

Fixed income Monthly Update | April 2020

Demand back in the driving seat

Highlights from April

Demand returns to the fore in the bond market: In March, the bond market was dominated by foreign investors' selloffs which led to a 259bps surge in average bond yields. However, in April, domestic investors started to dominate the scene with their demand leading to decline in bond yields by 188bps to 9.71%. The issuances that have seen the most interest have been short tenor bonds, which coincidentally were some of the most sold off in March, including the Mar-2025(-374bps), Jan-2026(-307bps) and Mar-2024(-259bps). With NTB yields and bank deposit rates at much lower levels, bonds became the most attractive option for investors, hence the increase in domestic demand.

Demand was also strong in the primary market with subscription rate at the auction reaching the highest level of the year so far – 4.59x. The FG offered ₦60 billion at the auction with subscription coming in at ₦275.67 billion. The total amount sold was ₦176.06 billion with majority of that (₦156.06 billion) coming via the competitive bids. Average stop rate at this auction declined 66bps to 11.17%.

NTB yields surprisingly decline further: Contrary to our expectation of NTB yields staying relatively unchanged this month, yields actually declined further by 98bps (vs 33bps in March) to 2.70%. Despite the low rates, demand for NTBs remained constant during the month, bringing yields to new lows. Majority of the demand was seen in long tenor bills which fell by 127bps MoM. In the primary market, across 3 auctions, the FG rolled over ₦285.70 billion ignoring the high subscription of ₦564.64 billion, which translates to a subscription rate of 1.98x. This subscription rate is much lower than March's which averaged 2.76x over its two auctions. Similar to the bond auctions, the PMA stop rates declined also. In this case, they were down by 70bps from March's close of 3.43% to end April at 2.73%.

OMO demand rebounds: March was pretty quiet in the OMO market as demand dried up at the 2 auctions held, ₦250 billion was offered, total subscription at ₦130.11 billion (0.52x) and only ₦110.51 billion sold – and April started off in a similar vein. Over the first two auctions ₦160 billion was offered but subscription was a disappointing ₦74.35 billion (0.46x) and total sales at ₦43.35 billion. But there was a complete turnaround in the subsequent two auctions where ₦200 billion was offered and subscription was a very strong ₦457.76 billion (2.29x). Market sources tell us that the increased demand came from FPIs who sold off bonds in March but were unable to repatriate their funds and so reinvested in OMO while waiting for the FX market to pick back up. The total sales in April of ₦290 billion, however, represents just a fraction of the ₦519.12 billion that matured (figure excludes maturity for non-banks). Over the month, the 1-year stop rate declined 28bps to 12.71%.

Interest in FGN Eurobond resurface: Back in March, Eurobond yields spiked 674 bps MoM to 13.3%, following the plunge in crude oil prices and the credit ratings downgrade by Fitch during the period. However, tides turned in April as demand resurfaced across all issuances, with average yields dropping 184 bps MoM to 12.1% and posting the largest declines. Investors' interests resurfaced from the start of the April, particularly in the Jan-2049 (-184 bps) and Nov-2025 Eurobonds. In addition, the funding from IMF which was secured later in the month, further boost market confidence as the inflows is expected to provide the necessary boost to the reserves. As a result, investors were less worried about the government's ability to meet its obligations.

Table 1: Net PMA Issuances/ (Maturity) in billion naira

	OMO Issuances	NTB 91-day	NTB 182-day	NTB 364-day	NTB Total	Bond 5-year	Bond 7-year	Bond 10-year	Bond 15-year	Bond 30-year	Bond Total	NTB & Bond Total
Mar-19	1,094	-	-	-	0	39.8	62.15	20	-	-	121.95	122
Apr-19	397.7	-	-	-	0	6.81	-	37.43	-	53.16	97.4	97.4
May-19	367.12	-	-	-	0	27.38	-	35	-	48.93	111.31	43.91
Jun-19	49.6	-	-	-	0	28.99	-	36.36	-	31.49	96.84	96.84
Jul-19	484.5	-	-	-	0	28.19	7.23	-	-	51.4	86.82	86.82
Aug-19	-347	-	-	-	0	14.05	17.68	-	-	27.8	59.53	59.53
Sep-19	174	-	-	-	0	20.33	-	71.16	-	55.12	146.61	146.61
Oct-19	-495	-	-	-	0	32.11	-	64.4	-	46.3	142.81	142.81
Nov-19	-710	-	-	-	0	59.87	-	96.7	-	96.36	252.93	252.93
Dec-19	-2,043	-	-	-	0	67.34	-	86.84	-	133.22	287.4	287.4
Jan-20	-807	-	-	-	0	29.3	-	106.4	-	276.13	411.83	411.83
Feb-20	-1,206	-	-	-	0	55	-	65	-	40	-444	-444
Mar-20	-561	-	-	-	0	15	-	-	30	25	70	70
Apr-20	-452	-	-	-	0	40.07	-	-	82.25	53.74	176.06	176.06

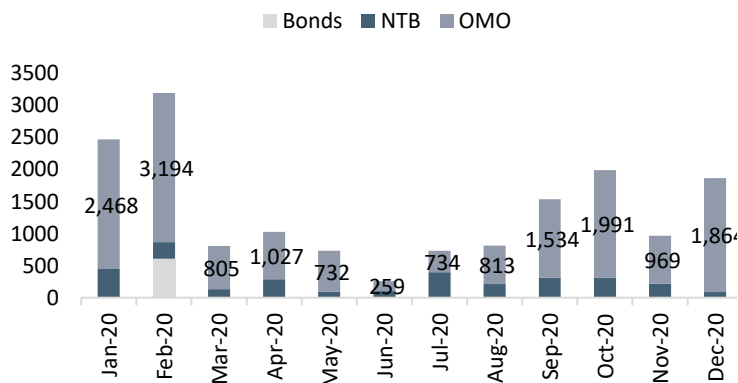
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Mar-19*	Apr-19*	May-19*	Jun-19*	Jul-19*	Aug-19*	Sept-19*	Oct-19*	Nov-19*	Dec-19*	Jan-20*	Feb-20*	March-20*	April-20*
OMO	13.04%	13.02%	12.78%	12.48%	11.84%	12.12%	12.29%	13.32%	13.30%	13.28%	13.09%	13.00%	12.99%	12.71%
NTB	11.82%	12.16%	11.58%	11.29%	10.87%	11.13%	12.05%	11.34%	8.15%	5.43%	4.51%	4.23%	3.65%	2.95%
BOND	13.50%	14.60%	14.28%	14.49%	13.70%	14.42%	14.49%	14.29%	12.77%	12.00%	11.18%	10.53%	11.83%	11.17%

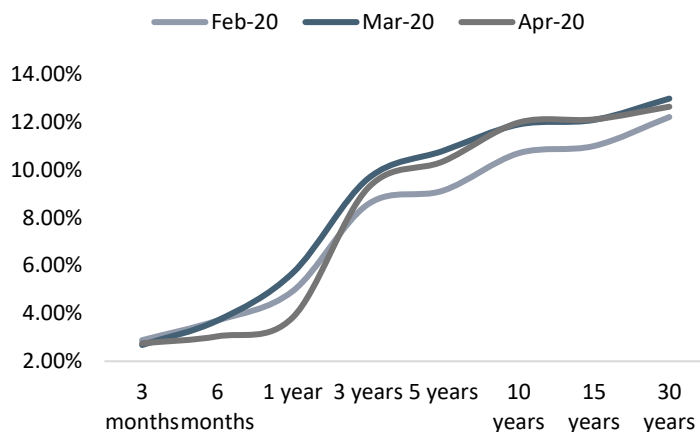
Source: FMDQ, ARM Research ** reflective of 1-year OMO bills

Figure 1: Maturity profile over 2020



Source:

Figure 2: Trend in Naira yield curve



Source: FMDQ, ARM Research

Outlook

The recent updates from the FG, some of which we fully expected, is expected to have a significant effect on fixed income yields in the coming months. To start, the FG released the details for the revised 2020 budget which shows a total deficit (including GOEs) of ₦5.19 trillion which is 2.39x the initial deficit (including GOEs) of ₦2.175 trillion. Meanwhile, amid the rising fiscal deficit, the FG obtained a \$3.4billion (₦1.22 trillion) loan from the IMF and is seeking an additional \$3.5 billion (₦1.26 trillion) from the World Bank and African Development Bank (AfDB). Additionally, the FG sought – and obtained – approval from the Senate to switch ₦850 billion, originally earmarked as foreign borrowings, to domestic borrowing. The effect of this was an increase in the planned domestic borrowing to ₦1.59 trillion and we see this having a significant impact on yields going forward.

So far this year, total net borrowings prints at ₦294.9 billion which means over the next 8 months, to meet its planned domestic borrowing target of ₦1.59 trillion, the FG will have to come to the market for a net amount of ₦1.31 trillion (gross: ₦3.05 trillion). Even with this increased domestic borrowing and loans from the IMF, and potentially the World Bank and AfDB, there is still a ₦1.12 trillion gap left in the budget, that still needs to be plugged.

As the FG moves to meet its domestic borrowing target, the increase in supply should lead to a rise in FI yields but that could slow towards the end of the year (especially Q4) as a result of the higher maturity profile. Total NTB and bond maturity for the rest of the year is ₦1.74 trillion, while the share of OMO maturity that belongs to PFA and banks is about ₦6.92 trillion – ₦4.8 trillion of these will mature in Q4. The higher demand resulting from this increased liquidity could place a ceiling on how high yields rise, especially for shorter term instruments (NTBs and short-tenor bonds) where we perceive majority of the interest would lie. That said, we see the plausibility of a mild uptick in yields over the next 4 months, as the FG ramps up borrowing and maturity over the period remain at their leanest. However, by September, when maturity jumps by 89%, we expect to see increased demand start to rein in the supply effect and push yields lower. That said, a risk to this outlook is the ₦ 1.12 trillion gap in the budget that we mentioned earlier; if the FG decided to plug this by further increasing domestic demand that could further increase the supply of FI instruments which would even raise rates higher than we anticipate.

In the Eurobonds market, we think current prices make an attractive entry point for investors. More so, as the need to gain exposure to dollar assets rise, amid devaluation of the naira. In addition, the recent funding by the IMF, and scope for even more FX inflows from the World bank and AfDB, are likely to give the necessary boost to the reserves and tame concerns on that front. Also, there has been a steady recovery in oil prices, we expect oil prices remain steady for the rest of the year (2020 forecast: \$40), as economies recover from impact of COVID-19. Thus, we see scope for increased demand in the FG's Eurobonds secondary market. However, it is worth stating, that the downside risk to our expectation lie in the volatility of the oil market which could reverse the recent gains in the oil prices and raise bearish sentiments in the Eurobonds market.

ARM Securities can purchase Treasury Bills and Bonds on your behalf. Rates quoted are indicative and will be firmed up upon client's confirmation. For enquiries contact:

ARM Securities

Research	234 (1) 2701653	research@armsecurities.com.ng
Institutional Sales & Trading	234 (1) 448 8833	trading@armsecurities.com.ng
Customer Service	234 (1) 4488282	customerservice@armsecurities.com.ng

[Please see our Disclaimer](#)