

Fixed income Monthly Update | August 2019

Liquidity influences takes center stage

Highlights from last month

CBN face some pressure. The apex bank came under intense pressure in the currency market this month after grappling with the fastest pace of outflow (+68% MoM to \$3.2 billion) this year. For context, following widespread risk off that trailed markets across Emerging economies, we saw foreign investors exit positions in Nigeria's fixed income market which drove expansion in fixed income yields (+97bps MoM to 13.61%) in the Month of August. As a result, despite several failed attempts to issue OMO at prevailing market rates (with two OMO auctions ending in a no sale), the CBN was forced to raised OMO rate twice to limit the rate of foreign investors repatriation. This is contrary to our expectation for lower OMO rates in August and a subsequent hike in the month of September when liquidity pressure kicks in.

NTB yields touch new highs: Akin to trend over the last three months, FG continue to stay off short end borrowings by rolling over NTB maturities (~~₦~~466.2 billion) in August. While this helped in trimming stop rates in prior periods, this month was an exception as average NTB stop rates edged up 26bps to 11.13%. This was largely driven by upward repricing of NTB yields at the secondary market following offshore selloff of short dated debt during the month. Elsewhere, secondary market treasury bills expanded 164bps to 13.19% on the back higher OMO rates and selloff at the short end of the curve. In fact, during the month, treasury bill yields touched its highest point this year (Average NTB yields: 15.51%) before pulling back due to pent up system liquidity from the two failed OMO auctions by CBN during the month.

Bond yields continue upward spiral. In a dramatic turn of events, investors interest at this month's FGN bond auction waned as subscription levels were below FG's offering for the first time in two-years. In fact, excluding Non-competitive allotment (~~₦~~44.5 billion), FG only managed to sell ~~₦~~5.76 billion worth of bonds. Thus, FG was unable to fill its coffers as total bond sale in August was 65% shy of total offer. Interestingly, despite the lower bond sale during the month, marginal clearing rates in August rose 72bps to 14.42%. Elsewhere, secondary market FGN bonds were not spared as foreign investors sell-off drove wide expansion in bond yields.

Fixed income maturities at its peak: The next four months will usher in fixed income maturities worth ~~₦~~8.2 trillion. No doubt the CBN will be faced with the toughest liquidity crisis this year – a repeat of H2 2018. Coupled with periodic inflows from FAAC, we see three possible paths for the CBN 1.) CBN softening its liquidity sterilization in a bid to keep its interest expense moderated; 2.) increase its spate of OMO mop ups and OMO rates to drive FX stability; and 3.) a reverse to the use of stabilization securities to rein in excess monies in the system to achieve FX stability. While we lean towards, option 2, we do not rule out a hybrid of option 2 and 3.

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 30-year	Total	Grand Total
Jun-18	-529.8	11.6	70	139.3	220.9	8.8	7.9	21	-	37.7	258.6
Jul-18	-458.1	-	-	-139.6	-139.6	8.9	11.6	46.4	-	66.9	-72.7
Aug-18	-904.1	27.3	-46.2	28.5	9.6	40.2	48.5	21.4	-	110.1	119.7
Sep-18	-74.6	-	-	-	0	17.5	7.4	71.9	-	96.8	96.8
Oct-18	86.96	-	-	-	0	12.7	20.1	55.3	-	88.1	88.1
Nov-18	526.7	-0.45	41.9	5.9	47.35	1.1	4.27	34.15	-	39.5	86.87
Dec-18	765.1	-2.65	-70	-	-70	1.05	3.41	1.29	-	5.8	-64.3
Jan-19	276.6	20.6	-24.8	-153.7	-157.9	5.85	20.1	91.04	-	117	-40.9
Feb-19	1,078	-	-	-	0	1.5	12.25	136.25	-	150	150
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

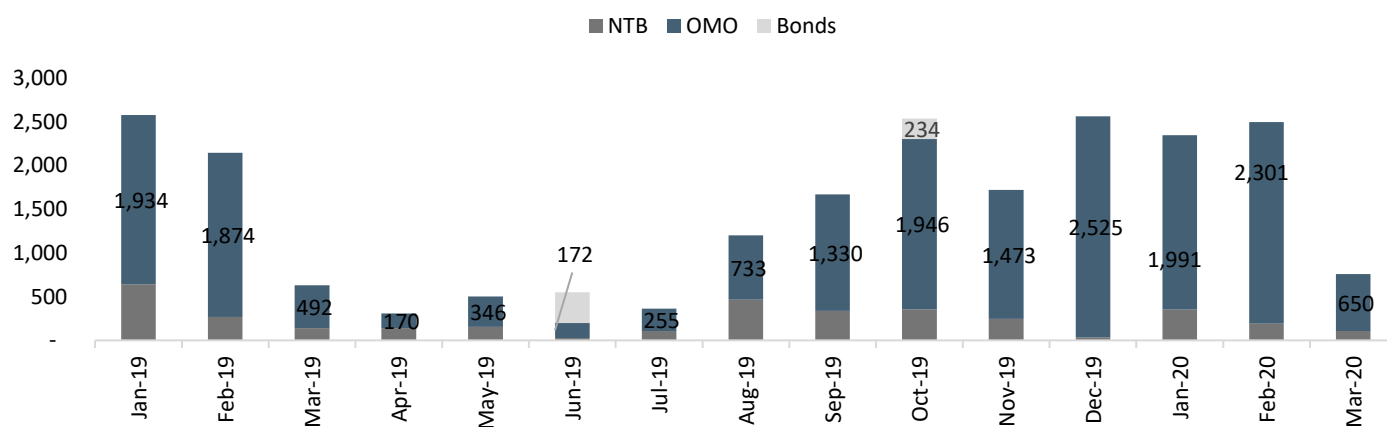
Source: FMDQ ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Jun-18	Jul-18	Aug-18	Sep-18*	Oct-18*	Nov-18*	Dec-18*	Jan-19*	Feb-19*	Mar-19*	Apr-19*	May-19*	Jun-19*	Jul-19	Aug-19
OMO	12.15%	12.15%	12.15%	13.40%	13.90%	14.50%	15.00%	15.00%	14.30%	13.04%	13.02%	12.78%	12.48%	12.3%	12.85%
NTB	10.67%	10.67%	11.07%	12.27%	12.23%	12.88%	N/A	13.01%	12.93%	11.82%	12.16%	11.58%	11.29%	10.87%	11.13%
BOND	13.70%	14.00%	14.56%	15.13%	15.16%	15.51%	15.42%	15.27%	14.75%	13.50%	14.6%	14.28%	14.49%	13.70%	14.42%

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

Figure 1: Maturity profile over 2019



Source: FMDQ ARM Research

Outlook

Going forward, CBN is faced with a conundrum of pursuing an accommodative monetary policy in line with waning inflationary pressures (headline inflation: -14bps MoM to 11.08%), tepid economic growth (Q2 19 GDP: 1.94%) and looser monetary conditions in advanced economies or taking a tightening stance to maintain naira stability. While a strong case for both stance exists, we see the CBN pursuing the latter. Our premise is anchored on the avalanche of liquidity staged to hit the system in the last four months of the year (~~N~~8.2 trillion). Further exacerbated by heightening Emerging market risk fueled by the ongoing trade conflict between US and China and its reverberating effect across various EM economies, we see scope for higher OMO rates (13.5% - 14.5%) and heightening OMO issuances in a bid to support naira stability. Consequently, while appetite for short end borrowings should remain weak on the back of FG's quest to trim its cost of debt, we see scope for higher NTB yields following CBN's tighter monetary policy towards the end of the year. Elsewhere at the long end, given that FG appears to have found comfort in part financing its fiscal deficit via CBN's overdraft, we rule out any sizeable ramp up in FGN Bond this year. Tying it all together, while the confluence of lower interest rate in DMs, waning inflationary pressures and CBN's financing of FG's fiscal paves way for little uptick in bond yields, CBN's rein on massive liquidity profile in Q4 19 should keep short end yields higher.

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