Ethiopia's Billion-Dollar Sovereign Bond: Recent Performance and Outlook

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Ethiopia's billion-dollar sovereign bond issued in December 2014 is the country's only debt instrument trading in global capital markets. As such, the bond is the sole Ethiopian financial instrument with a credit rating from the three main global credit agencies, thus setting a floor for borrowing costs by any other potential Ethiopian issuers. Of additional interest, the bond provides a daily indication—through its changing prices and yields—of global market sentiment towards Ethiopia.

In this context, we review the bond's performance over the four years since its issuance and find the following:

- **Size:** With only a single bond issued in 2014 and no additional issues since, Ethiopia shows among the lowest levels of Eurobond debt among African countries—in absolute and relative terms.
- **Rating**: Despite ups and downs in the macro/political landscape, the bond's credit rating has been stable in the past four years.
- **Bondholders:** US-based mutual funds are the largest group, including well-known emerging market investors (see pg 4).
- **Pricing and Yields:** The price of the bond (par value of 100) has moved from a low of 82 cents to a high of 107 cents, a swing of over 30 percent between the two extremes. Moving opposite to prices, yields were lowest in January 2018 (5.47%) and highest in January 2016 (9.68%), which we trace (approximately) to both emerging market developments and Ethiopia-specific factors.

Looking ahead, we consider three issues: (1) the likely direction of the bond's yields from here on; (2) the prospects of a second Eurobond issue, and; (3) the possibility of other tradeable Ethiopian bond issues in the near-term. We think that yields on the sole outstanding issue will trend downwards from here on (reflecting its scarcity value plus an improved balance of payments outlook) and that a second Euro-bond issue is unlikely (given policy preferences towards concessional loans). As for tradeable bonds by other Ethiopian issuers, this has now become a distinct possibility within the next two years (given announced plans for capital markets) and we expect that market-rate government securities, local corporate paper, and long-term private bank bonds would be among the first set of instruments within such a domestic bond market.

Ethiopia $1bn sovereign bond was issued in December 2014, in what was then a first-ever entry into global capital markets. The timing of the bond issuance was favourable, with 2014 marking a year of strong global growth (3.7 percent), low global interest rates (0.5 percent), and high flows of funds into emerging markets. Ethiopia followed other African countries that had just issued bonds in the preceding years ($1.5bn in 2011, $1.7bn in 2012, and $5.1bn in 2013). Per an ODI report on this topic, 2014 marked a peak year for African country bond issues with $6.5 billion issued in that year alone.[1] Key features of the Ethiopian sovereign bond (also known as a "Eurobond") are presented in Table 1.

Table 1: Ethiopia's Sovereign Bond: Summary of Key Terms

- Amount: USD 1 billion
- Orders Received: 3.2 billion (3.2x over-subscription)
- Coupon paid: 6.625 percent
- Due Date: December 2024
- Book-runners: JP Morgan and Deutschebank
- Annual Interest Payments: $66.25 million, or Birr 1.8bn billion for FY 2018-19
- Principal Payment: Bullet payment of $1 billion due December 2024
- Prospectus; 93 pages, publicly available on Irish Stock Exchange (see link below)

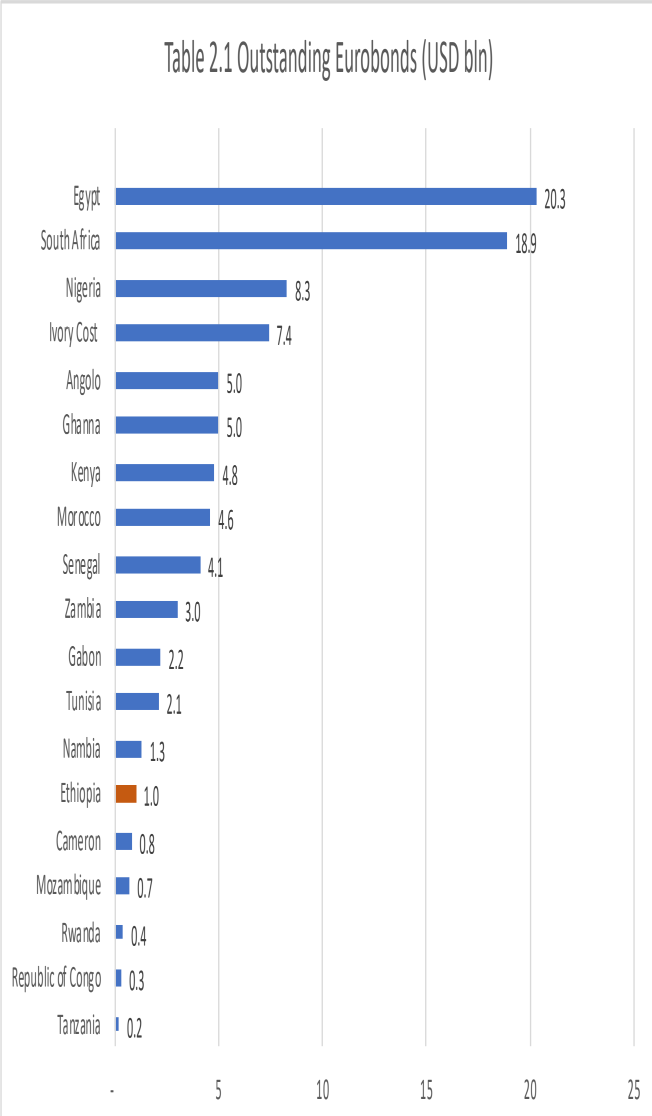
  https://www.ise.ie/Media/News-and-Events/2014/The-Federal-Democratic-Republic-of-Ethiopia-debt-prospectus-document-for-www-ise-ie.pdf

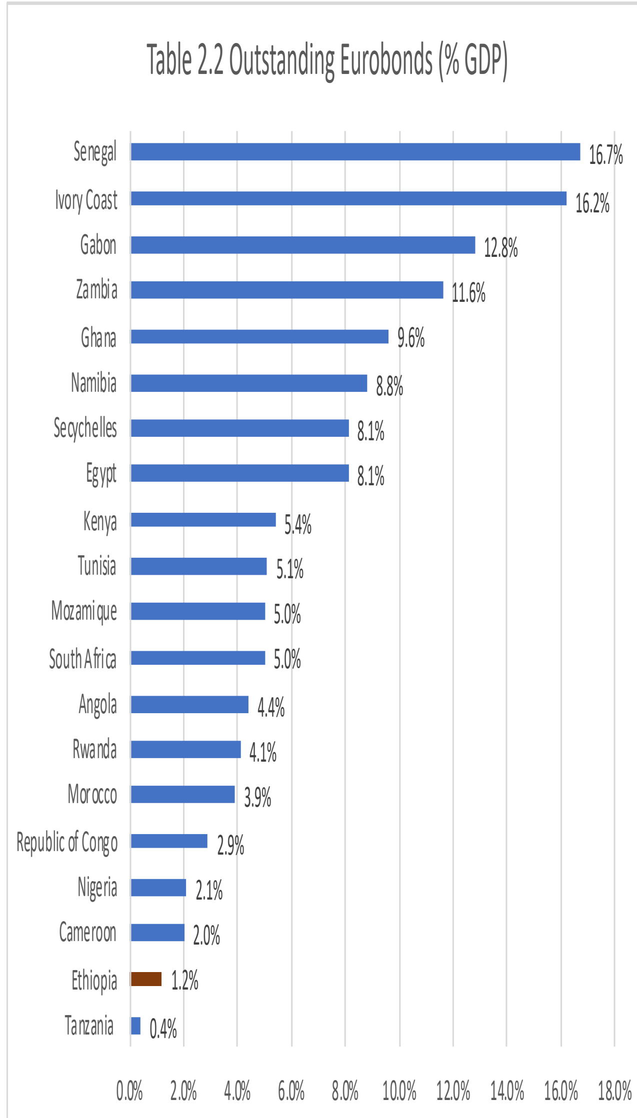
Source: Prospectus and press reports

With no additional bond issues since 2014, Ethiopia's outstanding stock Eurobond debt is among the lowest for African countries. In absolute terms, Ethiopia's $1 billion Eurobond is the 14th largest among African countries, and appears small compared to the size of outstanding Eurobonds in some peers such as Kenya ($4.8bn), Senegal ($4.1bn), Zambia ($3.0 bn)—not to mention the largest cases such as Nigeria ($8.3bn) or South Africa (18.9bn). Relative to GDP, Ethiopia shows the lowest stock of Eurobond issuance in the continent (after Tanzania), at just 1.4 percent of GDP versus a median Eurobond stock of 5.1 percent of GDP for other African countries.

[1] See ODI Paper "Sub-Saharan Africa International Sovereign Bonds" of January 2015.

Table 2: African Countries—Outstanding stock of Eurobonds





Source: Renaissance Capital, "African Eurobonds" Data as of October 2018

The holders of Ethiopia's sovereign bond are primarily US-based mutual funds and institutional investors, including some well-known emerging market investors. Per FactSet data as of September 2018, the largest holders were American Beacon Frontier Markets Fund ($125 million out of the $1 billion), Templeton Emerging Markets Bond Fund ($65 mn), Pictet ($51mn), and JP Morgan's Emerging Markets Bond Fund ($32 mn). For some of these investors, their holding of the Ethiopian Eurobond was a material share of their total portfolio—2 percent in the case of American Beacon. Twenty bondholders had at least $5 million in holdings, including active emerging market investors such as Ashmore, Blackrock, MFS, and Nordea. A listing of the 20 largest holders is provided in Table 3, as compiled in FactSet data.

Table 3: Holders of Ethiopia's Sovereign Bond

Rank	Name of Mutual Fund or ETF	% Total	Amount, $mn	% Portfolio
	Total- Top 20 Holders	**45.45**	**455**	**-**
1	American Beacon Global Evolution Frontier Markets Income Fund	12.45	125	1.986
2	FTIF SICAV - Templeton Emerging Markets Bond Fund	6.54	65	0.765
3	Pictet - Global Emerging Debt	5.11	51	0.957
4	iShares JPMorgan (USD) Emerging Markets Bond ETF	3.21	32	0.228
5	JPMorgan Funds - Emerging Markets Debt Fund	1.84	18	0.985
6	MFS Heritage Trust - Emerging Markets Debt Fund	1.84	18	0.313
7	Franklin Templeton Series II Funds - Em. Mkt. Debt Opps. II	1.80	18	1.896
8	iShares II Plc - JPMorgan (USD) Emerging Markets Bond	1.52	15	0.220
9	Ashmore SICAV - Emerging Markets Total Return Fund	1.47	15	0.468
10	Amundi Funds II - Emerging Markets Bond	1.37	14	0.237
11	M&G Investment Funds (3) OEIC - Emerging Markets Bond Fund	1.17	12	1.007
12	Ashmore SICAV - Emerging Markets Debt Fund	1.10	11	0.931
13	Deka - Multi Asset Income	0.97	10	0.814
14	JPMorgan Emerging Markets Debt Fund	0.86	9	0.959
15	MFS Meridian Funds - Emerging Markets Debt Fund	0.84	8	0.317
16	BlackRock Global Funds - Emerging Markets Bond	0.77	8	0.209
17	iShares VI Plc - JP Morgan (USD) EM Bond (EUR) Hedged	0.74	7	0.218
18	Multipartner SICAV - Invesco Cedola Emergente 2022	0.66	7	1.349
19	Nordea 1 - Emerging Market Bond Fund	0.61	6	0.309
20	Ashmore Emerging Markets Total Return Fund	0.59	6	0.453

Source: FactSet 2018

Partly reflecting the limited debt burden posed by Ethiopia's Eurobond debt, ratings agencies have kept stable their ratings on Ethiopia throughout the past four years. All three rating agencies have not changed their ratings on Ethiopia over the past four years: B for Standard and Poors; B1 for Moody's; and B for Fitch Ratings. It is also quite notable that the rating has not changed despite many ups and downs during the past four years, including on the political side (domestic unrest and instability in certain areas, two state of emergencies, a political transition in 2018) as well as on the economic side (including macroeconomic adjustments and major reform initiatives in 2017 and 2018).

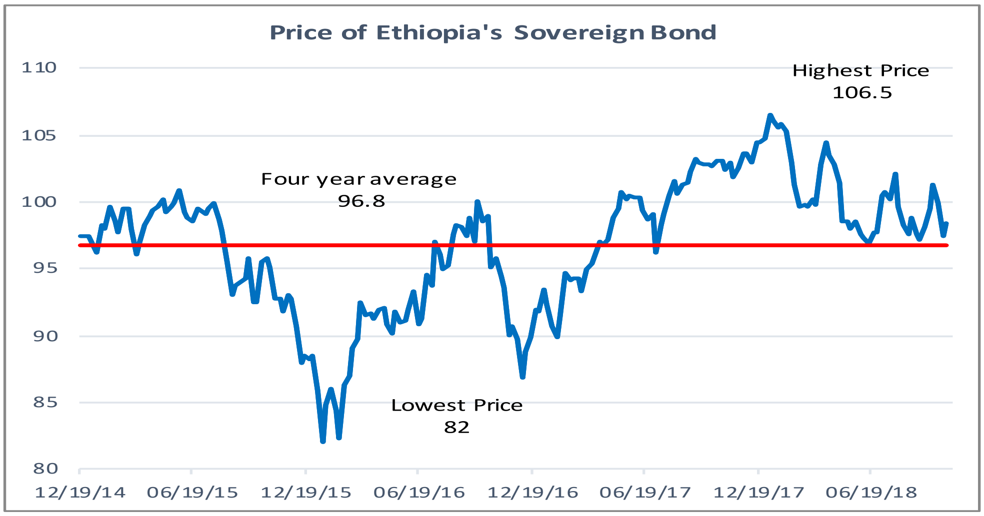
Table 4: Ethiopia's Sovereign Bond Ratings

Credit rating	2014	2015	2016	2017	2018
Moody's	B_1	B_1	B_1	B_1	B_1
S & P	B	B	B	B	B
Fitch	B	B	B	B	B

Source: Moody's, Standard & Poor's, Fitch

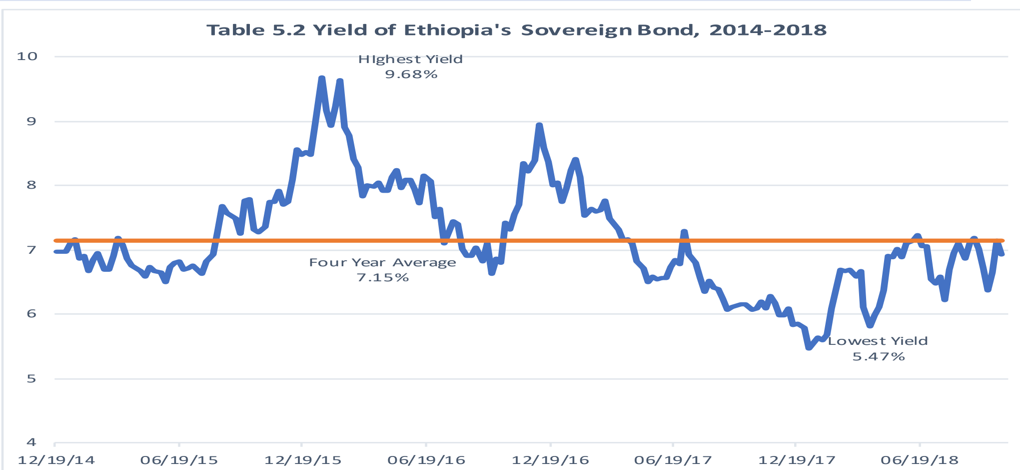
While ratings have stayed unchanged, the bond's price and yields showed notable movements over the past four years—with a swing of as much as 30 percent between the lows and highs. Ethiopia's bond yields have generally moved in line with broader emerging market yields. For example, the highest yield of 9.68 percent was recorded in January 2016, at a time when EM yields were at similarly elevated levels. At the same time, the lowest yield seen for Ethiopia's bond was the 5.47 percent recorded in January 2018, a period when emerging market yields were generally at multi-year lows (based on the EMBI yield measure that represents an average of emerging market sovereign bonds).

Table 5.1: Price of Ethiopia's Sovereign Bond



Source: FactSet

Table 5.2: Yield of Ethiopia's Sovereign Bond

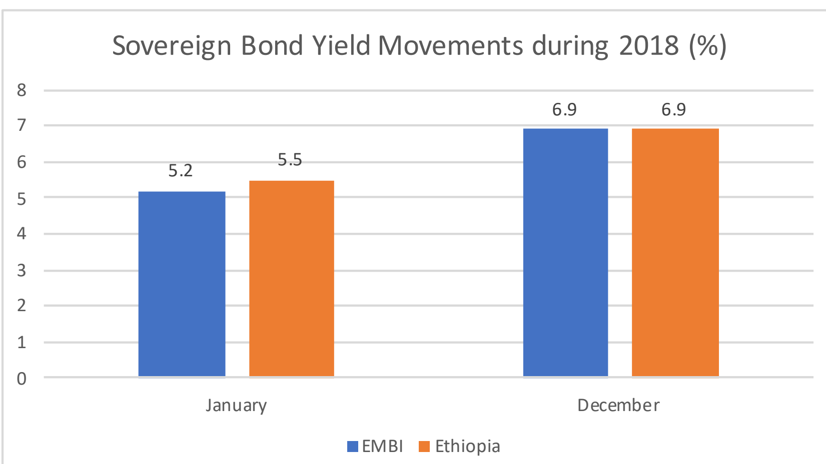


Source: FactSet

Looking at 2018 trends, the movement in yields seems to reflect both emerging market developments and Ethiopia-specific factors. After two years of declines in 2016 and 2017, Ethiopia's bond yield rose from around 5.5 percent in January 2018 to near 6.9 percent by December 2018, or a jump of 1.4 percentage points. Given major political developments in 2018, part of this increase might be taken as reflecting the political unrest at the start of the year (including an active state of emergency in place till June 2018) as well as uncertainties perceived by investors regarding the transition to a new administration. However, a review of other markets suggests that the rise in Ethiopia's yields actually coincides with broader emerging market trends (average EM yields also rose by around 1.5-2.0 percentage points during 2018), so it appears that external factors were also significant for 2018's observed rise in yields. Indeed, during the course of the year, Ethiopia's *spread* versus the average emerging market sovereign bond (EMBI Global) actually fell slightly, i.e., Ethiopia's bond yield was 0.3 percentage points higher than the average EM bond in early 2018 (thus suggesting it was viewed as that much 'riskier' than its peers) while it's yield now is roughly the same as the average EM sovereign bond.

Ethiopia's latest sovereign bond yield of 6.9 percent remains broadly favarable, when seen over the four-year period since its issuance and within a cross-country context. The lastest yield remains just below the 7.1 percent average yield since the bond's issuance in December 2014, and is thus very much in line with the historical average. Compared to other issuers, the end-2018 rate of 6.9 percent is also found to be better than or similar to those of countries such as Kenya (7.9%), Egypt (7.4%), Namibia (7.4%), Senegal (7.2%), and South Africa (6.9%).

Table 6: Bond Yield Movements during 2018: Ethiopia vs Emerging Markets Average



Source: Factset and CBonds

Looking ahead, we address three questions: (1) What direction are yields likely to move towards given the macro outlook? (2) Is a second Eurobond issue likely in the near-term, especially given Ethiopia's low Eurobond exposure compared to other African countries? and (3) Could non-sovereign bonds by private Ethiopian issuers be seen in the coming year or two?

Yields are likely to trend downwards over the coming year, but not by much in our view. The balance of payments outlook for 2018-19 is positive, given the likelihood for strong service export performance, rising remittances, and improved grant/concessional loan inflows. The current account deficit is also much improved in the last two years (with imports down from 25 to 17 percent of GDP) limiting debt sustainability risks. As long as the political environment remains relatively stable, an environment of continued strong growth and improving external position would tend to raise bond prices and reduce their yields (reflecting greater willingness by investors to accept country risk for a given coupon rate). On this basis, particularly our projections for surplus in the balance of payments surplus this year, we expect yields in 2019 will revert from the high of 6.9 percent seen in late 2018 towards the lower end of the 6.0 to 6.5 percent range seen during most of 2017.

With respect to the prospects for an additional Eurobond issuance, this remains quite unlikely in our view, even though Ethiopia's Eurobond exposure is low compared to its peers. As highlighted earlier, Ethiopia's Eurobond issuance so far is only $1 billion out of a total of about $26 billion in external debt (see Table 7), and issuing say another $1 billion issue would amount to adding only around 1 percent of GDP in extra debt (USD GDP is around $94 billion for the current 2018-19 fiscal year). However, despite this seemingly favorable backdrop, the debt servicing costs of a Eurobond are comparatively high, especially relative to World Bank and other concessional financing.[2] Moreover, against the background of a recent rise in debt service indicators, Ethiopia is also much more focused on seeking concessional loans, such as the $1.3 billion in World Bank financing concluded in late 2018 (with two similar-sized loan agreements from the World Bank are also likely over the next two years, per the World Bank loan documents). Given all of the above, we do not think a second Eurobond issuance is likely in the near-term, and especially not until exports pick up more markedly or one-off asset sales (privatization proceeds, telecom license sales) are arranged and completed.

[2] World Bank loans on IDA terms offers a 40-year maturity, a 10 year grace period, and an interest rate of 0.75 percent. For a $1 billion loan, the annual interest due on a World Bank loan would be approximately $7.5 million in the early years vs USD 66 million for a sovereign bond issue.

Table 7: Ethiopia's External Public Debt-- As of June 2018

	USD bns	% Total	% GDP
TOTAL	**25.9**	**100.0**	**32.35**
By lender:			
OFFICIAL LENDERS	**19.1**	**73.7**	**23.86**
Multilateral organizations	**10.5**	**40.5**	**13.10**
AfDF	1.9	7.4	2.38
IDA	7.8	30.0	9.70
IMF	0.1	0.4	0.11
Other multilaterals	0.7	0.0	0.91
Bilaterals (country governments)	**8.6**	**33.2**	**10.75**
Paris Club countries	0.5	2.1	0.68
Non-Paris Club (including China)	8.1	31.1	10.07
PRIVATE LENDERS	**6.8**	**26.3**	**8.50**
Commercial Banks	3.4	13.3	4.31
Suppliers credits	2.4	9.1	2.94
Bond and Notes Holders	1.0	3.9	1.25

Source: MoFEC

While a bond issue in the global capital market is unlikely in the coming years, an expanded set of domestic bond issues is now very much in prospect. Ethiopia's (little-known) existing domestic bond market currently involves state enterprise and regional government bonds issued at low interest rates for purchase by state-owned banks; these are, however, non-tradeable bonds that are held until maturity by the main buyer (Commercial Bank of Ethiopia). The size of this non-tradeable domestic bond market is already quite large, at Birr 291bn as of June 2018, or equivalent to around $10.7 bn or 13 percent of GDP (Table 8). Looking ahead, the existing domestic bond market is expected to be expanded by a new set of (market-based) issuers and instruments within the next two years, given policy announcements for the launch of capital markets by 2020. For this prospective domestic bond market, the following three groups are likely to be among the early instruments and issuers: (1) market-based securities issued by the federal government to finance part of its budget deficit; (2) local corporate paper by large firms; and (3) long-term bonds issued by private banks. As highlighted in our 2019 Macroeconomic Handbook, these three sources could—under certain plausible assumptions—raise as much as Birr 27bn within a few years of establishment. Collectively, the size of these emerging domestic bond issues could thus match (in Birr terms) the size of a $1 billion sovereign bond, though of course the funding in this case would be derived from domestic savers and be secured in local rather than foreign currency terms.

Table 8: Domestic Bond Issues--As of June 2018

	Birr bns
Public Enterprises	**245.5**
EEPCO	216.3
Railways Corporation	29.2
Regional Government	**45.9**
Oromia	0.4
Amhara	0.0
Tigray	0.1
SNNPRS	0.0
Addis Ababa City	45.3
Grand Total	**291.4**

Source: NBE

TABLE 9: Emerging Domestic Bond Prospects in Ethiopia: An Illustrative View of Potential Market Size

DEBT CAPITAL MARKETS, Estimated Birr Value in FY 2020-21	*Assumption*	Low est	High est	Mid-point
1 Market based government securities stock FY20, FY21		**8.3**	**9.9**	**9.1**
❏ Govt Deficits at 2.5% for FY20, FY21	*2.5%*			
❏ Govt Deficits at 3.0% for FY20, FY21	*3.0%*			
❏ Share of deficit financing from market securities	*10.0%*			
❏ Share of deficit financing from domestic sources	*50.0%*			
❏ Nominal GDP projection for FY20, FY21	*3,303*			
2 Private company bonds issued to domestic investors		**4.0**	**12.0**	**8.0**
❏ No of cos issuing bonds over three years, low-end	*20*			
❏ No of cos issuing bonds over three years, high-end	*30*			
❏ Average size of company bond issue, Birr bn, low-end	*0.2*			
❏ Average size of company bond issue, Birr bn, high-end	*0.4*			
3 Banks issuing bonds to domestic investors		**6.8**	**13.5**	**10.1**
❏ Banks issuing local bonds, FY 2019-2021	*8*			
❏ Average capital base in FY 2019-21, Birr bns	*4.2*			
❏ Bonds as percent of capital, low-end, Birr bns	*20%*			
❏ Bonds as percent of capital, high-end, Birr bns	*40%*			
			TOTAL--in Birr bns	**27.2**
			TOTAL--in % of FY18 GDP	**1.2%**
			TOTAL--in current USD bns	**$ 1.0**

Source: Cepheus Research