

Economic Report | Fiscal Policy
Testing the Eurobond waters: from Ghana with love
Economic Snapshot
August 2016 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	1.0%	17.6%	17.1%
Food	1.2%	16.4%	15.8%
All Items Less Farm	0.9%	17.2%	17.0%
Imported food	1.0%	20.7%	20.4%
Energy	1.2%	30.4%	30.0%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	315.25	-1.29%	-58.18%
EURNGN	353.81	-1.34%	-63.53%
GBPNGN	408.17	-0.88%	-39.01%
JPYNGN	318.00	-0.97%	-87.95%

Monetary Aggregates -July 2016

	(₦'bn)	MoM	YoY
M2	22,182	2.3%	20.4%
CPS	22,375	4.4%	19.9%
NCG	2,784	-3.8%	-3.2%
NFA	7,564	6.4%	33.0%
NDC	25,159	3.5%	16.8%

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	-1,292	165%	131%
External Reserves (\$'mn)	24,596	-5.9%	-18.0%
Foreign Debt (\$'mn)	10,718	0.9%	10.4%

Growth Data - Q2 2016

	(₦'bn)	%of total	YoY
Real GDP	16,102	100%	-2.1%
Agriculture	3,636	22.6%	4.5%
Oil	1,332	8.3%	-17.5%
Services	6,003	37.3%	-1.8%
Wholesale and Trade	2,834	17.6%	0.0%
Manufacturing	1,602	10.0%	-3.4%

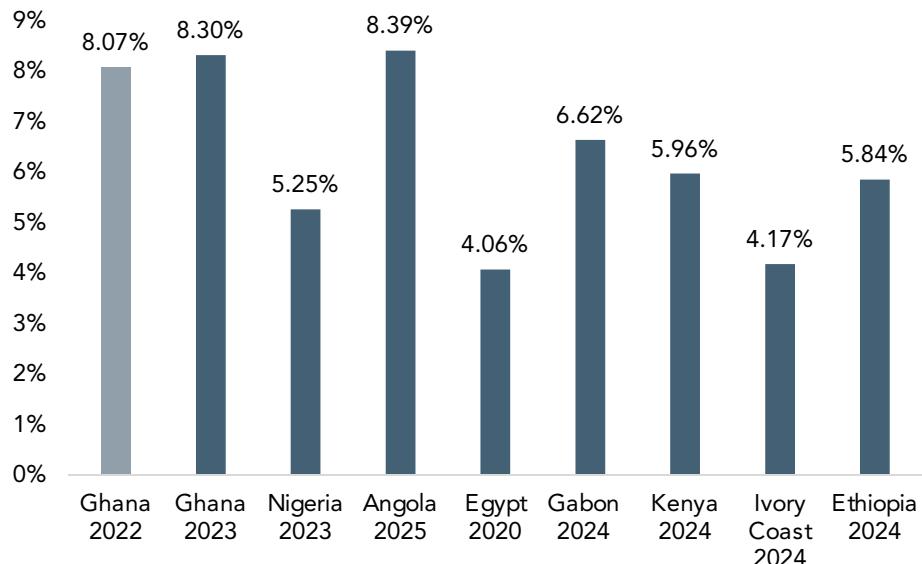
Amaka Ukoha
amaka.ukoha@arm.com.ng

A month after shelving a planned issue, Ghana re-entered the Eurobond market in September with a \$750 million, 5-year issue priced at 9.25% (vs. the double-digit yields in August). Despite concerns about investor pessimism about African debt after the IMF downgraded the continent's growth forecasts in July to a 23-year trough of 1.6% YoY, and uncertainty over potential US Federal Reserve tightening, the Eurobond was oversubscribed with orders exceeding \$4 billion. Ghana intends to use proceeds of the Eurobond issue to refinance maturing debt in 2017, boost FX reserves and provide funding for capital projects.

Ghana's weak fiscal indicators drives higher yields on Eurobond issuance

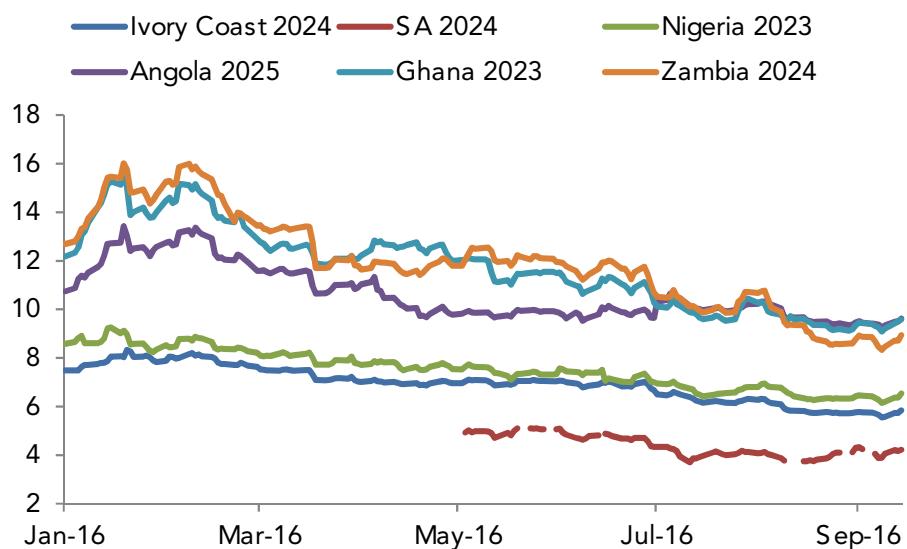
Despite the strong subscription levels, pricing was steep as Ghana's 2022 Eurobond was issued at a credit spread of 8.1pps over comparable US Treasuries. With the exception of Angola, Ghanaian paper has been trading at sizable premium to African peers implying investor unease over Ghana's fiscal fundamentals despite support from the \$1 billion loan guarantee from the IMF and commissioning of a new oil field (+25k bpd) in Q3 16. Thus, while appetite for higher yielding African paper remains strong, the prospects for tightening US monetary policy seemingly raised investor sensitivity to issuer credit profiles.

Figure 1: Credit spread: Ghana 22 at issue vs. SSA peers



Source: Bloomberg

Figure 2: Cross comparison of yields on African Debt

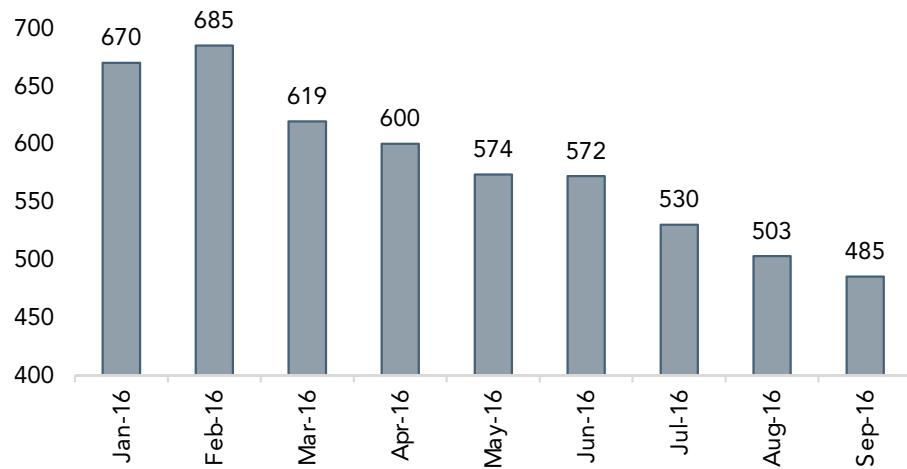


Source: Bloomberg

What is good for Ghana is good for Nigeria?

That said, the robust subscription levels at the Ghanaian issue has boosted chances of a Nigerian Eurobond after talks cooled following an unsuccessful road show in June. In between, Nigeria's economic policy makers have addressed a lot of issues which drove foreign apathy to Nigerian assets earlier in 2016. Ideally, the liberalization of currency markets and removal of energy subsidies should be positive for sentiment. Indeed, markets appear to have priced in this improvement as credit spreads of Nigerian 2023 Eurobond have tightened from an average of 670bps in January 2016 to a low of 485 bps as at September 2016. The development emanates despite sizable deterioration in the growth picture, disruptions to oil production and a one-notch downgrade by S&P. Overall markets could be more receptive to a Nigerian issue than previously feared.

Figure 3: Average Monthly Spread over US Treasuries on Nigeria's 2023 Eurobond



Source: Bloomberg, ARM Research

Looking at a side by side comparison between Nigerian and Ghanaian fundamentals reveals that the former has better economic fundamentals which properly positions Nigeria relative to Ghana in terms of securing favourable rates and tenure for its Eurobond auction. Assuming oil prices remain range-bound and no action on US interest rates, market developments are likely to pan out similar to the Ghanaian issue and we sizable scope for a Nigerian issue priced at a 500-600bps spread to the similar US treasuries.

Table 1: Debt indicators

	Nigeria	Ghana	South Africa	Zambia	Kenya
Fiscal Deficit % of GDP	-3.98%	-5.00%	-0.74%	-8.10%	-5.62%
Current Account Deficit % of GDP	-2.40%	-8.30%	-4.40%	-3.50%	-8.16%
Debt % of GDP	11.50%	73.30%	50.06%	52.95%	52.69
External debt/GDP	2.30%	36.40%	42.30%	28.90%	26.70%
External debt service/Revenues	2.10%	5.50%	10.10%	20%	22%
FX Reserves (USD' billions)	24.7	4.9	45.9	2.97	7.6
Import Cover (months)	7.2	2.6	5.2	3.1	5
Eurobond outstanding (USD' billions)	1.5	4.5	44.5	3	2.75

Source: IMF WEO, ARM Research

But the stone must be bigger to kill many ‘birds’

Having voiced our opinion regarding the need for a Eurobond issue as a means of tackling the revenue issues at the heart of the current growth struggles, we reemphasize a component that we consider critical to any issue being able to achieve that aim: size. We think the DMO’s plan for a \$1 billion issue, even though the agency has approval for a \$4.5 billion MTN program, is sub-optimal and can be much larger for several reasons. First, if anything, the need for the issue itself is magnified by the weak environment that has seen the FG budget a ₦2.2 trillion deficit (\$7 billion). Whilst still grappling with how to fund that, disappointments on oil production (H1 16: 1.6mbpd) and misses on non-oil revenues on shrinking corporate profitability and lower imports, widens the gap: our estimates for base case fiscal deficit for 2016 is ~₦3.8 trillion (\$12 billion).

Second, if one accepts that a key benefit for Eurobond issuance of an emerging market would be to support FX liquidity, then a \$1 billion issuance does little to help the currently pessimistic outlook on the naira. Nigeria’s planned issuance of \$1 billion amounts to 16.3% of total market turnover in August 2016 and represents a paltry 5 days in average daily market turnover. In addition, relative to the Ghanaian issue, which amounted to 15.3% of FX reserves, Nigeria’s planned \$1 billion translates to 4% which in our opinion is marginal compared to the forex challenges confronting the domestic economy. To move the eye of the

needle, using a naïve extrapolating from the Ghanaian scenario, a \$3.8 billion worth of Eurobonds would be needed.

Table 2: FX market turnover

	2014	2015	H1 2016	July	August
Average daily turnover (\$' millions)	770	571.35	275.11	279.35	226.53
Total Turnover (\$' millions)	194,902	140,964	33,970	6,146	4,531

Source: FMDQ, ARM Research

The third point relates to timing; though the US Federal Reserve has dithered on following through with its plan to raise policy rates, minutes from the last FOMC meeting suggests sizable scope for resumption of tightening in Q4 2016. Thus, if subscription levels are robust for Ghana with weaker fiscal metrics than Nigeria, why delay going for a bigger issue now before market sentiments turn? In our opinion, high investor appetite for African debt is largely underpinned by prevailing low base rate for credit issues. Given a hike in interest rates in the US, base rates will reset higher and pricing will turn unfavorable for Eurobonds from African issuers which will constrain ability to push sizable debt issues which points to the need for FG to push a speedy issuance of sizeable Eurobond debt.

Finally, post NGN depreciation, a bigger Eurobond issue more significantly shrinks the need for FGN domestic financing which should reduce pressure that's distorted the yield curve. In conjunction with likely slowdown in inflation, this would allow for monetary policy to work in tandem with fiscal policy. Given the speed of Nigeria's descent into recession, and the clear urgency for Nigeria's economic managers to tackle the current growth malaise, working towards a common goal is perhaps more important than ever and if a Eurobond issuance facilitates that, then the bigger the better. Hence, in our opinion, a sizeable Eurobond issue does more than just provide the FG with ready ammunition against the ongoing dollar speculation and FX scarcity issues confronting the Nigerian economy. Indeed, if ongoing talks with development financing institutions are then successful, the FGN can credibly make inroads towards nursing the economy back into health.

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