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Sub-Saharan Africa Fixed Income Report

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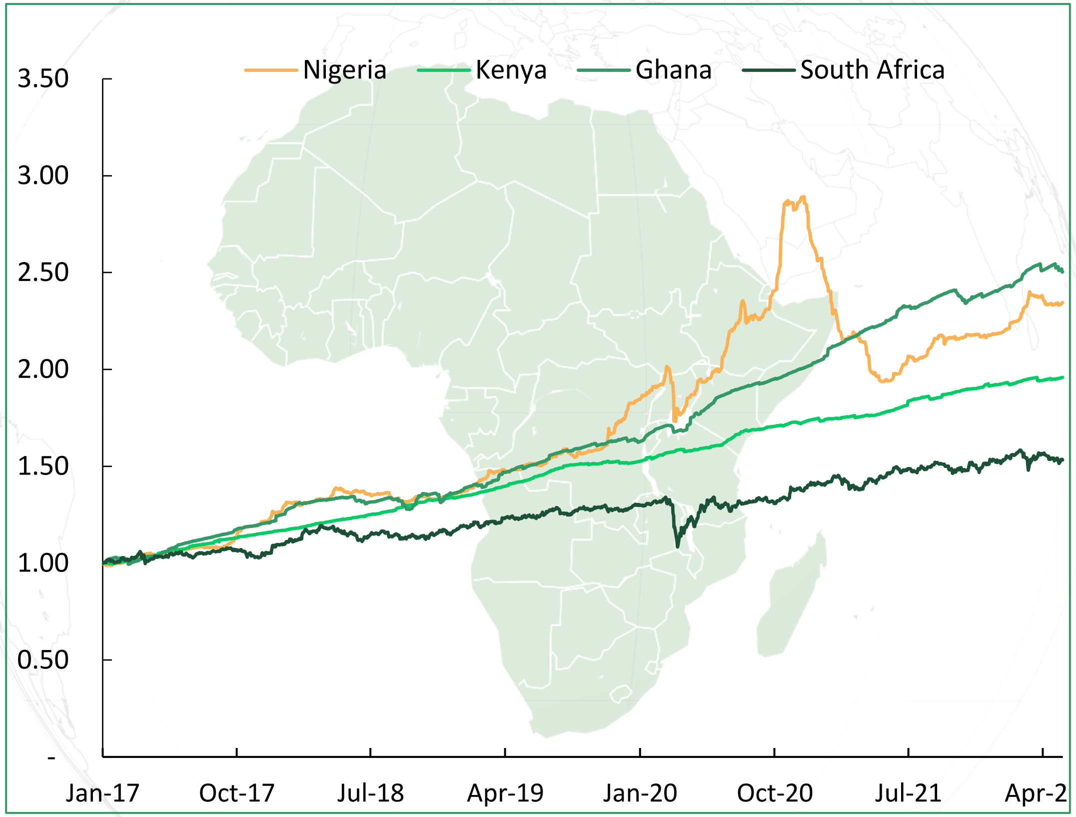
INTRODUCTION

Most Sub-Saharan African (SSA) countries have been faced with fiscal sustainability issues in recent times. While some of these issues are peculiar on a country-by-country basis, the general themes dominating the region include swelling debt stock, increasing budget deficit and weakening fiscal sustainability metrics. The surging inflation in the region has also kept the real rate of return for most countries in the negative.

All of these, coupled with increased dependence of SSA countries on external borrowings, have raised concerns about the ability of these nations to balance their weak revenue with soaring expenditure needs. This fiscal challenge has also led to the downgrade of some SSA countries by global rating agencies. Fiscal reforms are being carried out in some countries, although the benefits are expected to be reaped in the long term.

In this report, we take a macro-view at the fixed income markets of four (4) SSA countries: Nigeria, Ghana, Kenya, and South Africa.

S &P Sub-Saharan African Sovereign Bond Indices



Source: S & P Sovereign Bond Indices, Meristem Research

NIGERIA

Background

Prior to 2020, the Nigerian economy has been on a growth trajectory since exiting recession in Q2:2017. However, the economy slipped into another recession in Q3:2020, reflecting the Covid-19 pandemic drag on economic activities. The pandemic also impacted the Nigerian capital market like most emerging markets, resulting in significant capital flight. Although, the economy has since exited the recession, there is still need to consolidate on the growth. Also, the country's infrastructural gap requires adequate fiscal attention.

A budget of USD41.76bn (NGN17.13trn) has been proposed for 2022 as the country prepares for the 2023 general elections. This amount is split into c. 32% for capital expenditure, c. 40% for recurrent expenditure, and c. 23% for debt service. Meanwhile, the Federal Government of Nigeria (FGN)'s total debt stock was USD80.21bn (NGN33.13trn) as of December 2021. The proposed debt of USD12.52bn (NGN5.14trn) in the 2022 Budget will increase FGN debt stock to USD93.30bn (NGN38.27trn). Although the country's Debt-to-GDP ratio remains within acceptable threshold (18.82% in 2021 vs 55% IMF threshold), the pain point is the high debt service to revenue ratio (72.90% as at August 2021).

Rally in oil price informed the upgrade of the country's rating outlook by recognized international rating agencies to "stable" from "negative". This is because over 50% of the Government's revenue is sourced from crude oil sale. The major challenge with funding Government's budget has been double-phased: low revenue (tax) base; and high debt service to revenue ratio.

Macroeconomic Fundamentals	
Total 2022 Budget	**NGN17.13trn** *USD41.76bn*
Budget Deficit	NGN6.39trn *USD15.57bn*
Debt Financing	USD12.52bn
Deficit % of GDP	3.46%
Budget Deficit Mix (*As contained in approved budget*) Domestic Foreign	 50% 50%
Debt to GDP Ratio	27.87%
Debt Service to Revenue Ratio	36.12%
Rating:	
Fitch	B (Stable)
Moody's	B2 (Stable)
S&P	B+ (Stable)

Source: Budget Office of the Federation, Ministry of Finance, Rating Reports, Debt Management Office, Meristem Research

BOND YIELD MOVEMENT

The Nigerian yield curve has been on a downtrend since Q3:2019. Average fixed income yield declined to its five-year lowest of 3.66% in December 2020. A direct effect of the unattractive yield was a drop in activity level, as capital flight pervaded the market at the peak of the COVID-19 pandemic. For context, market turnover for sovereign bonds fell by c. 33% in 2021. Although we note the increase in Foreign Portfolio Investment (FPI) in the bonds market by 143.97%YoY to USD564.11mn in 2021, it still lags the 2019 value of USD1,022.39mn by 44.82%.

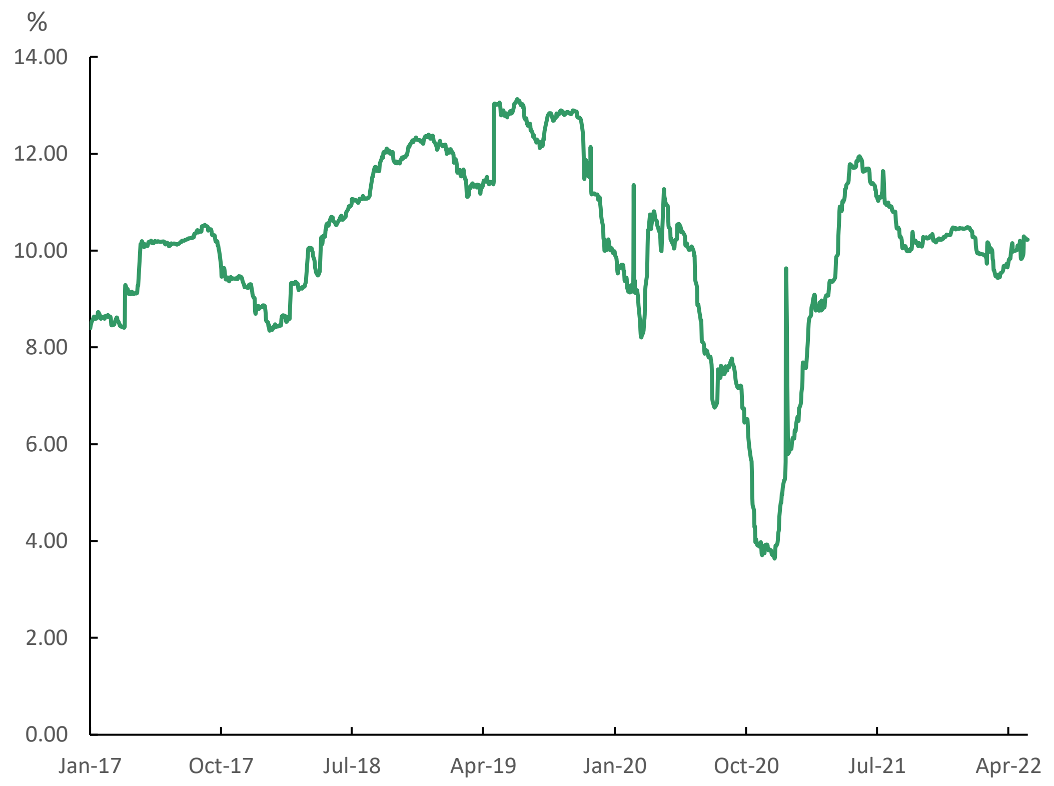
While average bonds yield increased in H1:2021, the need to minimize Government borrowing costs, access to international capital market, and paucity of viable investible opportunities for investors gave the Government some leeway to depress yields. Moreso, availability of CBN financing window through the Ways and Means is another funding source for the Federal Government.

Real rate of return has been negative on all Nigerian risk-free instruments such as FGN Bonds, Nigerian Treasury Bills, and OMO Bills, as inflation rate remains double-digit.

In Q1:2022, high system liquidity remained the pull factor for yields, causing a 49bps and 76bps decline in average Treasury Bills and Bond yield, respectively. Thus, the S&P/FMDQ Nigeria Sovereign Bond Index returned 8.56% in the first quarter of the year.

Notably, the Federal Government has also tapped into the International Capital Market to raise USD1.25bn priced at a yield of 8.375%.

5-year Historical Average Bond Yield



Source: FMDQ, Meristem Research

Background

Ghana's GDP grew by 6.50% YoY in 2019. However, the economy fell into recession in Q2:2020 for the first time in 40 years, attributable to high COVID-19 infections, lockdown, and slow vaccine rollouts. Nonetheless, with the introduction of vaccines and easing of the restrictions, the country exited recession in Q1:2021, as GDP expanded by 3.30%. In 2021FY, Ghana's economy grew by 5.40%.

The country's already weak fiscal sustainability position was worsened by the Covid-19 pandemic. Thus, its public debt to GDP ratio surged from 61.21% in 2019 to 76.10% and 77.80% in 2020 and 2021 respectively (higher than the World Bank / IMF's threshold of 55%). In 2021, the widened fiscal deficit (USD7,955.66mn from USD7,183.68mn in 2020) drove fiscal deficit-to-GDP higher to 7.70% exceeding its target of 7.40% for 2021. Given the budget deficit (USD4,811.56mn) for 2022, the country's total debt stock is estimated to hit USD63,051.36mn in 2022.

Further to Ghana's high debt level and its thin fiscal purse, rating agencies (Fitch and Moody's) downgraded Ghana's rating (to B- and Caa1 respectively) in 2022. However, S&P issued a B- rating for Ghana, maintaining a stable outlook for the economy. This is premised on the intended cut in expenditure by 20.00%, which is expected to improve fiscal sustainability.

In a bid to curtail its fiscal deficit, tackle spiraling inflation and restore the depreciating local currency, the Government announced cuts in expenditure and introduced a digital levy of 1.75% on electronics transactions.

Macroeconomic Fundamentals	
Total 2022 Budget	**USD17,878.77mn**
Budget Deficit	USD4,811.56mn
Deficit % of GDP (2022)	7.37%
Budget Deficit Mix	
Domestic	75.44%
Foreign	12.30%
Debt to GDP Ratio	77.52%
Debt Service to Revenue Ratio	36.82%
Rating	
Fitch	B- (Negative)
Moody's	Caa1 (Negative)
S & P	B- (Stable)

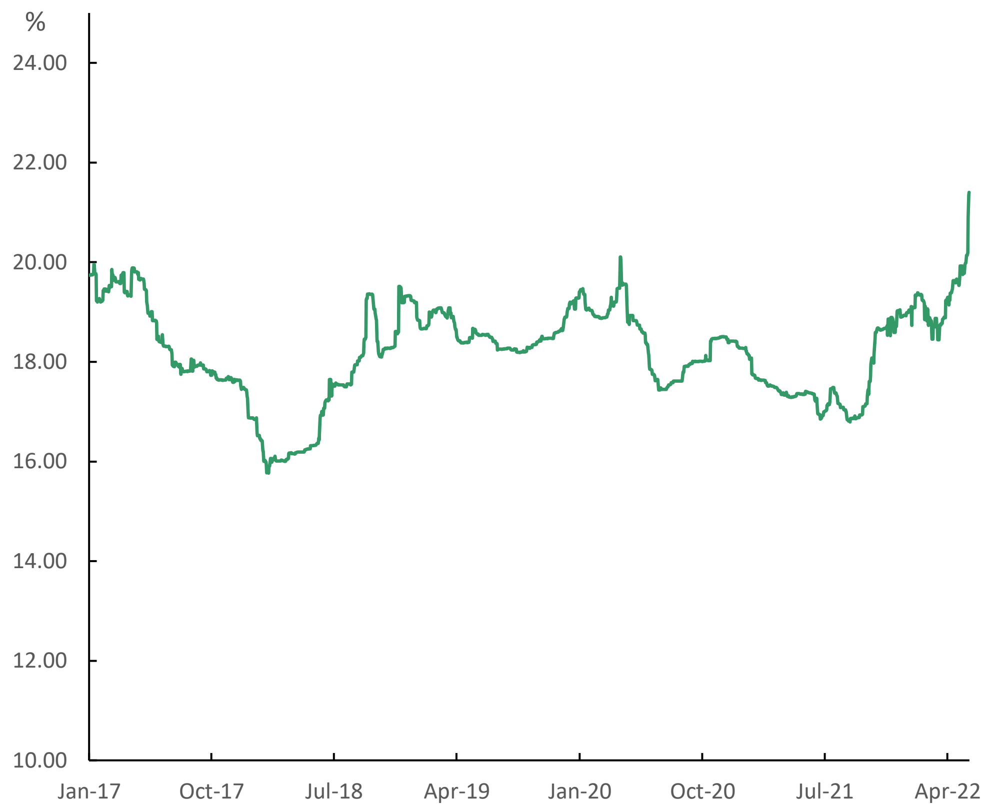
Source: The Budget Statement and Economic Policy, Ministry of Finance, Rating Reports, Meristem Research

BOND YIELD MOVEMENT

Although the Ghanian yield curve was stable for the most part of 2019, it began gathering pace at the start of 2020. The Ghanian average bond yield peaked at 18.55% in Q2:2020, before it began to decline reaching its lowest point of 16.73% in Q3:2021. However, due to the weak economic outlook and downgrade in credit ratings of the country, the yield curve started to rise from the third quarter of 2021, with average sovereign bond yield reaching its five-year highest point of 19.45% in April 2022. We note that among our representative SSA countries, the Ghanian fixed income market has the highest yielding instruments.

The ascent in yields has been largely driven by the reduction in demand for treasuries (as investors worry over the country's debt trajectory) and rate hike (250 bps to 17.00% in March) in a bid to curtail persisting inflationary pressures. In April 2022, Ghana's inflation surged to 23.60% (from 19.40% in March 2022), exacerbated by the Russia-Ukraine crisis. We note that investors have over the years enjoyed real rate of return as average yield (18.75%, 17.98% and 18.60% in 2019, 2020, and 2021 respectively) exceeded the annual average headline inflation rate (8.68%, 9.93% and 9.95% in 2019, 2020, and 2021 respectively). This trend has however been reversed, as investors' real rate of returns have been eroded given the country's current inflation level.

Historical Average Bond Yield



Source: Bloomberg, Meristem Research

KENYA

Background

Kenya exited its pandemic-induced recession in Q4:2020, with a 1.20%YoY GDP growth. Subsequently, Kenya's GDP expanded by 10.10% YoY in Q2:2021, representing the highest quarterly growth in GDP in over two decades. Per its most recent growth figures, Kenya's economy recorded a 7.50%YoY growth rate in 2021 (to USD83.18bn), exceeding its pre-pandemic growth rate of 5.10% (USD78.99bn).

Kenya's 2022 budget has a conservative revenue expectation, as the fiscal authority takes into account the lingering economic challenges caused by the pandemic. The Government projects revenue of USD18.43bn (16.40% of GDP), majorly to be sourced from taxes. However, this falls short of its proposed expenditure by USD8.62bn. As a result, fiscal deficit to GDP ratio is expected to hit 7.50% in 2022 (vs 8.70% in 2021).

As of December 2021, the Kenyan Government had a debt stock of USD71.09bn representing 89.19% of the country's USD79.71bn debt threshold. Also, the country's debt to GDP ratio was 66.35% (vs. 55% IMF threshold and 62.40% in 2020).

In 2021, S&P downgraded Kenya's long term foreign and local currency from B+ to B due to the negative effect of the pandemic on the country. Despite this downgrade, the country raised USD1bn in an oversubscribed Eurobond issuance at 6.30% - just three months after the downgrade.

Macroeconomic Fundamentals	
Total 2022 Budget	**USD27.05bn**
Budget Deficit	USD8.62bn
Deficit % of GDP (2022)	7.70%
Budget Deficit Mix	
Domestic	69.43%
Foreign	30.57%
Debt to GDP Ratio	66.35%
Debt Service to Revenue Ratio	28.42%
Rating:	
Fitch	B+ (Negative)
Moody's	B2 (Negative)
S&P	B (Stable)

Source: The National Treasury of Kenya, Office of the Controller of Budget of Kenya, Bloomberg, Meristem Research

BOND YIELD MOVEMENT

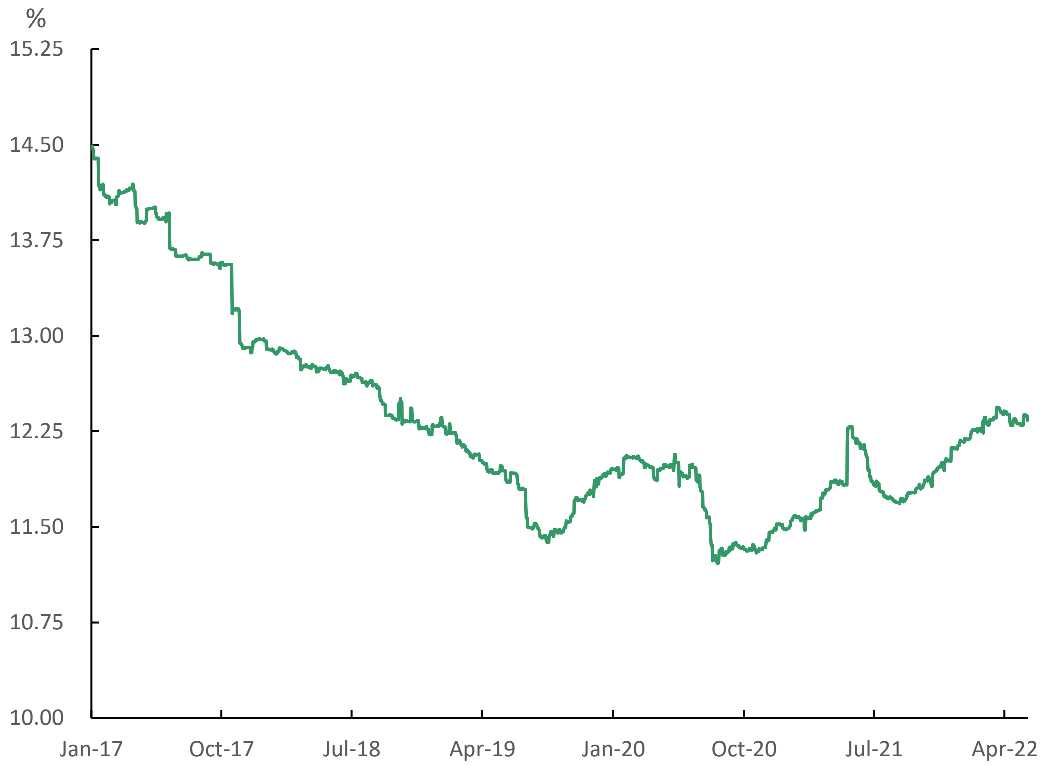
The Kenyan sovereign bond yields trended downwards for the most part of 2019, before reversing its direction towards the end of the year. However, in the heat of the pandemic in 2020, investors sought safe havens by rerouting funds into the fixed income market. Consequently, average yields for the Kenyan sovereign bond further declined. Also, the Central Bank of Kenya had two successive rate cuts in March and April 2020 (from 8.25% to 7.25% in March and from 7.25% to 7.00% in April). This resulted in a decline in the overall rate environment (rate on loans from commercial banks, overdraft rates, average deposit rates, interbank rates and commercial bank saving rates).

Meanwhile, from Q3:2021, yields began to rise steadily. This was largely due to the diversification of funds into riskier alternatives, as investors' outlook for growth improved. The steady rise in yields persisted into year 2021.

So far in 2022, average bond yields have continued to increase (from 12.17% as at the last trading day of year 2021 to 12.34% as at the 19th of May 2022.

While Inflation has been a burden for monetary authorities across Sub-Saharan Africa, (mostly shooting above Central Banks threshold), inflation in Kenya (average of; 2019: 5.20%, 2020: 5.29%, 2021: 6.11% and 2022: 5.63%) has remained within the Kenyan Central Bank's target band of 2.50%-7.50%. Furthermore, real rate of return has remained positive across both long- and short-term treasury instrument in Kenya.

5-year Historical Average Bond Yield



Source: Bloomberg, Meristem Research

SOUTH AFRICA

Background

South Africa is one of the largest economies in Africa by GDP (USD384.67bn as of 2021). By 2021FY, the economy had rebounded from the Coronavirus-induced contraction in the prior year (-6.43%), as GDP expanded by 4.90% YoY. This growth rate, which is the highest in 14 years, was largely driven by the expansion in its agriculture and manufacturing sectors.

Despite this faster rebound, its fiscal position remains precarious. In 2021, fiscal deficit to GDP surged to 10.03% (from 5.06% in 2020). The country's debt statistics depicts an increasing debt burden (USD42.73bn in 2021 vs USD28.74bn in 2020), as total debt rose significantly to 70.70% of GDP by 2021 (from 57.40% in the previous period). In addition, its debt service to revenue ratio has increased over the years, hitting 18.78% in 2021 (vs 5-year average of 13.58%). The steady rise in debt stock over the years, in addition to the country's weak revenue profile and consequent high debt service ratio, remain key risk areas where investors' confidence is concerned.

The impact of the pandemic on the country's fiscal sustainability impinged on the country's credit ratings. Moody's downgraded the country's credit ratings to Ba2 in 2020 (from Ba1 in 2019), as the aforementioned concerns already cast a shadow of doubt on the Government's ability to meet its future obligations. Fitch further downgraded South Africa's creditworthiness to BB-, following the downgrade from BB+ in 2019 to BB in 2020. S&P also downgraded the country's long-term sovereign credit ratings from BB to BB- in 2020.

Macroeconomic Fundamentals	
Total 2022 Budget	**USD143.54bn**
Budget Deficit	USD24.58bn
Deficit % of GDP (2022)	5.69%
Budget Deficit Mix	
Domestic	62.91%
Foreign	22.11%
Debt to GDP Ratio	69.50%
Debt Service to Revenue Ratio	15.59%
Ratings	
Fitch	BB (Stable)
Moody's	Ba2 (Stable)
S&P	BB (Stable)

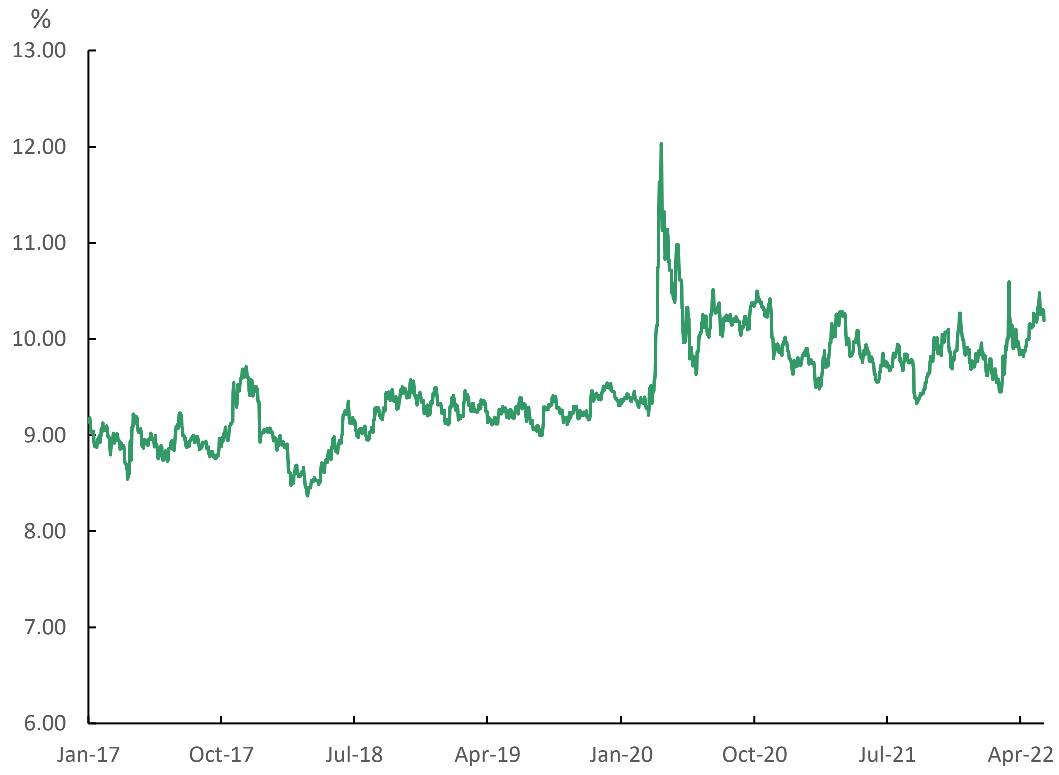
Source: South Africa Revised Budget 2022, Bloomberg, Meristem Research

BOND YIELD MOVEMENT

Since 2019, the average South African bond yields have been relatively stable. However, in March 2020, the average bond yields spiked to an all-time high (11.85%) - reflecting the sharp increase across the medium to long end of the curve. This spike was chiefly influenced by the Moody's credit downgrade and the aversion to emerging markets caused by the COVID-19 pandemic. However, following the lending rate cut and bond-buying programme launched by the nation's Central Bank in Q2:2020, yields moderated all through year 2020 and remained relatively stable in year 2021.

So far this year, the average South African Government Bond yields have risen by 41bps (from 9.79% as at the last trading day of year 2021 to 10.20% as at May 19, 2022). This is partly attributable to the growing inflationary pressures and the consequent negative real rate of returns. Also, we note the consecutive rate hikes by the South African Reserve Bank in January and March, which has also influenced the direction of yields.

5-year Historical Average Bond Yield



Source: Bloomberg, Meristem Research

CONCLUSION & OUTLOOK

Conclusively, we note that recent happenings have continued to favor an uptrend in yields in major Sub Saharan African (SSA) countries. Faster-than-expected surge in inflation and the expectations for hike in monetary policy rates in major countries have been the main driving factors. Thus, real returns remain depressed for most countries in the region.

For 2022FY, the direction of yields in major SSA countries remains uncertain as the predominant issues that have plagued the fixed income market in the region persist.

Specifically, in Nigeria, the direction of yield will be influenced by a couple of factors: expectation of a lower level of system liquidity, rising Government spending needs and correspondingly high budget deficit. Considering these factors, the general market expectation is for yields to rise, although with uneven changes across different maturity segments of the yield curve. While the international financing window through Eurobond issuance presents another deficit financing channel, investors pricing in hikes in policy rate in advanced countries and the increased domestic risks could make this a costly alternative. However, the use of the CBN Ways and Means window is a reckonable influence for a low rate.

Yields in the Ghanian fixed income market is also expected to remain elevated in the near term. This is premised on the country’s huge fiscal deficit, recent credit rating downgrade, and additional rate hikes in the year. On the flip side, the projections for additional revenue sources and a much-reduced pandemic-related expenditure as stated in its medium-term fiscal framework could put a moderation on the increase in yield.

For Kenya and South Africa, we expect yields to maintain its current uptrend, albeit at a slower pace. This is hinged on the current inflation trajectory in the countries, and the anticipation of additional rate hikes in the year.

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