Research Update:

Benin 'B+/B' Ratings Affirmed; Outlook Stable

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Overview

- Following the strong 2019 economic performance, the adverse effects of the COVID-19 pandemic will take a heavy toll on Benin's economy and public finances in 2020.
- Substantial external financial support from multilateral and bilateral partners will alleviate pressures on the balance of payments and the budget in 2020.
- Thereafter we expect business-friendly reforms to continue, growth to rebound and the budget deficit to decline, putting general government debt to GDP on a downward path.
- We are affirming our 'B+/B' long- and short-term sovereign credit ratings on Benin; the outlook is stable.

Rating Action

On June 19, 2020, S&P Global Ratings affirmed its 'B+' long-term and 'B' short-term sovereign credit ratings on Benin. The outlook is stable.

Outlook

The stable outlook indicates that we expect Benin's credit metrics withstand the shock to public finances and economic activity from COVID-19. Once the pandemic's effects abate, we expect high economic growth to resume, supported by the government action plan (PAG), an increase in public and private investments as well as structural economic and budgetary reforms, including measures to improve the business environment, agricultural output, and tax collection.

Upside scenario

We could raise the ratings if, following the pandemic, reforms boost economic growth to levels materially stronger than we forecast, reflecting a higher component of private sector investment and activity; and net government debt as a share of GDP decrease beyond our projections.

Downside scenario

We could lower the ratings if the government's budgetary performance deteriorates, and reforms lag, leading to real GDP growth rates significantly weaker than our forecasts. This could occur if COVID-19's impact is more protracted than we anticipate; or if presidential elections in 2021 lead to larger overruns on public expenditure, or increased tax arrears by firms, including importers and at the state-owned enterprise level.

As well, we could lower the ratings if economic and fiscal reform slackens, leading, for example, to a slip in fiscal performance following the pandemic. Benin's creditworthiness could also deteriorate if pressures on the West African CFA franc (XOF)-to-euro exchange rate appear. A devaluation--which we do not expect--would immediately increase government debt to GDP across the monetary union and weigh considerably on the West African Economic and Monetary Union (WAEMU) member state's fiscal performance.

Rationale

The pandemic will take a toll on Benin's economic and budgetary performances in 2020. Nevertheless, the ratings are supported by our expectation that the country's economic activity, and its external and fiscal positions, will gradually strengthen following the pandemic, spurred by Benin's program of reforms. The country's WAEMU membership, which we believe reduces country-specific external risks and provides a strong policy anchor, further supports our assessment. At the same time, Benin's low per capita income, substantial external leverage, and structural bottlenecks continue to constrain the ratings.

Institutional and economic profile: Beyond the pandemic, growth prospects appear robust if reform momentum to address underlying structural weaknesses and the implementation of the PAG continue.

- The pandemic, along with the border closure with Nigeria, will weigh on economic performances in 2020.
- Following the pandemic, we expect the PAG's implementation will continue, public and private investments will increase, and the government will advance with its agenda of economic and structural reforms, supporting strong growth over the next few years.
- Political tensions in the country could challenge the pace of reforms, however.

Following strong performance in 2019, we expect growth will slow in 2020 to about 3%, less than half of previous forecasts, due to the pandemic's adverse effects and the border closure with Nigeria. Our economic projections are uncertain, however, because they depend on how the pandemic evolves in Benin and globally.

Despite a very limited number of cases and less strict containment measures, there was no complete lockdown, which will limit the effects on the domestic economy, Benin remains a small open economy, with large re-exports. Its economy is therefore sensitive to demand from its main trading partners. For example, we expect demand for cotton, which represent over half of formal exports, from traditional partners such as Bangladesh, India, and Vietnam, to drop in 2020.

Benin has taken a series of measures to mitigate the human and economic implications of the COVID-19 pandemic, supported notably by a substantial increase in access to financing from the

IMF at the time of the sixth review of its Extended Credit Facility (ECF) program in April. An emergency package of measures, worth about 1.7% of GDP, have been prepared to address the outbreak's health and economic impact. The budget envelope for public health expenditure will increase to allow notably for the purchase of medical equipment and construction of temporary health facilities and retention areas for quarantined people. One third of the plan will consist of transfers to vulnerable households, representing above one quarter of the population. In addition to some flexibility with tax payment deadlines, targeted and temporary tax exemptions will be provided to businesses most affected by the pandemic.

While uncertainty is significant in the current environment, we expect economic growth to rebound starting next year and average 6.3% over 2021-2023. We expect that, over the medium term, both public and private investments will improve infrastructure and boost the tertiary sector (about 50% of GDP) and agricultural productivity (about 20%). Despite Nigeria's decision to close the border with its neighbours, including Benin, since August 2019, the activity in Port of Cotonou (managed by the Port of Antwerp International since 2018) and in the cotton sector (managed by the private sector since 2016), the implementation of key projects in the context of the PAG as well as improvement in the business environment propelled Beninese economic growth to about 6.9% in 2019. Furthermore, we understand that good progress toward reopening the border had been made before the pandemic's disruption as Benin implemented measures to curb smuggling agreed upon with its neighbor. Authorities are confident that, once the effects of the pandemic abates later this year, the border should reopen. Most of the commercial trade between Benin and Nigeria is informal and is not fully reflected in the trade and national accounts.

Under the country's 2016-2021 PAG, the Beninese authorities are committed to economic and budgetary reforms. In addition to key projects, notably in infrastructure, structural reforms in this context include policies to improve tax collection, business climate, and labor market outcomes. We believe that the implementation of the PAG will continue to boost foreign donors' and investors' confidence, as well as enhance domestic business activity.

We understand that, as the current IMF program is ending, authorities and the fund are negotiating a successor program to support the government's structural reform agenda over the next several years. We understand that, in addition to supporting inclusive growth and improvement in public finance management and domestic resource mobilization, program priorities would include improving education and increase local transformation in the agricultural sector. We believe this program would provide a solid and credible policy anchor for the country, as policy-making has improved over the past few years and performance in the current ECF has been deemed very satisfactory by the IMF.

Nevertheless, some of the population's perception of a deteriorating situation in terms of political participation, pluralism and civil liberties, also illustrated by a decline in some international indicators (for example, Benin ranked 113th out of 180 in terms of freedom of press in 2020 according to Reporters Without Borders, compared with 96th in 2019 and 84th in 2018), could challenge the pace of reforms. Indeed, political tensions and protests have emerged last year following the absence of opposition parties in April's 2019 legislative elections. We believe that an escalation in tensions, notably ahead of the 2021 presidential elections, could affect the government's capacity to implement the planned reform program. However, the turnout in the May 2020 local elections, at almost 50% of registered voters, was much higher than for the 2019 legislative elections despite the COVID-19 outbreak and without the significant protests witnessed before the legislative elections.

In our view, low GDP per capita of about $1,200 and low net FDI as a share of GDP point to Benin's structural weaknesses and limit the country's potential tax and funding bases. Benin's dependence on agriculture (70% of the workforce) makes its economy vulnerable to agricultural price volatility and adverse weather conditions. Energy shortages have also been a weak point, although increasing investments in infrastructure are leading to gradual improvement.

Flexibility and performance profile: COVID-19 will hinder fiscal consolidation in 2020, but medium-term objectives remain

- We anticipate the budget deficit will rise in 2020. However, significant external financial support will help cushion the outbreak's impact.
- Following the pandemic, we expect the series of economic reforms, bolstered by an IMF program, will support gradual reduction in external and fiscal imbalances.
- Benin's membership in the WAEMU provides the economy with monetary and external buffers.

The pandemic will weigh on the country's budget, via automatic stabilizers as well as exceptional measures taken to contain its adverse impact on both the population's health and economic activity. These include direct support to the health sector and tax measures aiming at supporting the private sector. In addition, the government aims to cushion the impact on the most vulnerable, mainly through cash transfers. Lower growth, combined with a higher budget deficit, will push general government debt slightly above 43% of GDP in 2020.

We expect significant external financial aid from bilateral and multilateral partners will support Benin's fiscal and external position. In April, the IMF increased significantly the amount it disbursed for the sixth review of its ECF program to help Benin cope with the pandemic. Indeed, the fund's board approved a special drawing rights (SDR) 76 million increase (about US$104 million) on top of the planned disbursement of SDR16 million. In addition, Benin benefited from the IMF's Catastrophe Containment and Relief Trust initiative and received SDR7.4 million in grants to cover debt service to the fund from April-October 2020. Discussions with other international institutions and bilateral partners on additional budgetary support are ongoing. Issuances on the regional market and expenditure reallocation will complement external financial support to cover the additional financing needs from the pandemic. We understand that, in line with the earlier position taken by the authorities, Benin has decided not to partake in the G20 debt service moratorium, as opposed to several countries in the region such as Senegal or Côte d'Ivoire, and is pushing for the use of innovative financing instruments to help sub-Saharan countries face the pandemic's economic impact.

In our view, given the government's ability to significantly improve its fiscal position in recent years, budgetary consolidation will resume gradually from 2021. Government revenue remains low but we expect they will increase, gradually owing to stronger economic activity, including a better performance in the cotton sector, and a series of fiscal reforms. The government aims for these reforms to enhance revenue intake, modernize the tax and customs administrations, and improve tax compliance. Lower budget deficit and higher growth should help the country put general government debt as a share of GDP on a slight downward path following the pandemic.

In our view, Benin faces two major challenges to its goal to consolidate public finances further. First, the informal economy is very large, which explains why much of the fiscal strategy is focused on formalizing the country's economy and, by doing so, collecting more revenue. Secondly, Benin has extensive infrastructure requirements, and ambitious plans to work on these, which we expect will keep pressure on government spending. In addition, stress on the budget could emerge ahead of the 2021 presidential election.

In addition to fiscal policy, measures taken by Central Bank of West African States (BCEAO) should also help mitigate the adverse economic effects of the pandemic in Benin and across the monetary union. For example, BCEAO has:

- Increased liquidity available to banks;
- Extended the collateral framework to access central bank refinancing to include bank loans to 1,700 prequalified private firms;
- Established a framework in cooperation with banks to support companies with repayment difficulties; and
- Allocated XOF25 billion to the trust fund of the West African Development Bank to strengthen concessional resources.

In addition, the BCEAO has also created a special refinancing window for "COVID bonds," issued on the regional market by member states, effectively increasing liquidity available to them at a lower rate than usual. These bonds are used as bridge financing for upcoming multilateral and bilateral support planned in the three months following issuance and can be fully refinanced at a fixed rate of 2.5%.

We forecast the current account deficit will widen in 2020, despite lower oil prices, as the pandemic weigh on external demand. Starting in 2021, as the pandemic's effect abates, Benin's exports will increase both in volume and value terms thanks to a rise in agricultural production, the modernization of the Port of Cotonou, and an increase in external demand. Uncertainty remains significant, however. The deficit will be primarily financed by external debt and inflows of foreign direct investment (for example in infrastructure, energy and telecommunications in the context of the PAG).

In our opinion, external risks are lessened by Benin's membership of WAEMU. Reserves at the eight member states--Benin, Guinea-Bissau, Burkina Faso, Ivory Coast, Mali, Niger, Senegal, and Togo--are pooled at the regional level at BCEAO, offering a buffer against country-specific balance-of-payment shocks. Although Benin's pegged exchange rate regime and its membership of a monetary union reduce its monetary flexibility, we believe that the WAEMU monetary arrangement mitigates most risks related to substantial exchange rate volatility, and helps contain inflation. The XOF is pegged to the euro, and the French treasury guarantees its convertibility. However, the level of the exchange rate is not guaranteed, and the XOF was devalued by 50% in 1994. We do not include another devaluation in our current base-case scenario (see "The Eco Era: What Will West Africa's New Currency Mean For The Region?" published Feb. 17, 2020, on RatingsDirect).

Key Statistics

Table 1

Benin--Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Economic indicators (%)										
Nominal GDP (bil. LC)	6,559	6,733	7,005	7,375	7,916	8,432	8,768	9,405	10,157	10,990
Nominal GDP (bil. $)	13	11	12	13	14	14	15	17	17	19
GDP per capita (000s $)	1.3	1.1	1.1	1.1	1.2	1.2	1.2	1.3	1.4	1.4
Real GDP growth	6.4	1.8	3.3	5.7	6.7	6.9	3.0	6.0	6.5	6.5
Real GDP per capita growth	3.3	(1.1)	0.4	2.7	3.7	3.9	0.2	3.1	3.6	3.6

Table 1

Benin--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Real investment growth	12.2	5.0	0.3	25.5	16.3	10.3	3.5	10.0	11.0	11.0
Investment/GDP	18.8	20.7	20.3	24.0	26.4	27.6	27.1	28.5	29.9	31.4
Savings/GDP	12.1	14.8	17.3	19.8	21.8	23.2	22.4	24.2	25.6	27.2
Exports/GDP	31.6	24.7	27.6	27.2	27.3	27.5	25.6	25.2	24.6	24.0
Real exports growth	24.9	(20.1)	13.5	7.0	5.0	8.0	(3.5)	5.0	5.0	5.0
Unemployment rate	2.6	2.6	2.5	2.5	2.4	2.2	2.5	2.0	2.0	2.0
External indicators (%)										
Current account balance/GDP	(6.7)	(6.0)	(3.0)	(4.2)	(4.6)	(4.3)	(4.7)	(4.3)	(4.2)	(4.1)
Current account balance/CARs	(24.3)	(22.1)	(9.8)	(14.3)	(15.2)	(14.3)	(16.8)	(15.5)	(15.6)	(15.4)
CARs/GDP	27.6	27.0	30.6	29.2	30.0	30.2	28.2	27.7	27.2	26.6
Trade balance/GDP	(5.4)	(4.6)	(0.9)	(2.7)	(3.9)	(3.3)	(3.2)	(3.4)	(3.4)	(3.3)
Net FDI/GDP	2.9	1.0	1.0	1.3	1.3	1.3	0.5	1.9	2.1	2.1
Net portfolio equity inflow/GDP	0.1	0.2	0.5	0.1	(0.0)	0.0	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	128.0	135.1	121.6	137.8	121.6	139.0	137.5	138.6	135.6	130.6
Narrow net external debt/CARs	32.0	32.2	50.2	49.5	79.2	83.6	98.1	92.8	91.1	88.7
Narrow net external debt/CAPs	25.7	26.4	45.7	43.3	68.8	73.1	84.0	80.4	78.8	76.8
Net external liabilities/CARs	52.5	43.4	75.4	84.5	128.4	136.3	151.0	149.4	154.5	158.4
Net external liabilities/CAPs	42.2	35.6	68.6	73.9	111.5	119.2	129.3	129.4	133.6	137.2
Short-term external debt by remaining maturity/CARs	28.0	44.9	36.5	33.5	28.6	54.9	57.5	53.6	52.4	51.0
Usable reserves/CAPs (months)	1.8	2.3	2.2	0.8	1.9	2.3	2.8	2.3	2.5	2.8
Usable reserves (mil. $)	727	733	269	778	944	1,131	1,006	1,140	1,358	1,580
Fiscal indicators (general government; %)										
Balance/GDP	(1.2)	(5.6)	(4.3)	(4.2)	(2.9)	(0.5)	(3.8)	(2.9)	(2.6)	(2.3)
Change in net debt/GDP	4.5	7.9	7.6	5.4	1.9	0.8	3.8	2.9	2.6	2.3
Primary balance/GDP	(0.9)	(5.0)	(3.4)	(2.8)	(1.3)	1.1	(2.2)	(1.2)	(0.9)	(0.7)
Revenue/GDP	12.6	12.6	11.1	13.6	13.6	14.1	13.0	13.9	14.3	14.3
Expenditures/GDP	13.9	18.2	15.4	17.8	16.5	14.6	16.8	16.8	16.9	16.6
Interest/revenues	2.2	4.3	8.1	10.6	11.7	11.4	12.7	12.0	11.6	11.4

Table 1

Benin--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Debt/GDP	22.4	30.9	35.9	39.7	41.1	41.3	43.0	43.0	42.4	41.5
Debt/revenues	177.2	245.3	322.1	292.3	302.3	293.2	331.1	309.5	296.8	290.4
Net debt/GDP	14.7	22.1	28.9	32.8	32.4	31.2	33.8	34.4	34.5	34.2
Liquid assets/GDP	7.7	8.8	7.0	6.9	8.7	10.0	9.2	8.6	8.0	7.4
Monetary indicators (%)										
CPI growth	(1.0)	0.3	(0.8)	0.1	1.0	(0.2)	0.6	1.0	1.0	1.2
GDP deflator growth	(0.8)	1.5	0.7	(0.4)	0.6	(0.4)	1.0	1.2	1.4	1.6
Exchange rate, year-end (LC/$)	540.28	602.51	622.29	546.95	572.89	583.90	572.30	575.40	584.52	593.93
Banks' claims on resident non-gov't sector growth	10.0	2.9	4.4	2.1	7.6	15.1	2.0	5.0	5.0	5.0
Banks' claims on resident non-gov't sector/GDP	18.5	18.5	18.6	18.0	18.0	19.5	19.1	18.7	18.2	17.6
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(1.2)	(5.1)	(0.8)	0.2	0.2	(1.8)	N/A	N/A	N/A	N/A

Sources: Ministry of Economy and Finance, World Bank (Economic indicators), BCEAO (External indicators), Ministry of Economy and Finance, BCEAO, International Financial Statistics (Fiscal and Debt indicators), BCEAO, Bruegel (Monetary indicators).
Adjustments: In order to arrive at the net GG debt, we subtract GG deposits in BCEAO and in financial institutions (liquid financial assets) from the GG debt stock.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Benin--Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	4	Institutions and governance are fairly predictable compared with those of peers at the same rating level. The country has established a track record of smooth transfers of power and economic policymaking has improved in recent years. However, there is a moderate risk of challenges to political institutions resulting from parts of the population desiring more political and economic participation. The checks and balances between institutions, enforcement of contracts, and respect for the rule of law is less reliable than in countries with stronger institutional assessments.
Economic assessment	5	Based on GDP per capita ($) as per as per Selected Indicators in Table 1.
External assessment	5	Based on narrow net external debt and gross external financing needs as per Selected Indicators in Table 1.
		Significant stock-flow mismatches.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per the Selected Indicators in Table 1.
		The country has significant shortfalls in basic services to the population and infrastructure as reflected, for instance, in a "low" score under the United Nations Development Programme's Human Development Index, which is likely to result in spending pressure for a long period of time.
Fiscal assessment: debt burden	5	Based on net general government debt (% of GDP) and general government interest expenditures (% of general government revenues) as per the Selected Indicators in Table 1.
		More than 40% of gross government debt is denominated in foreign currency.
		Nonresidents hold over 60% of government commercial debt.
Monetary assessment	5	The local currency (West African CFA franc) is pegged to the euro
		Price stability, one of our key measures of monetary policy credibility, is relatively successfully managed, especially compared with other sub-Saharan African sovereigns. Market-based monetary instruments are in place, but monetary policy effectiveness may be untested in a downside scenario.
		Monetary union membership (Benin is a member of the West African Economic and Monetary Union) constrains individual countries' monetary flexibility.
Indicative rating	b+	As per table 1 of "Sovereign Rating Methodology".
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	B+	
Notches of uplift	0	We do not believe that default risks apply differently to foreign- and local currency debt.
Local currency	B+	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Banking Industry Country Risk Assessment Update: May 2020, May 27, 2020
- Default, Transition, and Recovery: 2019 Annual Sovereign Default And Rating Transition Study, May 18, 2020
- Sovereign Ratings List, May 11, 2020
- Sovereign Ratings History, May 11, 2020
- Sovereign Ratings Score Snapshot, May 6, 2020
- Credit FAQ: COVID-19 And Implications Of Temporary Debt Moratoriums For Rated African Sovereigns, April 29, 2020
- Sovereign Risk Indicators, April 24, 2020. A free interactive version is available at http://www.spratings.com/sri.
- Economic Research: Jobs And The Climb Back From COVID-19, April 19, 2020
- Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP, April 16, 2020
- FAQ: Sovereign Ratings And The Effects Of The COVID-19 Pandemic, April 16, 2020
- Global Sovereign Rating Trends: First-Quarter 2020, April 8, 2020
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19-Related Slowdown In Tourism, March 17, 2020
- The Eco Era: What Will West Africa's New Currency Mean For The Region? Feb. 17, 2020

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Benin	
Sovereign Credit Rating	B+/Stable/B
Transfer & Convertibility Assessment	BBB-
Senior Unsecured	B+