
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<th>Quality</th>
<th>Momentum</th>
<th>Capital Use</th>
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<td>Asia Pac ex Japan</td>
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<td>Europe</td>
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</tbody>
</table>

Levels
Unfavorable
Neutral
Favorable
Changes
Deteriorating
Unchanged
Improving


Ongoing Development Spotlight

Like the rest of the globe, nations across Africa have experienced high levels of inflation. Also like most regions, one of the primary drivers of inflation has been the rising cost of food. For example, the West African Economic and Monetary Union (Benin, Burkina Faso, Côte d’Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo) saw the food and nonalcoholic beverages component of the consumer price index (CPI) increase 7.9% year over year. Rising food prices often result in social unrest, putting pressure on some of the continent’s more fragile countries. — Brad Fulton
Disclosure Section

Index Definitions

For other index, indicator and survey definitions referenced in this report please visit the following: https://www.morganstanley.com/wealthinvestmentsolutions/wmir-definitions

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Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer.

Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

Rebalancing does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

Because of their narrow focus, sector investments tend to be more volatile than investments that diversify across many sectors and companies. Technology stocks may be especially volatile.

International investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economies.

Investing in foreign emerging markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks.

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