

Rating Action: Moody's upgrades Benin's ratings to B1, outlook changed to stable

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New York, March 09, 2021 -- Moody's Investors Service ("Moody's") has today upgraded the Government of Benin's long-term issuer and senior unsecured debt ratings to B1 from B2. The outlook has been changed to stable from positive.

The key drivers of the decision to upgrade Benin's ratings are:

1. A solid track record of fiscal consolidation and improvements in the structure of debt, supported by strong public finance management despite the deterioration of some fiscal metrics due to the pandemic.
2. Rising economic resilience, with robust growth prospects supported by ongoing structural reforms.

The stable outlook reflects balanced risks around Moody's baseline expectation that the economy will return to robust growth and that Benin's fiscal and debt metrics will stabilise and comparatively improve over the medium term.

In a related decision, Moody's raised the local currency (LC) country ceiling to Baa3 from Ba1 and the foreign currency (FC) country ceiling to Ba1 from Ba2. Country ceilings indicate the highest rating level that would generally be assigned to the financially strongest issuers domiciled in a country, including the strongest structured finance transactions whose cash flows are generated predominantly from domestic assets or residents. The decision to upgrade the LC country ceiling in line with the sovereign rating reflects Moody's assessment that non-diversifiable risks are appropriately captured in a LC ceiling four notches above the sovereign rating, taking into account the small footprint of government in the economy, the weak, albeit improving, institutional framework, as well as the mitigating impact of Benin's membership in the West African Economic and Monetary Union (WAEMU) on external imbalances.

The concurrent upgrade of the FC country ceiling maintains a one notch gap to the LC country ceiling, reflecting Moody's assessment of limited Transfer & Convertibility (T&C) risks due to the French Treasury guarantee of the peg between the CFA franc and the euro.

RATINGS RATIONALE

RATIONALE FOR THE UPGRADE TO B1

BENIN'S PUBLIC FINANCE MANAGEMENT & GOVERNMENT DEBT STRUCTURE HAVE IMPROVED

The first driver supporting Moody's decision to upgrade Benin's long-term issuer ratings to B1 is the overall improvement in public finance management as well as in the structure of public debt. The authorities have demonstrated their ability to implement significant fiscal consolidation in recent years (excluding 2020), during which time the fiscal deficit was reduced to 0.5% of GDP in 2019 from 5.6% in 2015. That period saw structural reforms relating to both government revenues and expenditures supported by the IMF through an extended Credit Facility (ECF) program active between 2017 and 2020. The deterioration in public finance related to the pandemic, with a deficit reaching 5.1% of GDP in 2020, is likely to be temporary. Moody's expects the authorities' commitment to fiscal consolidation to remain unchanged, with a new IMF program likely to be concluded after the Presidential elections in April 2021 which will confirm the country's adherence to strengthening government finances further. The relatively strong economic recovery should support a rebound in revenues in 2021. At the same time, the government plans to progressively withdraw the financial package deployed during the pandemic to support fiscal consolidation. The intention to lower the fiscal deficit to the 3% of GDP WAEMU threshold by 2022 appears credible since the bulk of the increase in 2020 was due to the package deployed to support the economy and to fight the pandemic.

As a result, Moody's expects Benin's public sector debt-to-GDP ratio to stabilize at around 46% in 2021 and to decline slowly thereafter. The risk of State-Owned Enterprise (SOE) debt crystallizing on the government's balance sheet remains low, with SOEs' debt and government guarantees amounting to less than 1% of GDP in

2020. Overall, Benin's public debt-to-GDP compares increasingly favorably to B-rated peers. Notwithstanding, there are weaknesses which will constrain the rating for some years to come. In relation to revenue, the debt burden and debt affordability ratios worsened materially over the last 5 years (debt-to-revenue estimated at 327% and interest payments to revenue at 15.6% in 2020 respectively) and remain above B-rated peers. Their deterioration reflects both Benin's narrow tax base and the increasing reliance on commercial borrowing. However, structural reforms aiming at broadening the tax base, as well as the support provided by the economic recovery, should arrest and ultimately somewhat reverse the deterioration.

Importantly at this juncture, refinancing risk is low relative to B-rated peers. The government's strategy of targeting euro-denominated funding continues to reduce exchange rate risk within the context of Benin's membership of the West African Economic and Monetary Union (WAEMU). The share of government debt denominated neither in CFA nor in euro fell to around 28% at the end of 2020 from more than 50% in 2016. The government has no external market debt due before 2024, in part as a result of the decision to use a portion of the latest eurobond issuance to buy back close to two-thirds of the EUR500 million eurobond issued in 2019. While the government's gross borrowing requirement has risen to around 10% of GDP in 2021 from 8% in 2019, post pandemic, liquidity risk remains no higher than in 2018 when the gross borrowing requirement was around 10% of GDP. Overall, the average maturity of external debt currently exceeds 13 years while the average domestic debt maturity is around 3 years. Looking ahead, Moody's expects liquidity risk to decline alongside the anticipated fiscal consolidation over the medium term.

ROBUST ECONOMIC PROSPECTS AND RISING ECONOMIC RESILIENCE SUPPORTED BY ONGOING STRUCTURAL REFORMS

The second driver that supports Moody's decision to upgrade Benin's long-term issuer ratings to B1 is the continuous strengthening of the country's economic resiliency, supported by the implementation of structural reforms included in the PAG (Plan Action du Gouvernement 2016-2021). The plan aims to open and diversify the economy, as well as to improve infrastructure and address bottlenecks in the business environment to attract further private investment. Key structural reforms to which the government has committed include the liberalization of the labor market; the modernization of the port of Cotonou currently managed by the Port of Antwerp; the near-tripling of cotton production since 2015 (estimated at 715,000 tonnes in 2019) thanks to a targeted support policy and the introduction of fertilizers; and the improvement of the electrification rate to 53%, and the reduction of the share of electricity imports to 40% of the country's consumption in 2020 against 100% in 2016.

Benin's recent economic performance also supports the assessment of growing economic resiliency. Benin is among the few countries whose GDP expanded in 2020, despite the impact of the coronavirus outbreak exacerbated by the border closure with Nigeria -- Benin's largest trading partner. Moody's estimates the economy grew at an estimated 2.3% in 2020, well below the 6.9% reached in 2019 but well above the -3% median growth rate of B2-rated peers in 2020 (excluding Benin). That strong growth took place notwithstanding the small size of Benin's economy, the concentration on agriculture and low (though rising) income per capita. Looking ahead, we expect Benin's economic recovery to be faster than its peers, with real GDP growth forecast at 5% in 2021, and above 6% thereafter. Large infrastructure projects such as the construction of a new airport and investment in roads, ports and energy infrastructure will also support economic growth in the future. With the reopening of the border, the possibility that Nigeria's recovery is stronger than currently expected offers some upside risk.

The impact of external imbalances is reduced because of Benin's membership of the WAEMU's pool of foreign exchange reserves which has increased to USD15 billion in December 2020, equivalent to 5-6 months of import cover. Benin's current account deficit is likely to remain around 4% of GDP and inflation around 2% over the next three years. Despite increasing political tensions ahead of the April 2021 elections, political risk is also unlikely to derail Benin's economic development given the fragmented opposition and Moody's expectation that Benin's track record of overall peaceful elections will continue.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that the economy will remain resilient to the impact of the pandemic as shown in 2020 and return to robust rates of growth exceeding 6% by 2022. It also reflects the rating agency's expectation that the government debt burden will stabilize and gradually decline from 2021 onwards. In particular, the country's fiscal deficit is likely to return below 3% in 2022 given the authorities track-record and commitment to fiscal consolidation through both increasing revenue and reducing spending by progressively phasing out of the extraordinary economic support measures implemented to fight the pandemic. However, downside risks remain due to the uncertainty surrounding the evolution of the pandemic in the

region, given for example the distant vaccination prospects. Additionally, there are weaknesses which will constrain the rating for some years to come, related for example to the country's narrow tax base and to the relatively weak fiscal metrics associated with that.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Benin's ESG Credit Impact Score is highly negative (CIS-4), reflecting high exposure to social (S) risk, moderate exposure to environmental (E) risk, and weak governance that, together with low income levels, reduce the country's resilience to S and E risks.

Benin's exposure to environmental risks is moderately negative, reflected in its E-3 issuer profile score. While the country pursues its efforts to preserve its natural capital, its exposure to physical climate risk is high given the economic importance of primary sector, dominated by cotton and subsistence agriculture which is less resilient than sophisticated agriculture to climate-related disruptions.

Exposure to social risks is highly negative (S-4 issuer profile score), mainly related to poverty, poor educational outcomes, low income levels and poor access to basic services. Around half of the population lives below the poverty line (PPP \$1.90 per day), and the country ranks poorly (lowest decile) in terms of education, health and income. Despite its track record of political stability, there is risk of social unrest, especially given the level of youth unemployment.

Benin's institutions and governance profile is weak and captured by a moderately negative G issuer profile score (G-3). This is illustrated by the low, but overall improving, worldwide governance indicators especially voice and accountability and control of corruption indicators that are better than their respective median of B-rated peers.

GDP per capita (PPP basis, US\$): 3,423 (2019 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 6.9% (2019 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 0.3% (2019 Actual)

Gen. Gov. Financial Balance/GDP: -0.5% (2019 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -3.1% (2019 Actual) (also known as External Balance)

External debt/GDP: 24% (2019 Actual)

Economic resiliency: ba3

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 04 March 2021, a rating committee was called to discuss the ratings of Benin, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutions and governance strength, have materially increased. The issuer's fiscal or financial strength, including its debt profile, has materially increased. Other views raised included: The systemic risk in which the issuer operates has not materially changed. The issuer's susceptibility to event risks has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

FACTORS THAT COULD LEAD TO AN UPGRADE

A sustained and material reduction of the government debt burden and debt affordability beyond Moody's current expectations would put upward pressure on the ratings, particularly if evidence of a sustained improvement of Benin's institutions and governance framework.

FACTORS THAT COULD LEAD TO A DOWNGRADE

Negative pressure on the ratings could rise were Benin's fiscal metrics to deteriorate markedly against Moody's current expectations of a steady and structural improvement in the wake of the pandemic. An increase in ongoing borrowing requirements and refinancing risks driven by a failure to sustain the reform effort would be particularly negative. Similarly, a failure to return to robust rates of growth as Moody's currently expects would also be credit negative, particularly if driven by weaker than expected policy outcomes.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

The local market analyst for this rating is Aurelien Mali, +971 (423) 795-37.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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