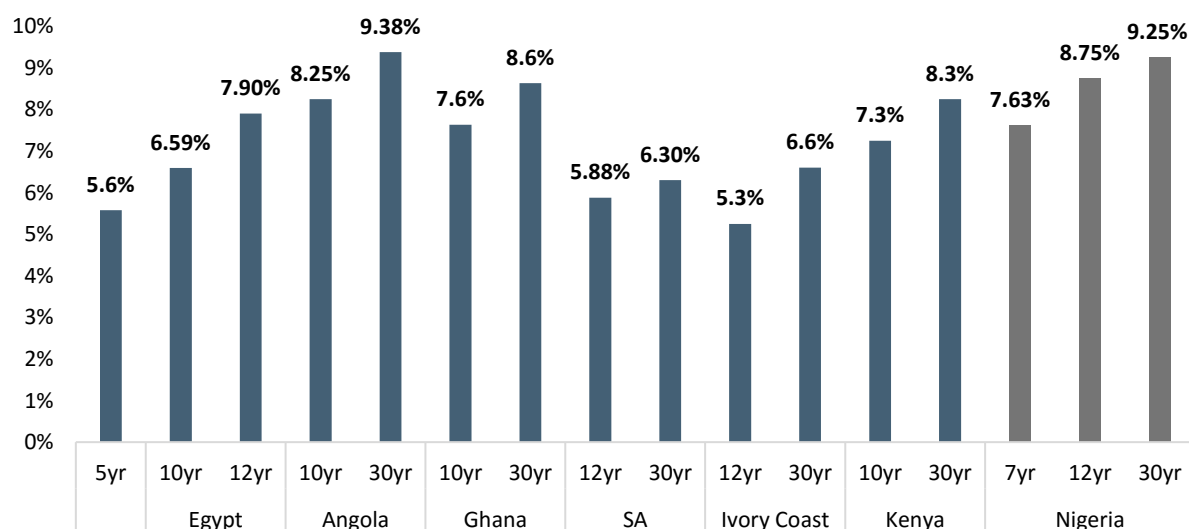


## Eurobond issuance: A Seven-day wonder?

Yesterday, the FG completed its \$2.86 billion (~~₦~~856.8 billion) Eurobond issuance, taking the country's total issuance for the year to \$5.3 billion. The offer is made up of a \$1.18 billion (7-Yr), \$1 billion (12-Yr), and \$750 million (30-Yr) priced at 7.625%, 8.75% and 9.25% respectively. As highlighted in our ***October fixed income update*** that scope for demand for Nigeria's sovereign issuances exist given its favorable macroeconomic fundamentals, the issue was 3.2x over subscribed, though over-priced considering Nigeria's improved fundamentals. Specifically, when compared to the February 2018 Eurobond issuance where the spread between Nigeria's Eurobond rates and comparable US treasury was 427 bps and 456bps for the 12year and 20 year respectively, the recent issuance which portends a 563bps and 589bps spread for the Nigeria's 12 year and 30 year appears expensive. For us, we think the higher pricing reflects ongoing EM risk off emanating from the recent spate of interest rate hike in the US (2%-2.25%) – that has resulted in higher US treasury yields (10-year: +70bps Ytd to 3.1%), the ongoing trade spat between US and China and the recent currency bouts faced by major EM economies earlier in the year.

**Figure 1: Eurobond yields at issuance across African countries in 2018**



Source: Bloomberg, ARM Research

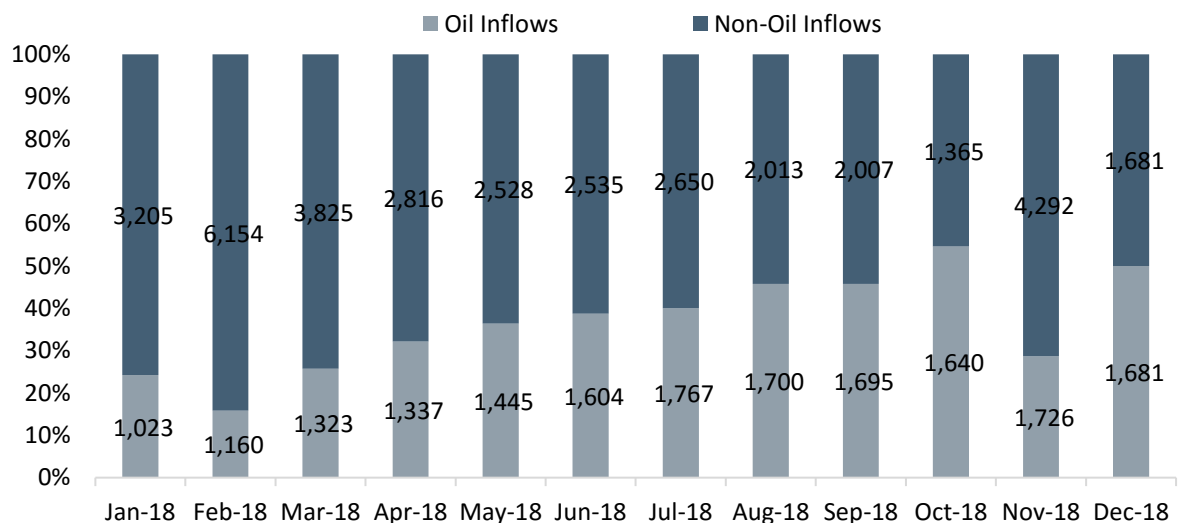
## Will Eurobond Inflow come to the rescue?

After recording net inflows in the first 6 months of 2018, the market switched to a net outflow on the back of foreign portfolio outflows. For context, total outflows from July – October 2018 stood at \$20.6 billion (monthly average of \$4 billion) with offshore demand at the IEW accounting for c.31% of the

total outflow, while total inflows stood at \$14.8 billion (monthly average of \$3.8 billion). Consequently, the CBN depleted the reserve by \$5.8 billion in a bid to keep the naira stable.

Prior to the just concluded Eurobond Issuance, we had expected the external reserve to close the year at \$38.4 billion. Our view was based on the expectation that offshore investors repatriate ~\$3.4 billion, which is 80% of offshore holdings of maturing fixed income instruments in November and December estimated of \$4.3 billion<sup>1</sup>. However, we believe the proceeds of the Eurobond will cushion the depletion in the external reserve. Overlaying the proceed of the Eurobond on our non-oil inflow for the month of November, we now see total inflow to the CBN rising to \$6.1 billion (Ex-Eurobond: \$3.1 billion), which will support the reserve to hold its ground at the psychological level of \$40 billion by the end of the year. Thus, we expect the stability in the currency to linger, albeit a slight weakening in the range of ₦365/\$ - ₦368/\$ by year end, dictated by findings of sub-aggregation of demand at the IEW by the apex bank before settlement relative to the hitherto automatic interplay of demand and supply at the window.

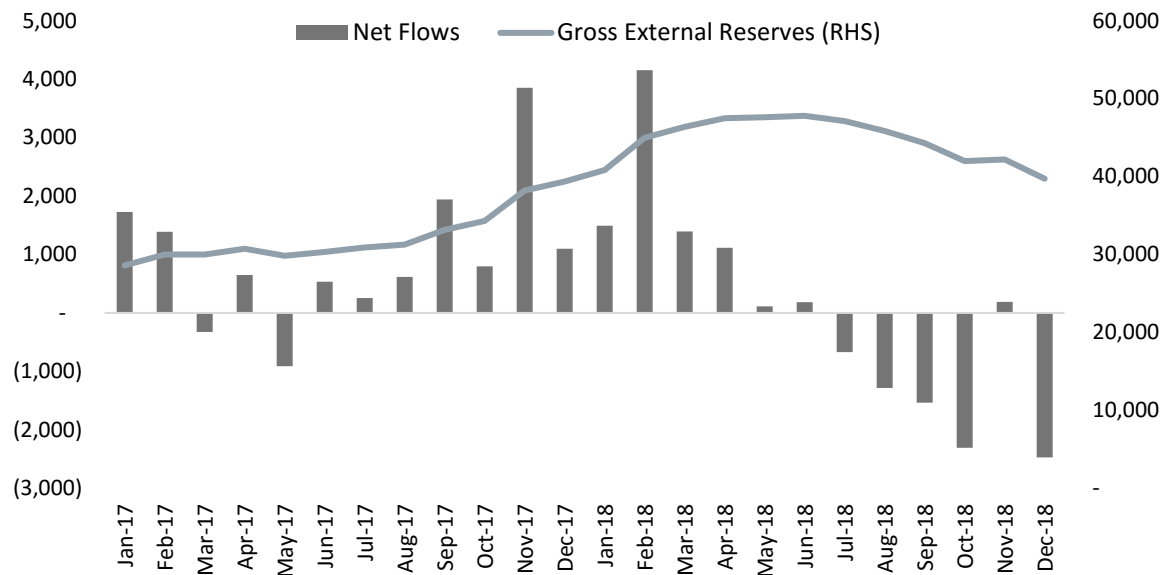
**Figure 2: Foreign Currency flows through the CBN (\$'Million)**



Source: FMDQ, ARM Research

<sup>1</sup> N4.3 trillion maturing FI instruments, foreign holdings is estimated at 36%.

**Figure 3: Net flows and aggregate gross reserve position**



Source: CBN, ARM Research

### *Scope for higher yields persists*

On FG's 2018 fiscal outlay, we modelled a fiscal deficit of ₦1.78 trillion. To fund the deficit, we estimated domestic borrowings of ₦388 billion and external borrowings forecast same as FG's at ₦850 billion. Consequently, the successful Eurobond issuance of \$2.86 billion (₦872 billion) largely accounts for the external leg on borrowings. Thus, given FG net-issuance YTD of ₦172.5 billion (Bond: net issuance of ₦571.5 billion, Treasury Bills: net repayment of ₦398.9 billion), we estimate an average monthly issuance of ₦50 billion for November and December (YTD monthly average of ₦87 billion) alongside possibility of ₦100 billion Sukuk. Thus, the impact of lower paper supply over the rest of the year reduces the scope for an uptick in yields. Irrespective, given elevated maturity profile over the rest of the year at ₦4.3 trillion posing liquidity concerns as well as inflationary pressure, we see scope for higher OMO rates which translates to higher fixed income yields over the rest of the year.

### *Debt Rebalancing hitting its strides*

The recent appetite for external borrowings is borne out of FG's quest to curtail its rising cost of debt service as well pursuing its medium-term debt strategy of achieving an optimal debt mix of 60:40 between local and foreign debt respectively. Truthfully, on the former, given elevated rates in the local market (+21bps YTD to 14.6%), borrowing externally provides ample savings for the Federal government as our analysis points to fiscal savings of ₦61 billion annually in interest payments from the issuance of \$2.86 billion as against borrowing the equivalent amount from the local market. In terms of

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its impact on Nigeria's debt service to actual revenue which has been on the rise in recent times – rising to a whopping 62% in 2017 (vs 45% in 2016) –, our prognosis points to higher debt service to actual revenue ratio albeit lower at 66% in relation to 68% if we had considered domestic borrowings. In addition, in terms of debt mix, factoring in the \$2.86 billion, Nigeria's debt is still in line with FG's planned debt mix as Nigeria's current debt mix stands at 33:67 split between external and domestic borrowings (vs 30:70 prior to the Eurobond issuances). Although Nigeria's Debt as a percentage of GDP after the Eurobond issuance rose a tamer 77bps to 20.5% (vs 19.7% prior to the issuance), it still appears favorable when compared to major African peers (South Africa: 53.1%, Kenya: 56.4%, Egypt: 101.2%).

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