



Fixed income and Equity Monthly Update | February 2021

Recovery in rates continues strongly

Highlights from last month

Bond yields continue Northward sail: The renaissance in the bond market carried on into 2021 as the average bond yield rose 104bps MoM to print at 8.49% in February (January: +174bpsMoM). Despite the overall monthly rise, we saw downticks during the first and last weeks of the month, with yields declining by 7bps and 14bps respectively. This was probably a result of investors taking up buying positions in response to expanding yields seen across the curve. Specifically, in week 1, demand was directed towards the Mar-2036 and Feb-2028 instruments which shed 42bps and 35bps WoW respectively while in week 4, the Mar-2025 (-181bps) and Jan-2026 (-145bps) attracted the highest demand. Amongst individual bonds, the largest monthly selloffs were observed in the Apr-2029 (+188bps), Jul-2030 (+169bps) and Feb-2028 (+161bps) papers.

Demand still subdued at bond auctions: At the primary auction, just as in January, the DMO once again offered a total of ₦150.00 billion across the 10-year, 15-year and 25-year instruments. The offer attracted some level of demand with a subscription rate of 1.26x (total subscription: ₦189.5 billion), although lower than January's subscription rate of 1.95x. The total sold in February came in at ₦202.55 billion which is more than the offered amount and also more than what was sold in January (₦170.36 billion). However, 60% of that sale (₦122 billion) occurred via non-competitive allotments compared to 28% (₦48 billion) in January's auction. Meanwhile, the average stop rate jumped 254bps to 11.1%. Overall, the upward pressures on yields generally reflects the expansion at the primary market.

NTB yields also recover further: In a similar trend to what we saw in the bond space, the average NTB yield firmed 44bps to 1.49% in February (January: +57bpsMoM). Anchoring the rise were upticks in the 182-day (+102bps) and 360-day (+90bps) bills. At the two auctions that took place during the month, the DMO offered a cumulative ₦298.00 billion worth of treasury bills, the same amount that matured in February. At the first auction, ₦169.78 billion was offered but ₦130.88 billion was sold, despite a total subscription of ₦198.7 billion (subscription rate of 1.17x), while average stop rate rose 105bps to 2.33%. At the second and final auction, the DMO offered ₦128.21 billion, while total subscription was down to ₦192.06 billion, resulting in a subscription rate of 1.49x. Meanwhile, the average stop rate rose once again, this time by 134bps to 3.67%.

OMO issuances remain low: In the OMO space the CBN continued to wind down their balance sheet by reissuing only a fraction of the total maturity at auctions. A total of ₦746.12 billion (Jan: ₦460 billion) was sold over the four auctions that took place in February, despite a total offering of ₦780 billion (Jan: ₦455 billion), while ₦1.1 trillion worth of OMO bills matured (Jan: ₦1.04 billion). Notably, the Central Bank hiked the one-year stop rate by 436bps to 10.1% (467bps across all tenors to an average of 8.53%), a move aimed at retaining the interest of foreign investors. Consequently, this saw yields in the NTB space trend higher on the back of selloffs, as investors switched their attention to the higher yielding OMO bills.

Table 1: Net PMA Issuances) in billion naira

	OMO Net Issuances	NTB Net Issuance	Bond Apr-26	Bond Mar-37	Bond Apr-29	Bond Mar-35	Bond Jul-45	Bond Mar-50	Bond Total
Jul-20	-736	0	25.00			42.00	75.00	36.52	178.52
Aug-20	-641	0	33.42			22.95	16.09	53.69	126.15
Sep-20	-944	-40	69.31			25.43	6.81	4.6	106.15
Oct-20	-1,329	0				22.50	27.50		50
Nov-20	-602	0				40.00	40.00		80
Dec-20	-1,452	0				20.00	10.00		30
Jan-21	-583	-129		70.90		83.43	16.03		170.36
Feb-21	-351	-20		85.62		98.90	18.03		202.55

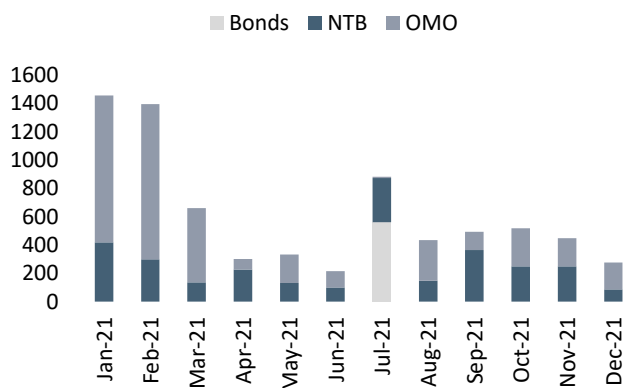
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

Rate as end of	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21
1yr OMO	13.09%	13.00%	12.99%	12.71%	9.90%	8.99%	8.99%	8.94%	8.70%	7.50%	7.50%	5.80%	5.74%	10.10%
Avg NTB	4.83%	4.23%	3.43%	2.73%	3.06%	2.53%	2.03%	2.10%	1.79%	0.61%	0.09%	0.58%	1.28%	3.67%
Avg BOND	11.18%	10.53%	11.83%	11.17%	11.17%	10.38%	8.81%	8.93%	8.09%	5.49%	5.39%	6.97%	8.56%	11.10%

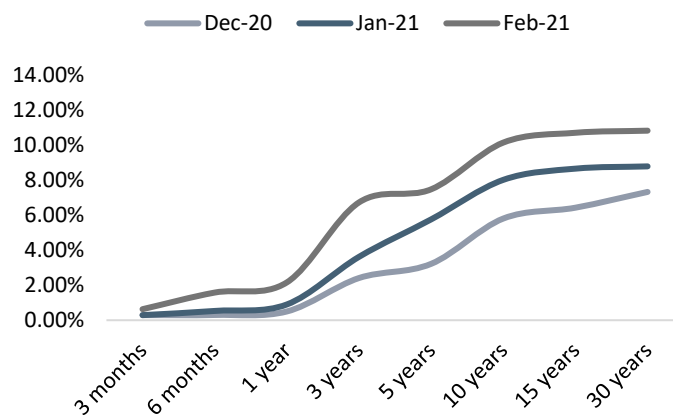
Source: FMDQ, ARM Research

Figure 1: 2021 Maturity profile (billion naira)



Source: FMDQ, ARM Research

Figure 2: Trend in Naira yield curve



Outlook

A couple of developments in the fixed income market over the past two of months has forced us to revise our forecast for yield direction over FY21. Firstly, there have not been rollovers in the OMO market like we expected; over the first two months of the year the CBN has offered ₦1.07 trillion at their OMO auctions which is about 50% of the ₦2.14 trillion that matured over the same period and they have sold ₦1.03 trillion. Still in the OMO market, the rise in the stop rates (the 1-year rate is up 430bps YTD to 10.1%) has been faster than we anticipated as we expected the CBN to keep rates lower for longer to reduce their borrowing costs. Rather, it seems they are focused more on attracting foreign investors and their precious FX hence the hike in the stop rates. Secondly, and more importantly, there has been lower demand at the NTB and bond auctions and what little interest has been present at these auctions has come at higher rates. This has meant that the DMO has been unable to sell its total offerings at the auctions and what they have sold they have sold at higher rates than what they probably would have expected. This has led to increases in the average stop rate at both the bond (+413bps YTD) and NTB (+309bps YTD) auctions.

What is helping the investors case, as they push back against the low rates and demand higher rates at the auction, is the awareness the FG needs to ramp up their borrowing. The FG have a domestic borrowing target of ₦2.34 trillion they need to meet and have only issued ₦373 billion of new borrowings so far. Additionally, it seems that the FG are going to stop relying on the backdoor funding from the CBN, which has been a reliable source of financing the last few years, after international organizations raised concerns about the process. The expectation now is that the FG would turn to more domestic borrowing to plug the hole left by the CBN turning off its financing tap. Last year it is estimated that they borrowed approx. ₦2.5 trillion via this backdoor means so going to the market to borrow even half of that on top of the original borrowing target would have huge implications for yields.

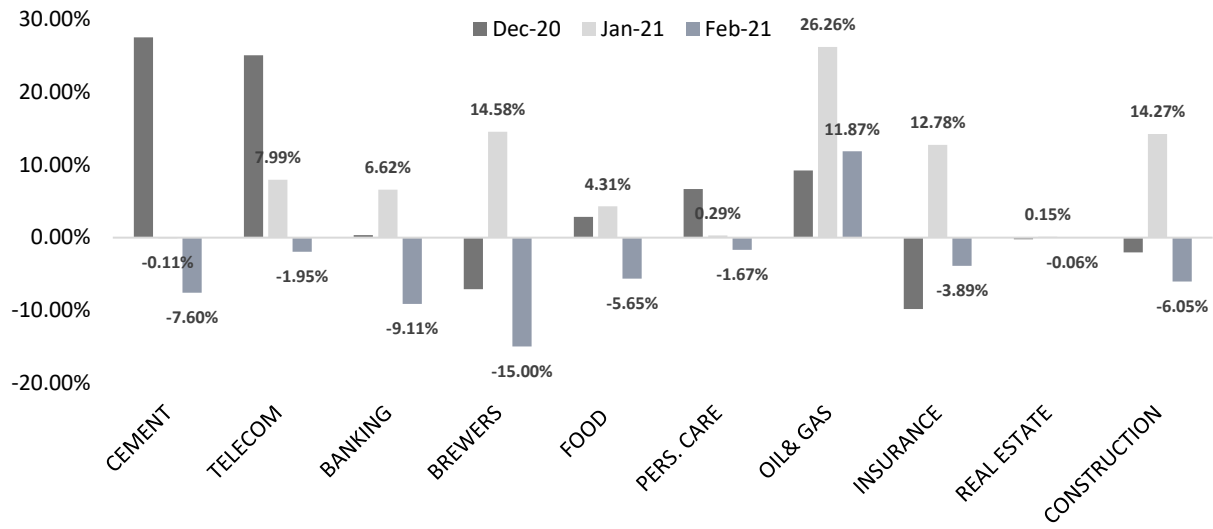
Investors pushing back in the auctions we have had so far this year has already led to higher primary market stop rates which has led to an upward repricing of secondary market yields. Any additional borrowing, to what was initially budgeted, would increase the supply of fixed income instruments which would make the high liquidity in the system less of an issue thus supporting higher yields. Barring any further surprises, the expectation now is for higher yields in 2021. But there are a lot of moving pieces and assumptions so the advice to investors is to stay short until the FG's stance on how they will make up for the loss of backdoor funding from the CBN is clearer.

Equities market set to trend southwards in H121

We see a need to review our equities market expectation for H121 following recent developments in the fixed income space. Surprisingly, we have seen an upward re-pricing in OMO yields in the secondary market very early in the year, which closed at an average of 6.29% at the end of February 2021, a significant jump compared to an average yield of 1.89% a month ago. Similarly, average yields in the fixed income space, according to data from FMDQ, has also shown material increase in February 2021 compared to the previous month. These combined with expectations for further devaluation in the Naira weighed negatively on investors' sentiments in the equities market leading the NSEASI to record its first monthly loss in the year 2021 in February where it declined by 6.16%. This followed a 5.32% MoM gains in January 2021 where we saw broad based improvement across different segments of the market except for Cement which shed 0.11% MoM over the same period according to our equity's tracker. While the losses recorded in the Cement segment was largely in line with our expectations following strong gains in FY 2020 which we anticipated could trigger profit taking on some of the names in the segment, we had expected same to play out in the Telecommunication segment. However, the Telecommunication segment recorded gains in January 2021 contrary to our expectations, albeit posting a slower MoM improvement of 7.99% (vs 25.09% MoM gains in December 2020). We note that all other segments, still referencing our equities tracker, posted MoM improvement in January 2021 which is broadly in line with our expectations as highlighted in our NSR 2021 Equities Outlook Report.

Just as earlier highlighted that the NSEASI posted its first monthly loss of 6.16% in February 2021, this was largely driven by broad based selloffs in the market with the exception of the Oil & Gas segment which according to our tracker shows a gain of 11.87% MoM. The biggest losers in February were the Brewers (-15.00% MoM), Banking (-9.11% MoM) and Cement (-7.60% MoM) segments. The overall equity performance in February 2021 points to a net outflow of funds from the market. This is contrary to our expectations that proceeds from profit taking in some segments would be channeled into other segments of the market that either underperformed or recorded mild gain in FY'20 and are perceived to be positioned for a recovery in FY'21 as the negative impact of covid-19 eases. The broad-based sell-off across most of the counter, based on our tracker, is most likely a reaction to the upward re-pricing in yields in the fixed income space. Given our expectations that yields may continue to push northwards going into the remaining part of H1'21, we see the potentials for more profit taking in the equities market which may eventually lead to a negative performance at the end of H121.

Figure 3 – ARM’s Equities Tracker showing performance in different segments



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