

## Fixed income Monthly Update | August 2018

### *External factors propel yields to new frontiers*

#### Highlights from last month

**External forces propel Emerging market Eurobonds to new frontiers.** Eurobond yields for most Emerging market counters have been on an upward spiral with spread between JP Morgan's Emerging Markets Bond Index (EMBI) and US treasuries expanding 85bps YtD. In most cases, the rhetoric for individual countries is far from being fundamentally driven as the international market continues to become expensive. Firstly, most Frontier and Emerging market Eurobonds have witnessed widespread selloffs following hike in US benchmark interest rate (+50bps YTD to 2%) and FED's guidance of a minimum of one more rate hike before year end. In addition, the topsy-turvy in the Eurobond market was further exacerbated by the continuous trade spats between US and China. More recently the bleak economic picture in Turkey and Argentina have left Emerging markets selloff unabated. In Turkey, the marked depreciation in the Lira (-25% MoM in August) following widening current account deficit (+2% QoQ to \$16.1 billion in Q2 18), US sanctions and concern over the independence of the Central Bank further dampened investors' appetite for emerging market assets. Meanwhile, Argentina struggled to shore up global investor confidence following lingering economic woes that plunged the peso to a record low against the dollar (-28% MoM). Consequently, Argentina's policy makers raised interest rates to 60% in August. Thus, the confluence of external factors and susceptibility of FG's revenue to volatile crude oil prices drove average Eurobond yields in Nigeria higher by 66bps MoM to 7% in August.

**CBN maintains 'laid-back' posture.** CBN sustained its tolerance for naira liquidity for the third straight month in August by net repaying ₦904 billion.

This came in as a surprise following marked selloff in the fixed income market and MPC's unease over impending naira liquidity at its last meeting. In our view, the waning inflationary pressure in August (-9bps MoM to 11.14%) and stability in USDNGN within ~₦359/\$ and ₦362/\$ band at both IEW and parallel market provided comfort for the apex bank and informed further stickiness in OMO rates at 12.15%.

**Bond yields soars.** Our view that the FG will ramp up its borrowing over the rest of the year (₦437 billion over H2) to plug its fiscal deficit after failing to fill its coffers in H1 18 (H1 2018: net repayment of ₦49.7 billion) largely played out in August. During the month, actual bond issuance of ₦110.1 billion was 22% higher than planned issuance and 65% higher than last month issuance. As expected, investors priced in higher secondary market bond yields at the August auction thereby pushing stop rates higher (Average stop rates in August: +57bps MoM to 14.56%). This in addition to offshore selloff at the secondary market drove bond yields higher by 95bps MoM to 14.84%.

**Treasury bill yields nod higher.** FG bucked its four consecutive months of net repayments after rolling over ₦455.97 billion worth of treasury bills due to mature in August. We believe, the DMO is gradually maxing out of the \$2.5 billion earmarked for refinancing maturing treasury bills. Consequently, following dent to FG's purchasing power at the August NTB auction, average stop rates at the auction closed 40bps MoM higher to 11.07%. This in addition to offshore selloff at the short end drove an 89bps MoM spike in treasury bill yields to 12.85%.

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

	OMO Issuances	NTB 91-day	NTB 182-day	NTB 364-day	Total	Bond 5-year	Bond 7-year	Bond 10-year	Bond 20-year	Total	Grand Total
<b>Jul-17</b>	369.8	13.8	-13.3	24	<b>24.5</b>	3.9	-	47	55.1	<b>106</b>	<b>130.5</b>
<b>Aug-17</b>	117.6	-38.5	-10.4	48.5	<b>-0.4</b>	9.2	-	17.5	29.4	<b>56.1</b>	<b>55.7</b>
<b>Sep-17</b>	-25.6	-21.4	26.2	118.7	<b>123.5</b>	35.3	-	76.9	131.6	<b>243.8</b>	<b>367.3</b>
<b>Oct-17</b>	180.3	-39.1	-35.8	118.4	<b>43.5</b>	3	-	118.1	-	<b>121.1</b>	<b>164.6</b>
<b>Nov-17</b>	13.9	-29.2	-38.5	234.4	<b>166.7</b>	14.6	-	73.2	-	<b>87.8</b>	<b>254.5</b>
<b>Dec-17</b>	918.8	-	-	-	<b>-</b>	24.8	-	61.5	-	<b>86.2</b>	<b>86.2</b>
<b>Jan-18</b>	1,003.3	-	12.7	-	<b>12.7</b>	45.1	-	64.9	-	<b>110</b>	<b>122.7</b>
<b>Feb-18</b>	129.2	-	30	-	<b>30.0</b>	27.2	-	52.4	-	<b>79.6</b>	<b>109.6</b>
<b>Mar-18</b>	-182.4	16.7	-2.5	94.5	<b>108.7</b>	10.05	8.9	45.1	-	<b>64.1</b>	<b>172.8</b>
<b>Apr-18</b>	-70.8	-6.7	23.6	-126.8	<b>-109.8</b>	38.3	12.8	38.9	-	<b>90</b>	<b>-19.8</b>
<b>May-18</b>	742.7	83.4	41.7	33.4	<b>158.5</b>	3.5	8.5	38.5	-	<b>50.5</b>	<b>209.0</b>
<b>Jun-18</b>	-529.8	11.6	70	139.3	<b>220.9</b>	8.8	7.9	21	-	<b>37.7</b>	<b>258.6</b>
<b>Jul-18</b>	-458.1	-	-	-139.6	<b>-139.6</b>	8.9	11.6	46.4	-	<b>66.9</b>	<b>-72.7</b>
<b>Aug-18</b>	-904.1	27.3	-46.2	28.5	<b>9.6</b>	40.2	48.5	21.4	-	<b>110.1</b>	<b>119.7</b>

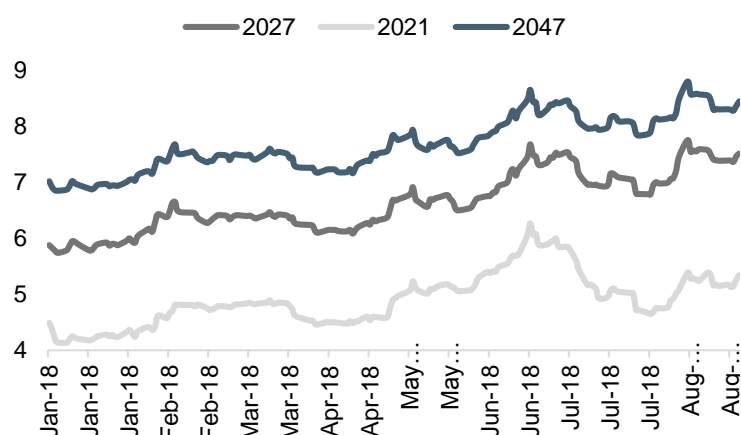
Source: FMDQ, ARM Research

**Table 2: Average OMO, NTB and Bond stop rates**

	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18
<b>OMO</b>	18.30%	18.20%	17.30%	17.20%	17.00%	13.90%	13.70%	13.80%	13.73%	12.02%	12.15%	12.15%	12.15%	12.15%
<b>NTB</b>	16.50%	16.40%	15.90%	14.70%	14.60%	0.00%	13.40%	13.10%	12.77%	12.08%	10.40%	10.67%	10.67%	11.07%
<b>BOND</b>	16.20%	16.80%	15.90%	15.00%	14.80%	13.20%	13.40%	13.84%	13.51%	12.83%	13.51%	13.70%	14.00%	14.56%

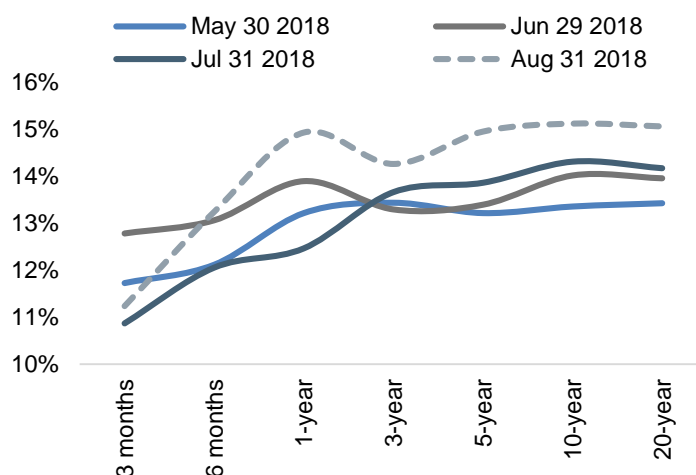
Source: FMDQ, ARM Research

**Figure 1: Trend in Eurobond yields over 2018**



Source: FMDQ, ARM Research

**Figure 2: Trend in Naira yield curve**



Source: FMDQ, ARM Research

## Outlook

There appears to be no respite insight in the near term over the misfortunes plaguing most emerging market debt counters. From the perspective of available option, the rhetoric is still in favour of developed markets given the expectation of further rate hikes in the US as well as ECB gradual tilt towards monetary policy normalisation. More so, with the possibility of further sanctions by the US on Chinese import worth \$200 billion in September, investors sentiment should continue to favour safer haven assets. This in addition to contagion effect from ailing economies (like Turkey and Argentina) could leave EM Eurobond yields elevated with Nigeria not spared. As a result, the CBN who already stroked a hawkish tone at its last MPC meeting is faced with the herculean task of striking a balance between making rates attractive to cultivate offshore interest and endearing economic growth. To our minds, given the recently released guidelines for accessing Real sector support facility (RSSF) through the Cash Reserve Ratio (CRR) and Corporate Bonds which is channelled towards steering economic growth, alongside the gradual collapse of base effect induced inflationary plunge, the CBN will be inclined towards switching its monetary stance to a more hawkish one. Especially, the recent depletion in the reserves (-3% MoM to \$45.8 billion) further provides ample justification for shift in monetary stance. Hence, we see scope for a slight hike in OMO rates over the near term, as evidenced by the higher bids by participants at the last OMO auction in August (12.15% - 15% for the 203 Day paper) which forced a 'NO SALE'.

On the fiscal side, having net repaid ₦49.7 billion over H1 2018, FG will need to borrow more over the rest of the year with our projection pointing to domestic borrowings of ₦437 billion in H2 18 and overall borrowings of ₦388 billion over 2018. Especially, with the FG gradually exhausting the \$2.5 billion earmarked for refinancing maturing treasury bills we see scope for higher stop rates at subsequent NTB auctions. As a result, we think the fiscal authorities will net-issue in subsequent Treasury bill auctions, albeit lower in the range of ~ ₦100 – ₦200 billion over H2 2018. Overall, the confluence of higher interest rate in the US, emerging market contagion and prospect for higher fiscal borrowings points to higher fixed income yields over the rest of the year.

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