Sub-Saharan Africa: Unlocking value in fixed income markets

Research views

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April 2018

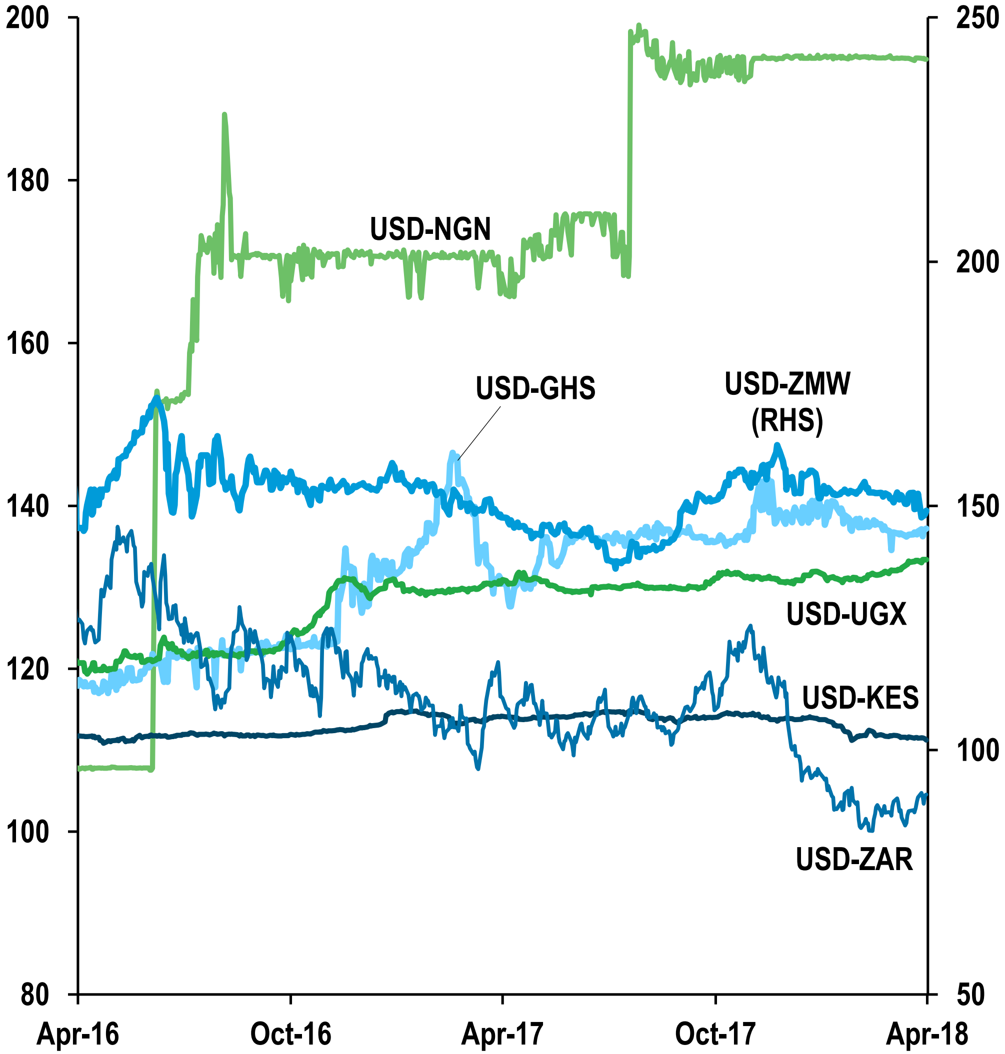
Key local market opportunities

Standard Chartered

SSA FX risks remain broadly contained for now

SSA exchange rates

FX, normalised levels, 1-Jan-14 = 100; USD-ZMW (RHS)



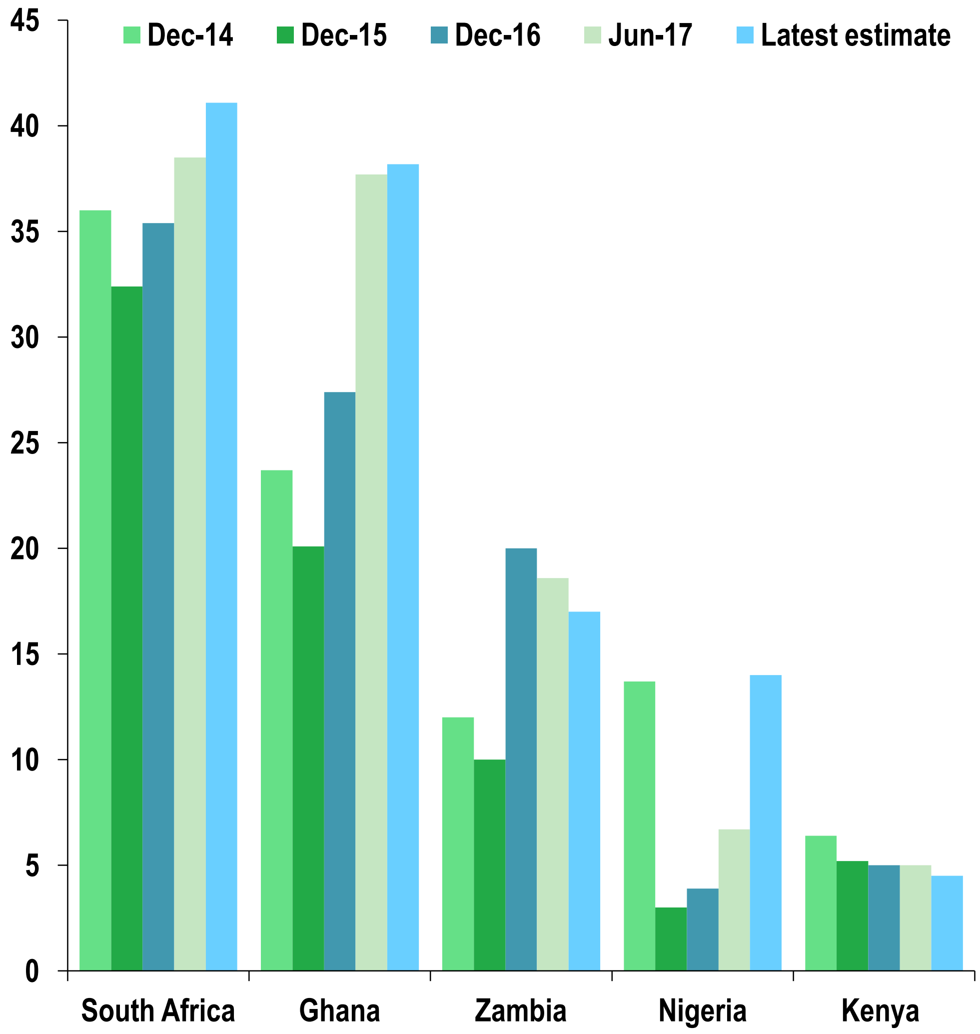
- Broad SSA FX resilience has been supported by a combination of external and idiosyncratic factors
- The ZAR has benefited from positive political, budget, rating and flow developments, in addition to a weak USD
- The launch of the I&E window in Nigeria, portfolio inflows, higher oil prices and a build-up of FX reserves have anchored USD-NGN stability
- GHS pressure is mitigated by fiscal and external rebalancing, confidence under an extended IMF programme and foreign bond purchases
- The KES has been supported by a soft USD, limited corporate demand and flows into infra bonds
- The UGX benefits from muted credit growth, despite risks from low rates and capex imports
- ZMW resilience reflects LHS FX flows, still-robust copper prices and limited demand; risks come from low FX reserves and public debt woes

Source: Bloomberg, Standard Chartered Research

Foreign investor appetite for SSA debt remains decent

Foreign participation in SSA debt markets

%

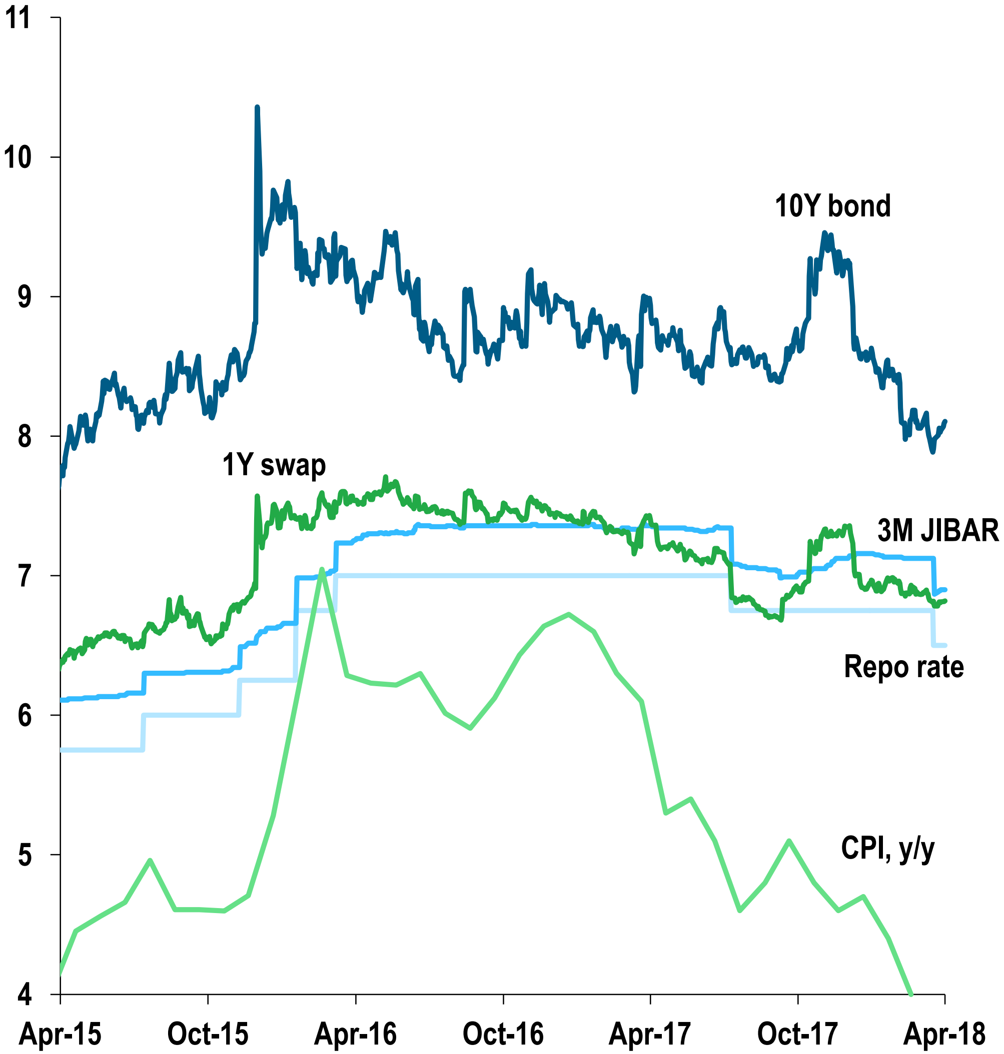


- Foreign bond purchases in SSA markets have been supported by the global search for yield, but overall EM debt fund flows and offshore buying of EM debt have been less consistent since mid-Q1-18
- South Africa has received USD 2.3bn of debt inflows since February amid a presidential power shift, decent budget reading and positive Moody's review
- The launch of Nigeria's I&E FX window contributed to large portfolio flows into T-bills and, to a lesser extent, bonds
- Ghana has very large foreign participation in its debt market (USD 6.2bn or 38.2%; 73-87% in 5Y-15Y)
- Foreign investor appetite for Kenya's infrastructure bonds has picked up, despite marginal offshore participation in regular bonds
- In Zambia, non-residents' debt holdings increased to USD 860mn in Q4-2017 (17.4% of the total stock)

South Africa – Attractive carry for EM fixed income investors

Rates and inflation in South Africa

%

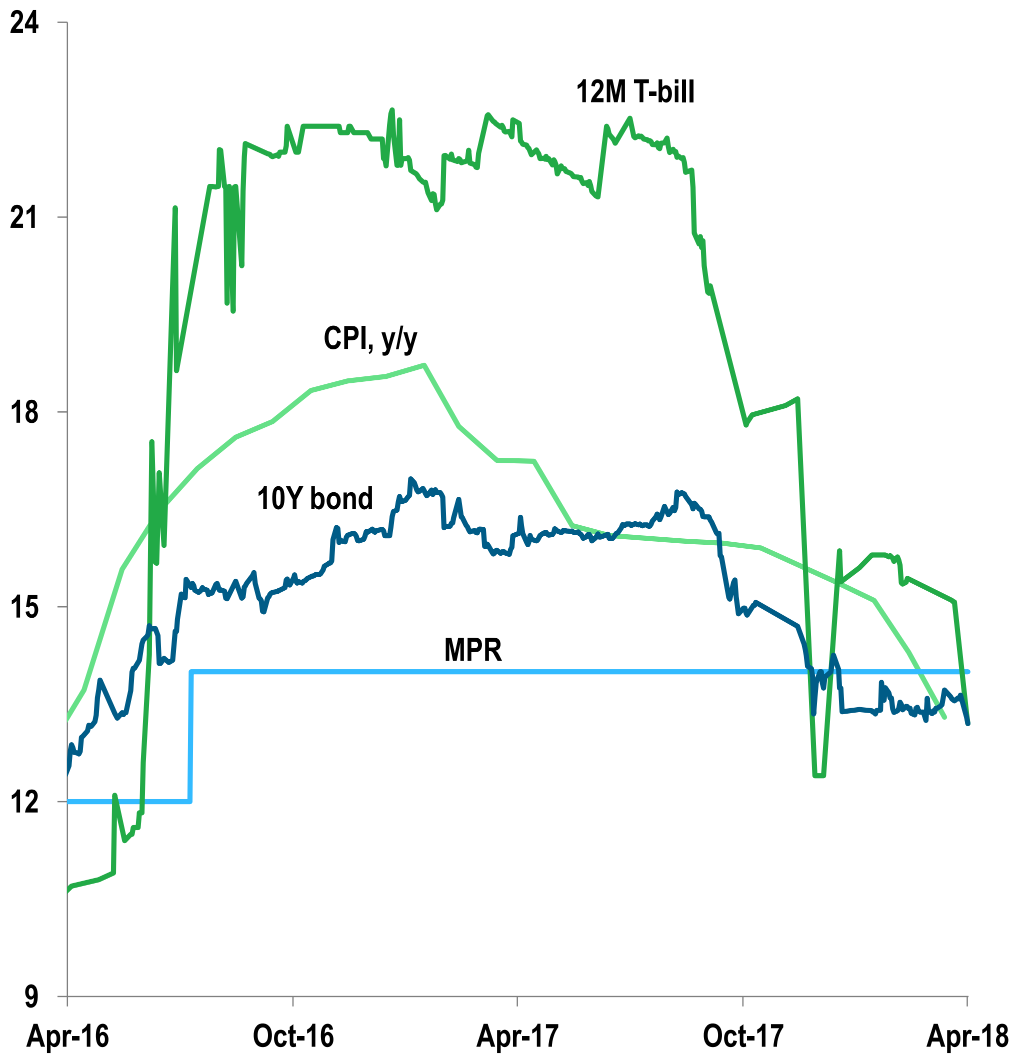


- In South Africa, bonds have consolidated recently (10Y: 8%) as investors lightened long positions after a significant rally in previous months
- A 25bps SARB rate cut on 28 March had little impact on the curve, but bonds initially reacted to reduced auction sizes and Moody's decision to affirm its Baa3 rating (which is required for WGBI inclusion)
- Although further price gains may prove challenging at relatively rich valuations, local bonds should offer attractive carry to global fixed income investors
- We see scope for 30Y/10Y to flatten from current levels (c.90bps) and would use unexpected switch auctions to re-enter such positions
- Bonds could outperform interest rate swaps further (current differential: c.42bps in 10Y), but the potential for pack compression is now more moderate

Nigeria – Managing the downward pressure on yields

Rates and inflation in Nigeria

%



- Outstanding OMO issuance has increased rapidly to mop up excess liquidity, and significantly exceeds the stock of regular T-bills (which has declined after recent Eurobond issuance)
- The CBN has allowed modestly lower OMO rates (c.15.4% for 245-day), but still-ample liquidity has pushed T-bill yields sharply down in the secondary market (12M: c.13%)
- In our view, the CBN may seek to avoid a collapse in local rates to prevent foreign profit-taking
- If yields back up as in early January, carry positions in 6-12M T-bills could become more appealing
- The CBN could ease formal monetary policy provided that inflation falls further (13.3% in March)
- Bond yields are closer to neutral nominal levels; duration gains could be supported by contained supply and a fall in short-dated rates, but price returns will likely be moderate from here
- GBI-EM re-inclusion looks unlikely in the near term

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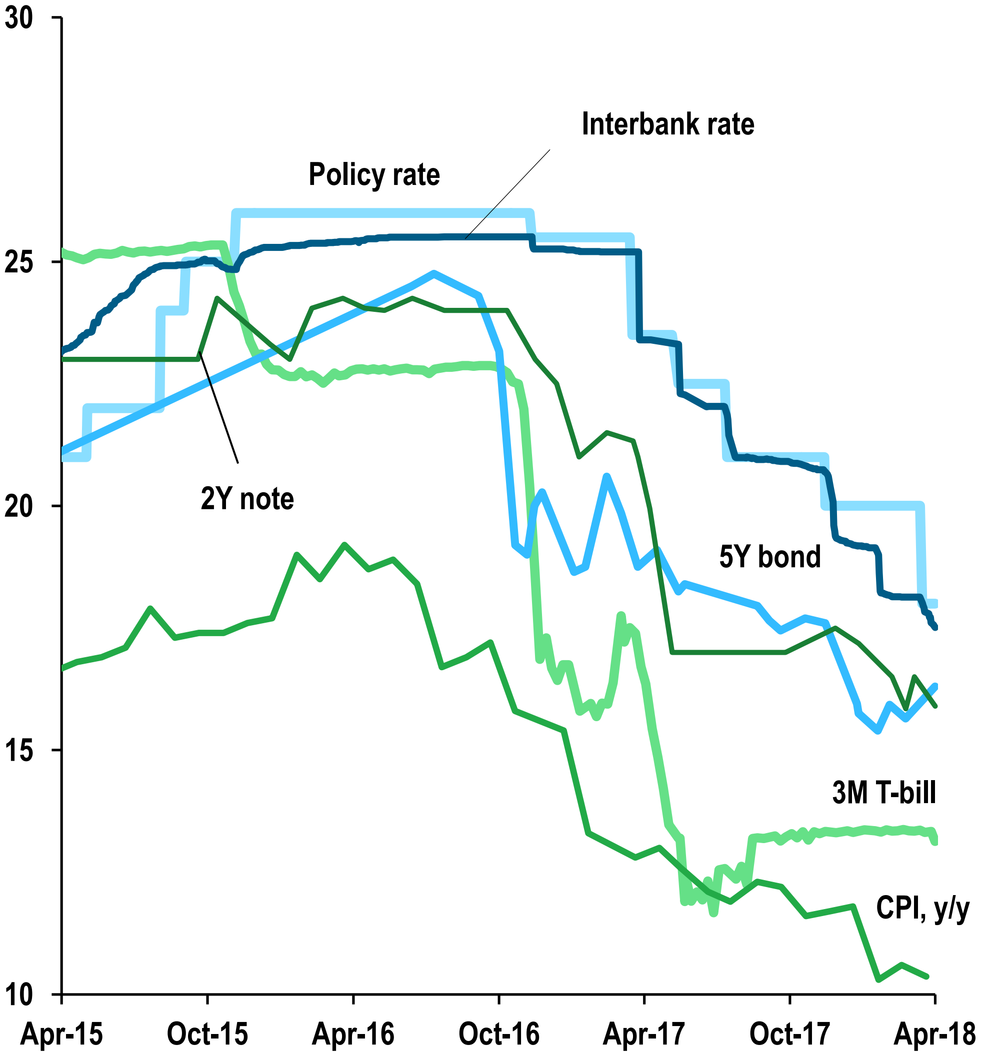
Source: Bloomberg, CBN, NBS, Standard Chartered Research

Ghana – Bonds should deliver value

Rates and inflation in Ghana

%



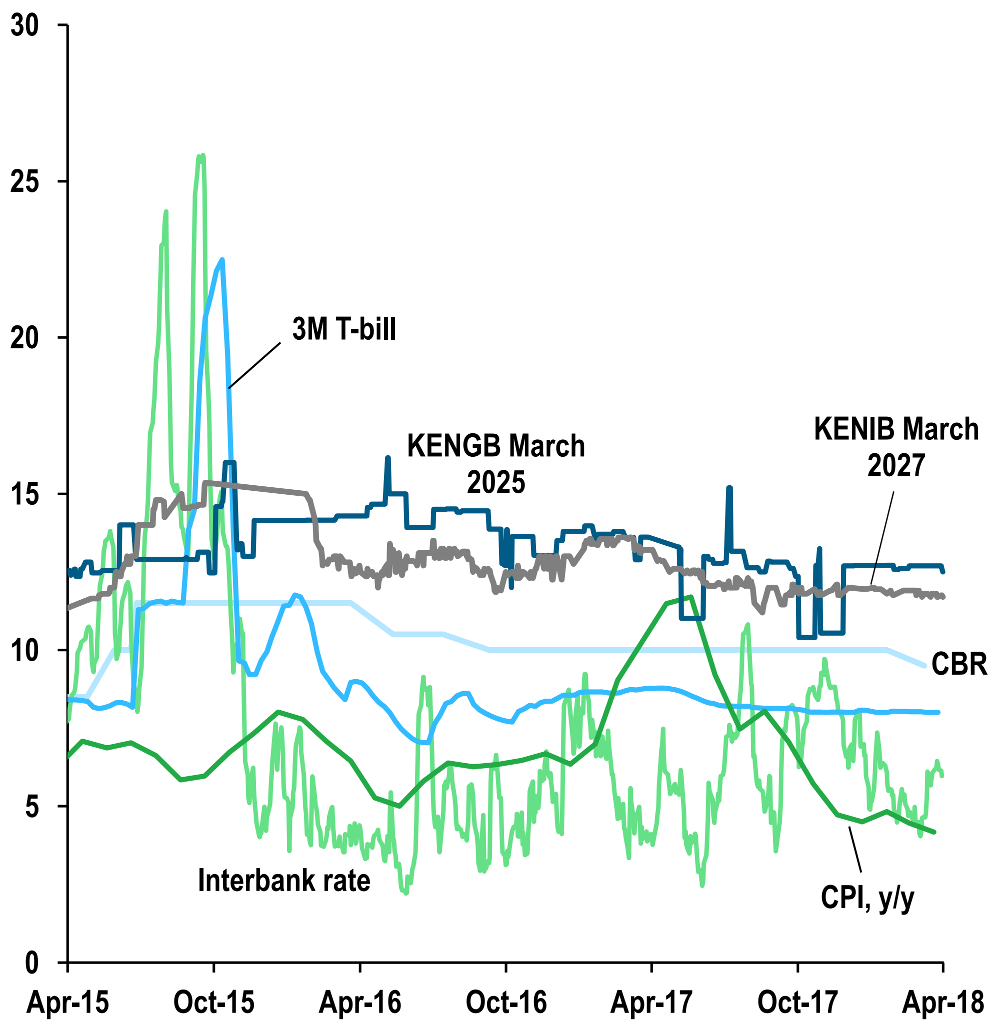
- In Ghana, the sharp rally in bonds since mid-2016 has lost steam after recent auctions cleared near the top of the price guidance and/or were overallocated
- A lack of issuance beyond 2Y in May could support the long end; 3Y/10Y bonds will be on offer in June
- Offshore demand remains strong amid improved fundamentals; pension fund demand has also increased given new investment guidelines
- Carry will likely drive returns from current levels, but BoG easing, muted inflation and GHS resilience could contribute to moderate duration gains
- Given crowded foreign positioning in bonds, a position in the 2Y note would also help diversify risk exposure
- ESLA bonds offer a pick-up over the sovereign

Source: Bloomberg, BoG, GSS, Standard Chartered Research

Kenya – Infrastructure bonds offer low-volatility carry

Rates and inflation in Kenya

%



- Dovish CBK policy, supportive liquidity and limited tolerance for higher market rates could anchor carry in bonds
- A net KES 269bn has been issued YTD in FY18 (ends June 2018), versus a target of KES 294bn
- (Offshore) demand for tax-free infrastructure bonds has been strong, but regular bond sales have often been undersubscribed
- Investors can lock in a modest primary market premium at the infrastructure bond auctions
- Upside risks to yields could come from a relaxation of the lending rate cap (CBR+400bps), although credit growth may take time to recover and bond auctions will still likely be managed

Source: Bloomberg, CBK, KNBS, Standard Chartered Research

Credit market opportunities

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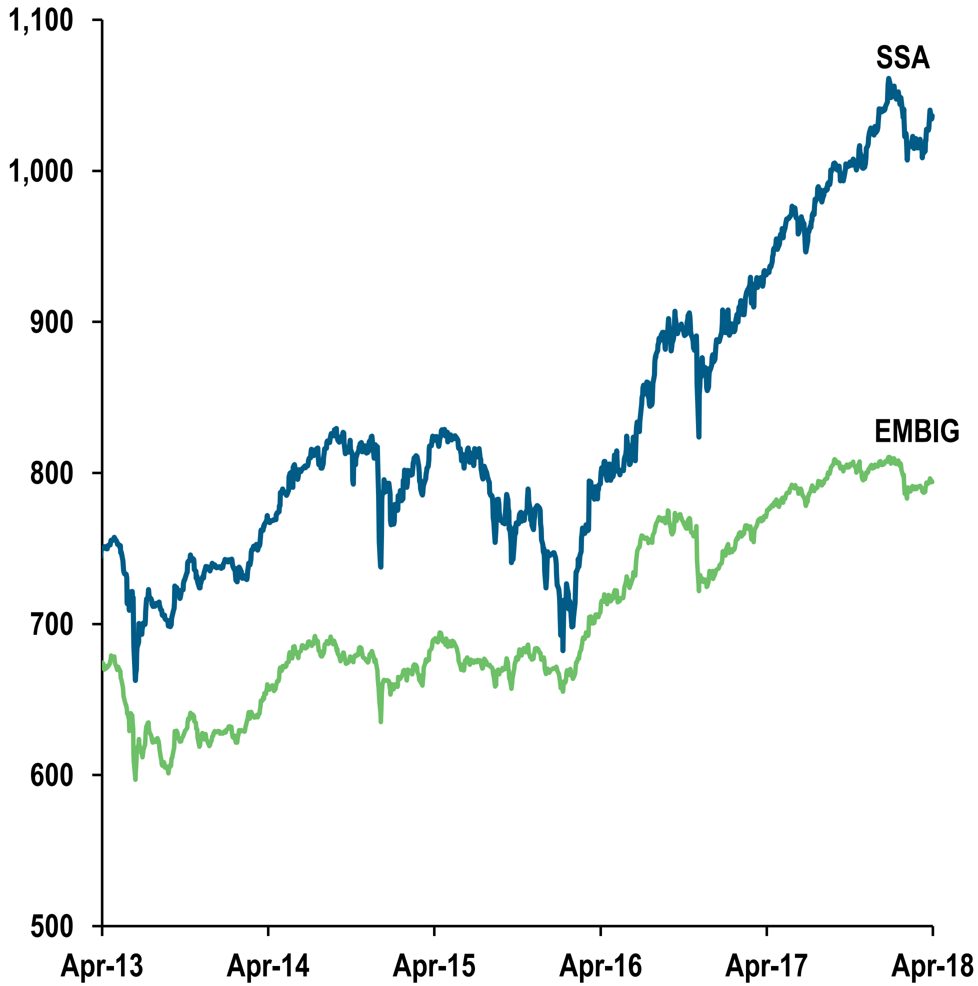
SSA Eurobond returns could moderate in 2018

EMBIG versus SSA total Eurobond returns
Index



- Africa posted robust total returns in 2017, outperforming other regions in the EMBI Global and high-yield credits as a whole
- Price returns are still negative YTD (amid higher UST yields until February), but have turned positive over the past month
- SSA carry remains decent; this may offset less favourable price performance in 2018
- EM HC debt fund flows have been less consistent and more volatile in Q1-2018
- Yet significant demand for primary-market issues points to still-substantial global liquidity
- Investors will likely focus on carry, value optimisation in new issues, buy-on-dips opportunities and select RV trades

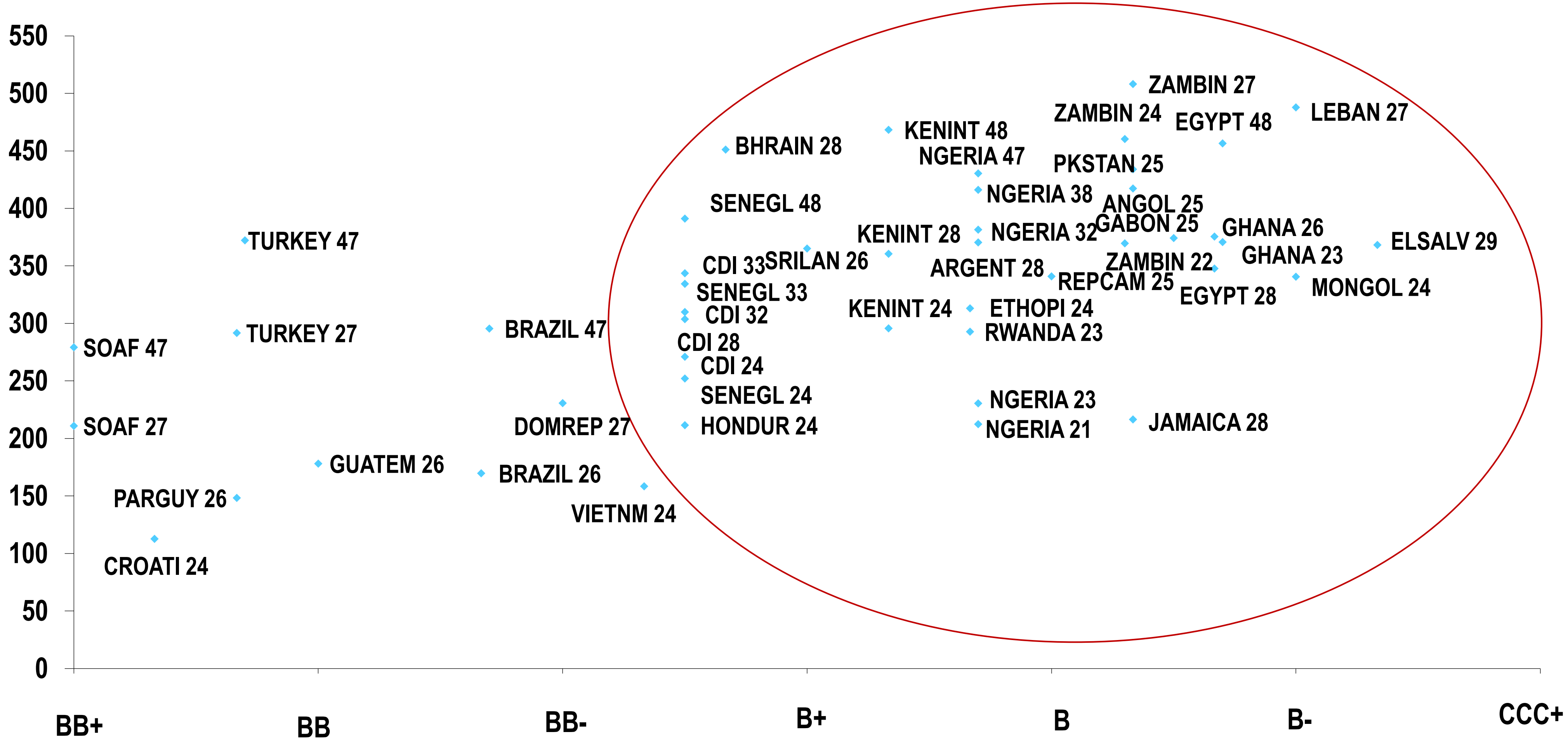
Standard Chartered

Source: Bloomberg, Standard Chartered Research

SSA credit spread differentiation persists, despite close ratings

Eurobond spreads versus ratings

Z-spread (bps); average credit rating

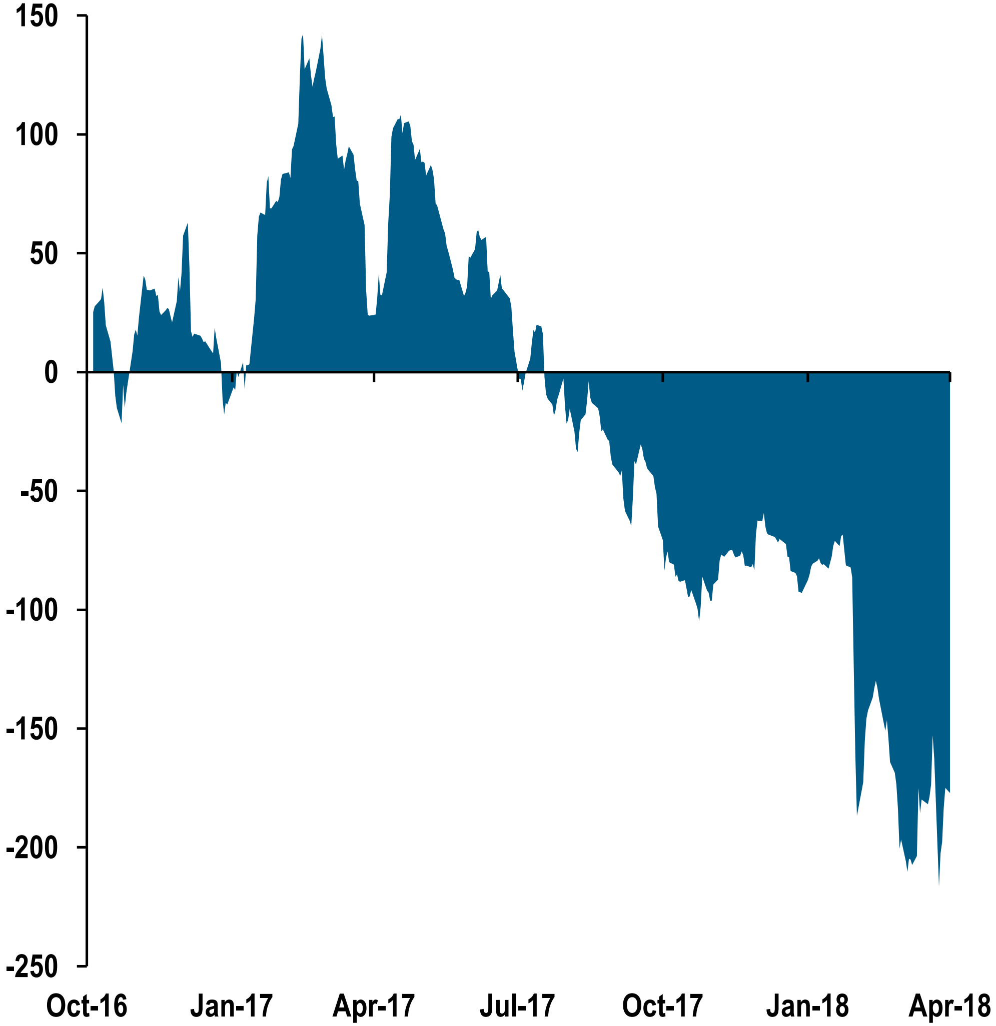


Source: Bloomberg, Standard Chartered Research

ZAMBIN cheapens on delayed IMF programme discussions

GHANA 22/ZAMBIN 22 spread

Z-spread differential, bps

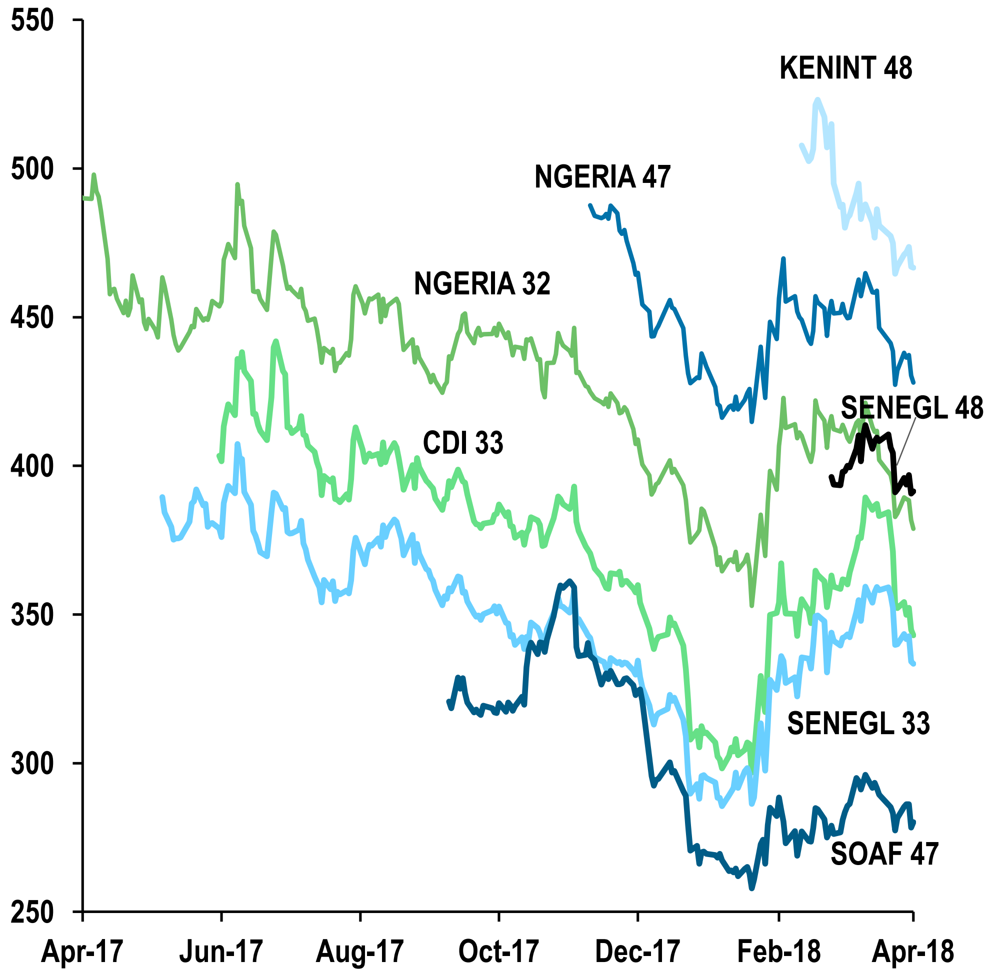


- The ZAMBIN complex has underperformed until recently on delayed IMF programme discussions and uncertainty around FCY debt sustainability
- ZAMBIN bonds are now trading significantly wide to GHANA and most comparable SSA issuers
- Recent Finance Ministry comments have sought to reassure investors and could help to contain spreads
- At first glance, ZAMBIN has cheapened in a still-expensive EM credit universe, which justifies an opportunistic *Overweight* position
- But can it cheapen further in the absence of an IMF deal?

Long-dated NGERIA bonds still trade wide to selected peers

Eurobond spreads

Z-spread, bps

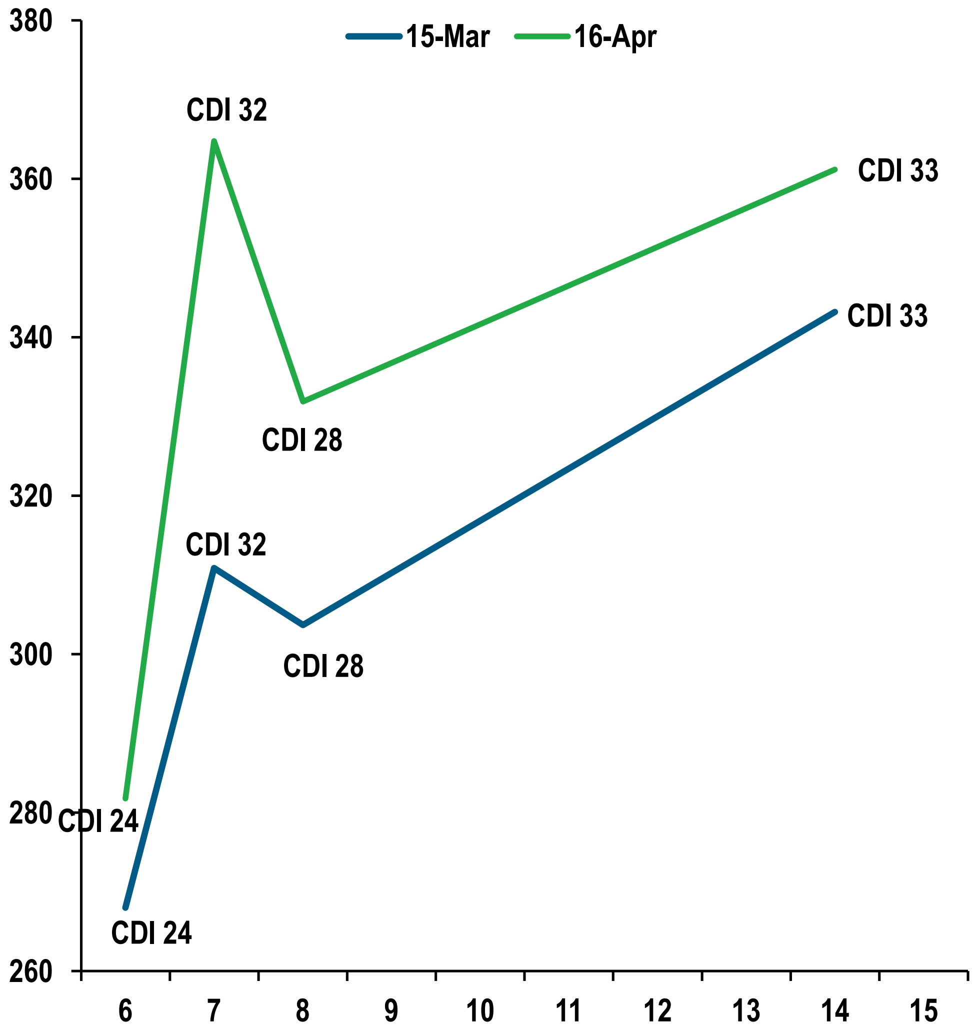


- NGERIA 32 and 47 still trade wide to selected peers (for example CDI and SENEGL), despite higher oil prices and a relative improvement in fundamentals
- This may reflect Nigeria's lower sovereign ratings (B2/B/B+)
- That said, Nigeria's FCY debt service remains marginal, while the CBN has built up substantial FX reserves
- New issuance should be easily absorbed by the market (c.NGN 850bn earmarked for FCY borrowing in the 2018 draft budget)
- We see room for NGERIA 32 and 47 to gain on an RV basis

Focus on the CDI complex

CDI USD Eurobond curve

Z-spread (bps) versus average life

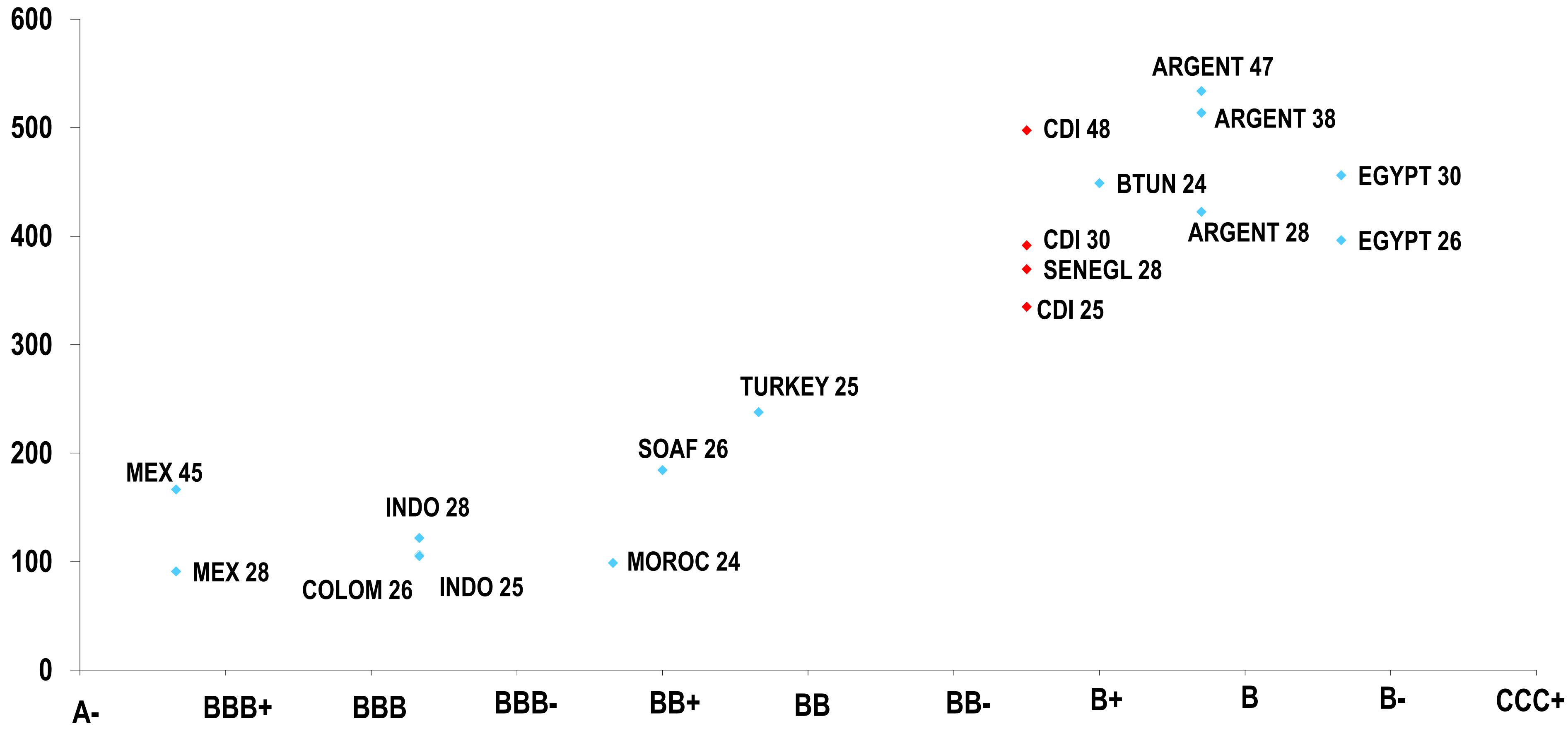


- CDI 32 has outperformed CDI 28 and CDI 33 over the past month as the risk of optional redemption/liability management in June dissipated after recent EUR issuance
- Given CDI 32's enhanced amortisation structure, it has a shorter average life than CDI 28 and CDI 33
- However, in a better-supported risk environment, the price could be sticky around the 100 level
- We think the CDI complex should trade modestly tight to SENEGL
- CDI 48 appears to offer pockets of value given the steep CDI EUR curve

SSA EUR issuance has been well received by the market

EUR-Eurobond spreads versus ratings

Z-spread (bps); average credit rating



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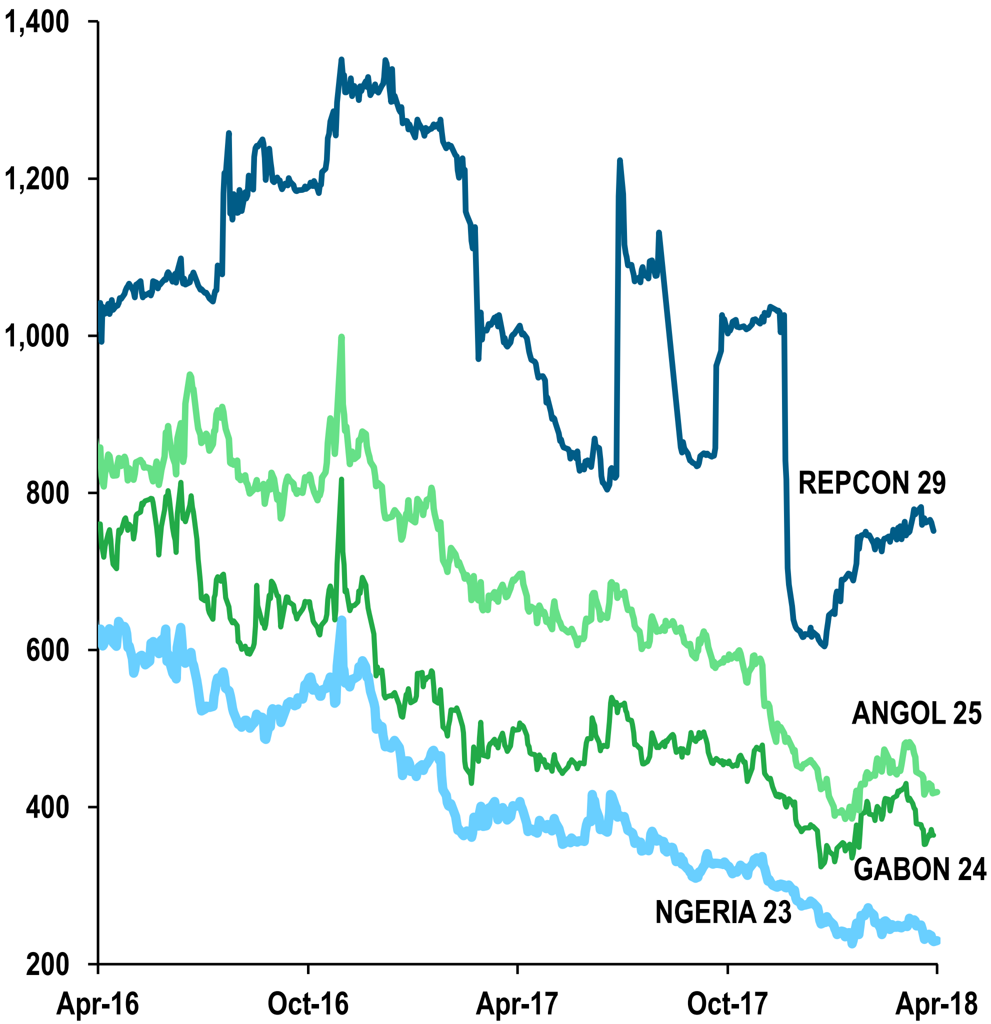
Source: Bloomberg, Standard Chartered Research

Further ANGOL 25 RV gains could be modest

Eurobonds issued by SSA oil producers

Z-spread, bps



- ANGOL 25 outperformed mainstream SSA oil peers in late 2017 on expectations of reforms, AOA devaluation and a funded IMF programme
- The bond has underperformed NGERIA YTD (at least until recently)
- RV gains could be moderate from here as ANGOL 25 only trades 26bps wide to GABON 25, but the complex offers attractive carry in the SSA Eurobond space
- AOA devaluation is insufficient to address FX shortages and ensure significant macro rebalancing
- An IMF PCI could help anchor confidence, but a funded programme looks unlikely amid higher oil prices and recent FCY (re)financing, despite risks from low net FX reserves

Standard Chartered

Source: Bloomberg, Standard Chartered Research

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	Standard Chartered terminology	Impact	Definition
Issuer – Credit outlook	Positive Stable Negative	Improve Remain stable Deteriorate	We expect the fundamental credit profile of the issuer to <Impact> over the next 12 months

Standard Chartered Research offers trade ideas with outright Buy or Sell recommendations on bonds as well as pair trade recommendations among bonds and/or CDS. In Trading Recommendations/Ideas/Notes, the time horizon is dependent on prevailing market conditions and may or may not include price targets.

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