Sub-Saharan Africa (SSA) Eurobonds, & Cytonn Weekly #03/2019

Focus of the Week

Africa has increased its appetite for foreign debt in recent times with the latest issues being by the Republic of Nigeria, which issued three debt instruments in November 2018. The increased affinity for foreign currency-denominated debt by African nations is driven by:

i. Reduced financial aid to African countries by Western donor nations,
ii. The need to finance heavy infrastructure projects,
iii. Covering for budget deficits, and
iv. Financing of maturing debt obligations.

This note analyses SSA's Eurobond performance in the year 2018 with the aim of painting a picture of the investor confidence and risk tolerance, and an outlook on yield performance for the year 2019. The analysis will be broken down as follows:

I. Background of Eurobonds in Sub Saharan Africa,
II. Eurobond Performance in Sub-Saharan Africa,
III. Debt Sustainability in Africa: Case Study of Mozambique Debt Crisis,
IV. Outlook on SSA Eurobonds.

Section I. Background of Eurobonds in Sub Saharan Africa

Collectively, the year 2018 saw the Sub-Saharan Region (excluding South Africa) raise USD 13.7 bn through various Eurobond issues. The new instruments attracted a lot of interest as evidenced by the oversubscription in all the issues, with the Kenyan issues recording the highest oversubscription of 7.0x, underlining the sustained investor confidence in the African debt market. This may partly arise because, by comparison, African sovereign debt offers the highest yields to investors globally. Data from Bloomberg indicates that Africa offers an average dollar-bond yield of 6.0%, higher than the Emerging Market average of 5.5%, as well as the North American average of 4.5%; and the Asia Pacific average of 4.0%. African Eurobond issuers possess different risk characteristics depending on the issuer and the tenor of the bonds. Such risks include political, economic and therefore credit risks as highlighted in our focus on Sub-Saharan African (SSA) as an Attractive Investment Destination.

Section II. Eurobond Performance in Sub-Saharan Africa

Analysis of New 2018 Issues

Four countries issued new Eurobonds in Sub Saharan Africa in 2018, with the issuers being:

i. Kenya, with a USD 1.0 bn, 10-year tenor bond and another 30-year tenor bond of a similar amount; earmarked for infrastructural development and active debt management. The issue raised USD 14.0 bn from investors, thus an oversubscription by 7.0x,

ii. Senegal, with two bonds of USD 1.0 bn each, which were 4.7x oversubscribed with USD 9.3 bn in bids received. The stated plan was for new infrastructure development as well as refinancing some USD 150.0 mn of foreign debt, due in 2021,
iii. Ghana, with a dual-tranche Eurobond in May 2018, raising a total of USD 2.0 bn in 10-year and 30-year instruments of USD 1.0 bn each. The funds, which were for budgetary purposes and liability management, were 4.0x oversubscribed with USD 8.0 bn in bids received,
iv. Nigeria's triple-tranche debt note of USD 1.2 bn with a 7-year tenor, USD 1.0 bn with a 12-year tenor and USD 0.8 bn with a 30-year tenor in November 2018, with total bids received amounting to USD 9.5 bn translating to a 3.2x oversubscription. 97.0% (USD 2.8 bn) of the funds generated were to be used in part to finance the 2018 budget, while the remaining 3.0% (USD 82.5 mn) was used to refinance the balance of the USD 0.5 bn bond that matured in July 2018. Nigeria had also issued two Eurobonds in February 2018.

Key to note is that most Eurobond issues in 2018 have been motivated by refinancing needs as part of debt-management strategies mooted by the various governments, with part of the bond proceeds being used to meet existing debt obligations of the respective issuers. The table below summarizes the recent Eurobonds issued in 2018:

Yield Changes for SSA Eurobonds Issued in 2018

Country	Issue Tenor (yrs)	Issue Date	Maturity Date	Coupon	Yield at Issue Date	Oversubscription	Yield as at December 2018(% points)	Issue to Dec 31 Yield Change(% points)
Nigeria	12	23/02/2018	23/02/2030	7.1%	6.8%	4.6x	8.7%	**1.9%**
Kenya	10	28/02/2018	28/02/2028	7.3%	7.0%	7.0x	8.9%	**1.9%**
Kenya	30	28/02/2018	28/02/2048	8.3%	8.0%	7.0x	9.7%	**1.7%**
Nigeria	20	23/02/2018	23/02/2038	7.7%	7.3%	4.6x	9.0%	**1.7%**
Ghana	11	16/05/2018	16/05/2029	7.6%	7.6%	4.0x	9.1%	**1.5%**
Senegal	30	13/03/2018	13/03/2048	6.8%	6.9%	4.7x	8.3%	**1.4%**
Ghana	31	16/05/2018	16/06/2049	8.6%	8.7%	4.0x	9.8%	**1.1%**
Senegal	10	13/03/2018	13/03/2028	4.8%	4.8%	4.7x	5.9%	**1.1%**
Nigeria	30	21/11/2018	21/01/2049	9.2%	9.2%	3.2x	9.6%	**0.4%**
Nigeria	7	21/11/2018	21/11/2025	7.6%	7.9%	3.2x	8.2%	**0.4%**
Nigeria	12	21/11/2018	21/01/2031	8.7%	9.0%	3.2x	9.1%	**0.1%**

Key to note from the table above is that there was no drop in yields for any African Eurobond issuance that happened in 2018. The yields on the new issues rose during the year 2018, mainly attributable to two key reasons:

1. The turbulence witnessed in global financial markets due to the trade tensions between U.S and China, which began around mid-April, dampening investor sentiment in emerging markets and causing volatility in commodity prices hence adversely affecting commodity-dependent African economies, and,
2. The increment in the Federal Funds Rate four times in 2018, (currently at 2.25% - 2.5%), also led to a general increase in Eurobond yields in most emerging markets due to the higher yields on US Treasuries that caused capital flows into their fixed income markets and out of emerging markets, coupled with the increased risk perception for emerging market debt.

Coming into 2019, we expect yields on Ghanaian Eurobonds to decline due to prospects of relative economic and political stability, whereas Kenyan, Nigerian and Senegal Eurobond yields might rise due to potential political risks arising from the looming elections later in the year in Nigeria and

Senegal, coupled with volatility in global commodity prices, especially for oil-producing Nigeria. The downgrading of Kenya's debt distress rating from low to moderate by the IMF would mean investors will expect higher yields on any new debt issued.

Analysis of Existing Issues

This section analyses some of the Eurobonds issued in Sub Saharan Africa before 2018.

Yield Changes in SSA Eurobonds Issued Before 2018

Country	Issue Tenor (yrs)	Issue Date	Maturity Date	Coupon	Yield at Issue Date	Yield as at Year Open	Yield as at December 2018	Year-on-year Change (% Points)	Issue Date to Dec 2018 Yield Change(% points)
Zambia	**10**	20/09/2012	20/09/2022	5.4%	5.2%	5.9%	15.4%	9.5%	**10.2%**
Zambia	**10**	14/04/2014	14/04/2024	8.5%	8.4%	6.4%	15.6%	9.2%	**7.2%**
Zambia	**12**	30/07/2015	30/07/2027	9.0%	9.3%	7.1%	14.0%	6.9%	**4.7%**
Nigeria	**30**	28/11/2017	28/11/2047	7.6%	7.3%	7.0%	9.1%	2.1%	**1.8%**
Senegal	**16**	23/05/2017	23/05/2033	6.3%	6.1%	5.7%	7.9%	2.2%	**1.8%**
Kenya	**10**	24/06/2014	24/06/2024	6.9%	6.4%	5.6%	8.2%	2.6%	**1.7%**
Ghana	**11**	18/09/2014	18/01/2026	8.1%	7.9%	6.2%	8.9%	2.7%	**1.0%**
Senegal	**10**	30/07/2014	30/07/2024	6.3%	6.1%	4.7%	6.8%	2.1%	**0.7%**
Ghana	**10**	08/07/2013	08/07/2023	7.9%	7.9%	5.7%	8.3%	2.6%	**0.4%**
Ghana	**6**	15/09/2016	15/09/2022	9.3%	5.9%	6.2%	6.1%	(0.1%)	**0.2%**
Kenya	**5**	24/06/2014	24/06/2019	5.9%	4.8%	5.3%	5.0%	(0.3%)	**0.2%**
Ghana	**15**	14/10/2015	14/10/2030	10.8%	10.3%	6.3%	8.9%	2.6%	**(1.4%)**
Senegal	**10**	13/05/2011	13/05/2021	8.8%	8.0%	3.8%	5.8%	2.0%	**(2.2%)**

From the table above,

a. Zambia recorded the highest increases in Eurobond yields, with the 10-year instruments for both the 2012 and 2014 issues increasing by 9.5% and 9.2% points respectively, while the yield on the 12-year bond issued in 2015 increased by 6.9% points. This makes Zambian Eurobonds the worst performing in Sub Saharan Africa, due to concerns of a widening fiscal deficit and deteriorating credit worthiness on the back of high debt levels. According to Zambia's budget, the country's fiscal deficit stands at 7.4% of GDP, with debt levels expected to rise to 69.0% of GDP by the end of the financial year 2018. Zambia's increasing debt levels, coupled with the 19.0% depreciation of the Kwacha in 2018, present the risk of rising debt-service costs for the economy, hence necessitating demands for higher premium on sovereign debt issued by the country.
b. With the exception of Ghana's 6-year instrument issued in 2016 and Kenya's 5-year paper issued in 2014, all other sovereign bond yields in SSA have increased moderately - within a band of 2.1-2.6 percentage points.
c. The Nigerian Government had earlier issued two Eurobonds for USD 2.5 bn across two maturities: 12-years and 20-years, in order to finance repayment of government securities denominated in the local currency. The increase in Nigerian bond yields has partly been attributable to inherent weaknesses in fiscal policies, as well as the looming elections, while Ghana bond yield increases have largely been attributed to weakening investor sentiment because of the emerging banking sector risk that led to a government bailout for failing banks, which increased the stock of public debt.
d. The rising yield on Kenyan Eurobonds signals higher country risk perception by investors, partly attributed to International Monetary Fund (IMF) raising the risk of Kenya's debt distress from low

to moderate in October 2018, resulting in investors demanding a higher return for the risk.

The declining yields have further been weighed down by the declining commodity prices, coupled with the depreciation of most of the local currencies of the respective nations. Below is a summary of the performance of the different resident currencies for the year 2018:

Select SSA Currency Performance vs USD

Currency	Dec-18	Dec-17	Y-O-Y Change
Kenya Shilling	101.2	103.2	1.4%
Nigerian Naira	362.6	360.0	(0.7%)
CFA Franc (Senegal)	577.5	564.2	(2.3%)
Ghana Cedi	4.9	4.5	(8.6%)
Zambian Kwacha	11.9	10.0	(19.0%)

The depreciation of local currencies has the effect of making dollar denominated debt more expensive. This would pose the danger of rising debt-service costs, especially taking into account the diminishing revenues because of commodity price declines.

Section III: Debt Sustainability in Africa: Case Study of Mozambique Debt Crisis

Debt distress is a situation where an entity fails to meet its periodic obligations because a large portion of revenue is used in paying down debt, to a point where periodic debt payments become unsustainable. In this section, we shall give an example of the Mozambican debt crisis as a pointer to the possible economic implications of unsustainable debt levels that could be brought about by issuing Eurobonds.

Mozambique fell into debt distress in 2016 after it defaulted on a USD 0.7 bn, 10-year tenor Eurobond that was due in January 2020. The Eurobond was issued in January 2013 to refinance what it termed as ‘tuna bonds’. Ematum, a state-owned fishing company, borrowed the tuna bonds, taken out in 2013 to finance a new tuna fishing fleet. The loans, a USD 500.0 mn and a USD 350.0 mn notes, were borrowed from Credit Suisse Bank and Russian-based VTB Bank, respectively. The loans were securitized with the help of the two banks and a French bank, PNB Paribas, after which they were divided into smaller chunks and issued as unlisted securities. These securities came to be the now infamous tuna bonds. The Mozambican government guaranteed the debt, meaning it would have to pay up in case Ematum was unable to. As fate would have it, Ematum was unable to meet its obligations, amounting to USD 260.0 mn per annum, due to a shortfall in annual tuna catch below the 200,000 tonnes needed to make its business model viable. At the time, the government’s fiscal position was worsening due to plummeting commodity prices and an underperforming agricultural sector. High budget deficits meant extensive borrowing to plug the shortfalls, necessitating budget cuts in order to lower the deficit. Nevertheless, it struggled in financing the debt, announcing a restructuring of the Eurobond in April 2016. Bondholders agreed to swap the tuna bonds maturing in 2020 for new, interest-only Eurobonds maturing in 2023. This was on the premise that income from Mozambique’s newly discovered offshore natural gas fields would be used in financing the debt.

After the restructuring, Mozambique admitted to undeclared borrowing of a further USD 1.4 bn in commercial and bilateral debt. Following the disclosure, 14 donor countries (including the IMF) froze financial aid to the country, further deteriorating the already dire fiscal position. The International Monetary Fund (IMF) estimated the proportion of public debt to the country’s GDP at 128.3% in 2016, with external debt arrears amounting to USD 709.6 mn by the end of 2017. The government announced that it could not pay any of its debt obligations until 2021, the year it expected to start receiving revenues from the sale of natural gas. Instead, it offered to restructure the debt, now amounting to USD 2.1 bn including the tuna bonds, which would need restructuring yet again. Real GDP growth slumped to 3.8% in 2016 after registering growth rates of 7.4% and 6.6% in 2014 and 2015, respectively. Fiscal deficits were notably high, peaking at 10.7% in 2014 and easing off to 7.2% in 2015, before closing the year 2016 at 7.6% of GDP. The IMF forecasts the debt crisis to continue over the medium term to reach 126.0% of GDP by the end of the year 2022.

The path to recovery for Mozambique lies in the commercialization of liquid natural gas (LNG) reserves, expected to begin generating income in 2023. However, the economic outlook remains bleak in the medium term, with the IMF expecting GDP growth to slow down to 2.2% by the year 2022, after which it is estimated to grow by 9.9% once natural gas sales commence in the year 2023. Even then, growth is hinged on timely completion of the LNG processing facilities, which will require heavy foreign direct investment as well as private debt financing. The total costs of development of the facilities are estimated at USD 25.0 bn, of which 60.0% (USD 15.0 bn) will be financed by debt. In the meantime, GDP growth will ride on expansion in coal mining and infrastructure investments. In addition, fiscal consolidation is required in order to improve the country’s external position, while austerity measures are needed to reduce public spending. Prudence should be exercised in contracting of new debt, to avoid non-concessional arrangements and focus borrowing efforts on immediate, high-impact projects. The country also needs to improve management of state-owned enterprises (SOEs), with a possible privatization wave looming.

From the case study above, key take-outs for African countries include:

1. The need to diversify economies away from commodity exports, which are prone to fluctuating revenues due to volatility in global prices. This will serve to alleviate pertinent budget deficits hence reducing reliance on debt for budget financing,
2. Debt should only be taken out for the sole purpose of financing high value infrastructural projects that have an immediate high impact on the economy, and;
3. Fiscal consolidation is paramount in order to minimise fiscal deficits for countries aiming to improve their external position with regard to foreign funding. Austerity measures should be adopted to reduce government spending, thereby freeing up capital for development expenditure.

Section IV: Outlook on SSA Eurobonds

From the analysis, it is evident that Eurobond yields in Sub Saharan Africa rose in 2018, partly due to the aggressive tightening monetary policy regime adopted by the U.S Federal Reserve, coupled with the China-U.S trade tensions, which dampened investor sentiment in emerging markets. The volatility of commodity prices adversely affected export revenues for resource-endowed countries like Nigeria and Zambia. Internal country risks also exacerbated the rise in yields, such as the developing banking sector risks in Ghana. As a result, most foreign investors began pulling out their capital in the wake of rising US treasury yields and a strong dollar, thereby increasing the risk profile of most emerging market economies. However, with the truce arrived at between US and China after the G20 Summit, we expect yields to stabilise going forward as investors respond positively to the agreement between the two economic powers not to extend tariffs on trade commodities. We thus expect SSA countries to continue accessing foreign debt through the issue of Eurobonds this year, with plans underway in Ghana to raise USD 3 bn, and Ivory Coast that targets to raise USD 1 bn from Eurobond sales.

While external debt might be a cheaper and more easily accessible financing option for African governments, it also poses the sustainability question due to rising debt levels as well as volatility in commodity prices and exchange rates. Unsustainable debt levels may cause distress and increase probability of default, and the possible effects of the heavy debt burden will be felt most by the taxpaying citizens. Countries seeking to increase revenue may opt to increase the tax base, eliminate trade barriers and boost local industries as opposed to increased borrowing that is not sustainable.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com