

Fixed income Monthly Update | June 2018

Foreign selloffs stoke 'bear steepener'

Highlights from last month

Local yields tail hawkish US FED, shun plunging headline inflation.

For the second consecutive time this year, the US FED raised interest rate by 25bps to a range of 1.75% - 2% at its June FOMC meeting. Also mirroring patterns from the FED dot plot, the monetary authority signaled additional two rates increases this year which could bring total rates hikes to four in 2018 (vs three times earlier signaled at the start of the year). While this decision resounds FED's commitment to gradually increase interest rates to historical normal levels, the major driver reflects heightening concern over looming inflationary pressures in the US over 2018 stoked by impressive growth—Q1 18 GDP (2.2% YoY) reading and ebbing jobless claims. To buttress, economic projections of the Federal Reserve Board Members reveal upward revision to 2018 Real GDP estimates (to 2.8% from 2.7%) as well as Inflation (to 2% from 1.9%), and downward review to Unemployment rate for 2018 to 3.6% from 3.8%. This cascaded into FPI flight from Nigeria's FI (fixed income) market with knock on effect driving average yields higher by 50bps to 13.38% in June 2018 as FPIs take advantage of attractive yields in the US.

CBN at ease. Surprisingly, despite US FED's decision to raise rates and lingering off shore sell offs in the Nigerian FI market, CBN's body language in the month was one that signaled dovishness. In June, CBN net repaid ₦435 billion (vs net issuance of ₦742 billion in May) worth of OMO bills while leaving OMO rates inert at 11.05% and 12.15% for the ~90 and ~250-day paper respectively. To our mind, the relative calmness in

USDNGN, particularly at the parallel market segment and waning inflationary pressures (-87bps MoM to 11.61%) prompted CBN's ease on market liquidity (System liquidity: +20% MoM to ₦263 billion) in June 2018.

Bond yields edge higher. As posited earlier, the pass through of lingering foreign investors selloffs partly explains the elevation of yields at the long end of the curve. Overlaying this with higher stop rates at the June Bond auction, average Bond yields rose 30bps MoM to 13.5% in June. For context, at the auction, investors demanded a higher return for taking on FG's risk (Bond stop rates: +18bps MoM to 13.7%) following attractive alternatives at the secondary market as bids on the 10-year were as high as 15.19% while demand remained thin with bid to offer of 1.1x.

Treasury bill yields nod higher. In addition to foreign investors selloffs across the money market space, average treasury bill yields edged higher by 69bps to 13.25%, largely supported by higher CBN's FX sale and selloffs by banks. For context, CBN's FX intervention to the various segment of the market rose 20.2% MoM to \$2.2 billion in order wade off depreciation on the naira. This in addition to its decision to increase its frequency of dollar sales to the BDCs (from 2 to 3 times) strained liquidity from the market. Furthermore, the market also witnessed flashes of selloffs from banks as they unwind ahead of H1 18 financial reporting. Based on the foregoing, average stop rates at the June NTB auction (June: +17bps to 10.6%) tracked higher despite lower paper issuances (-20% to ₦40 billion in June).

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
Jan-17	700.5	22.7	-20	133	135.7	35	-	74.9	105.1	215	350.7
Feb-17	91.8	45.2	-	120	165.2	60	-	30	70	160	325.2
Mar-17	141.1	-24.1	-110.5	305.1	170.6	30	-	50	80	160	330.6
Apr-17	212.7	-24.2	-2.7	-43.9	-70.8	-445.3	-	34	56.3	-355	-425.8
May-17	-89.2	-16	23.4	96	103.4	10	-	35	65	110	213.4
Jun-17	-203.4	65.2	28.3	33.6	127.1	4.2	-	30.3	64.8	99.3	226.4
Jul-17	369.8	13.8	-13.3	24	24.5	3.9	-	47	55.1	106	130.5
Aug-17	117.6	-38.5	-10.4	48.5	-0.4	9.2	-	17.5	29.4	56.1	55.7
Sep-17	-25.6	-21.4	26.2	118.7	123.5	35.3	-	76.9	131.6	243.8	367.3
Oct-17	180.3	-39.1	-35.8	118.4	43.5	3	-	118.1	-	121.1	164.6
Nov-17	13.9	-29.2	-38.5	234.4	166.7	14.6	-	73.2	-	87.8	254.5
Dec-17	918.8	-	-	-	-	24.8	-	61.5	-	86.2	86.2
Jan-18	1,003.3	-	12.7	-	12.7	45.1	-	64.9	-	110	122.7
Feb-18	129.2	-	30	-	30.0	27.2	-	52.4	-	79.6	109.6
Mar-18	-182.4	16.7	-2.5	94.5	108.7	10.05	8.9	45.1	-	64.1	172.8
Apr-18	-70.8	-6.7	23.6	-126.8	-109.8	38.3	12.8	38.9	-	90	-19.8
May-18	742.7	83.4	41.7	33.4	158.5	3.5	8.5	38.5	-	50.5	209.0
Jun-18	-434.5	11.6	70	139.3	220.9	8.8	7.9	21	-	37.7	258.6

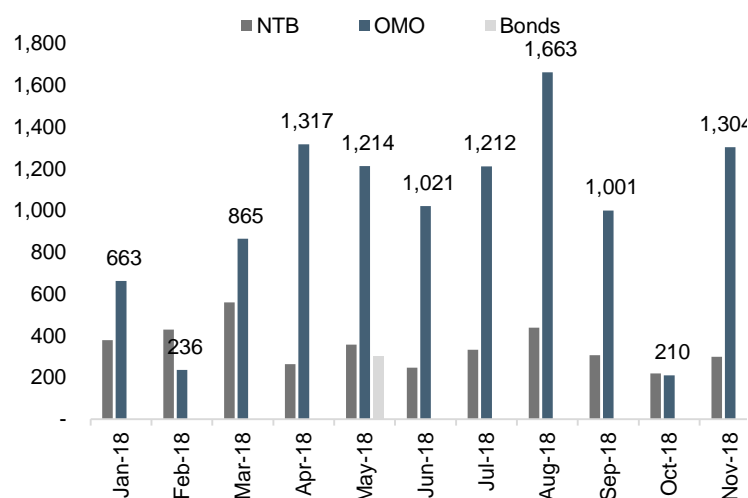
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

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

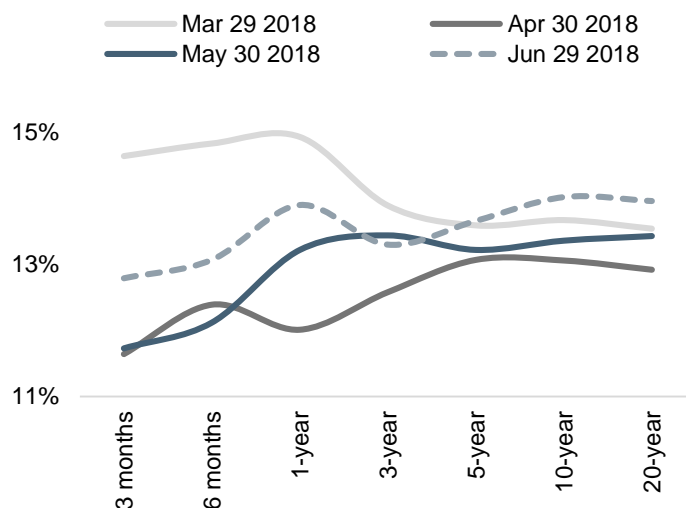
Source: FMDQ, ARM Research

Figure 1: Maturity profile over 2018



Source: FMDQ, ARM Research

Figure 2: Trend in Naira yield curve



Source: FMDQ, ARM Research

Outlook

No doubt, the hawkish renditions by the US FED incites the possibility of further sell-off in Nigeria's fixed income space, with knock on effect driving local treasury yields higher. Overlaying this with our expectation for higher FX sale by the CBN over H2 18 and its need to cultivate offshore interest we see scope for liquidity tightening over the period. Given the foregoing, we are pessimistic of a cut in MPR over 2018 and expect the monetary policy committee to leave the MPR unchanged at 14% over 2018 which could widen the spread between inflation and fixed income yields.

On the fiscal side, given improved revenue picture, we estimate aggregate revenue to print at ₦5.08 trillion (oil and non-oil estimate of ₦2.88 trillion and ₦2.20 trillion respectively) which covers ~84% of total recurrent expenditure (both debt and non-debt) and statutory transfers. This portends that FG is under less pressure to meet its recurrent obligations and will only have to grapple with funding its CAPEX plans for 2018. That said, we see scope for significantly lower FG paper issuances over H2 2018 as our expectation of \$2.8 billion Eurobond issuance by the FG in the near term should support FG's capital expenditure needs over 2018.

Overall, we expect the confluence of liquidity strain by the CBN and expectation of further rates hike in the US to drive Nigeria yields uptick in H2 2018. However, while our fiscal prognosis points to tamer paper issuances over the rest of the year, we see scope for higher stop rates at the Bond and NTB auctions as investors would most likely price in higher rates at the secondary market emanating from CBN's increased dollar sales and persisting selloffs in the FI market. As a pointer, at the June Bond auction, investors priced in higher Bond yields at the secondary counters which led the FG to cut back its planned borrowings by 48% to ₦31 billion in June.

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