

Fixed income Monthly Update | June 2019

FG's fiscal deficit: Where's the plug?

Highlights from last month

FG's Q1 fiscal deficit: Where's the plug? According to recent publication by the CBN (Quarterly statistical bulletin), Nigeria's fiscal deficit for the first quarter of 2019 printed at ₦1.54 trillion. This is 2.3x more than the planned borrowings for the period on annualize basis. Surprisingly, despite the fiscal deficit (83% of FY 19 planned deficit), FG's borrowings remained subdued with net borrowings of ₦230.4 billion in Q1 19 and absence of information on external borrowings. The variance between actual borrowings in relation to fiscal deficit largely reflects FG's reliance on non-conventional means of deficit financing. For context, in addition to local borrowings, FG drew down its Budgetary account deposit with CBN to the tune of ₦459.8 billion, in addition it overdrew ₦530.1 billion – 18% of prior year revenue – from the CBN. In our view, FGN's resolve to tap back door financing from the apex bank largely explains its tamer paper issuances this year amidst burgeoning fiscal deficit.

CBN's easing continues. CBN continued its easing into June, with net OMO issuances for the month falling short of prior month by 86% to ₦49.6 billion and OMO rates shedding 31bps MoM to 12.48%. Also, in deviation from prior months, the apex bank tapered its spate of OMO issuances by issuing OMO bills only twice in the month. This is in sync with our view that the lower fixed income maturities between April and August which diminishes the possibility of sizeable FPI repatriation provided legroom for monetary easing by the CBN.

FG shuns short end borrowings. Amidst higher fiscal deficit, FG continues to shun short end borrowings. In June FG only rolled over ₦147.3 billion staged to mature at lower stop rates (-29bps MoM to 11.3%). This came in despite lower bids at the auction (Average upper range bids: -14bps MoM to 13%) and high subscription levels (₦262.6 billion). No doubt, FG's apathy for short dated borrowings reechoes its resolve to keep cost of borrowings in check. Nonetheless, average secondary market NTB yields towed a different path with yields jumping 2bps MoM to 12.63%. This mirrors spike at the short end of the NTB yield curve with the 30- and 90-days paper jumping 89bps and 27bps to more than offset plunge in 182- and 364-day paper.

Bond yields nod higher. Despite the ₦350 billion worth of FGN bonds staged to mature in June, FG kept its bonds supply subdued (June Bond Issuance: ₦96.8 billion). For context, the monthly and quarterly (Q1 19) FGN Bond issuances were only 0.28x and 0.87x of total maturity respectively. Regardless, despite the tamer bond supply (13% MoM) average marginal clearing rate rose 21bps MoM to 14.49% at the PMA. This emanated amidst slimmer subscription levels (-41% MoM to ₦160 billion). Consequently, following higher marginal clearing rates at the PMA, average Bond yields at the secondary market edged up by 16bps MoM to 14.26%.

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
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
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	150.0
Mar-19	1,094	-	-	-	0	39.8	62.15	20	-	121.95	122.0
Apr-19	397.7	-	-	-	0	6.81	-	37.43	53.16	97.4	97.4
May-19	367.12	-	-	-	-67.4	27.38	-	35	48.93	111.31	43.91
Jun-19	49.6	-	-	-	0	28.99	-	36.36	31.49	96.84	96.84

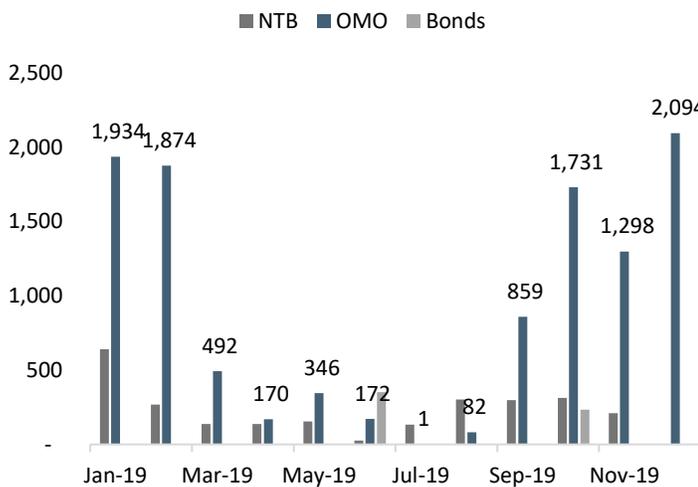
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Apr-18	May-18	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*
OMO	12.02%	12.15%	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%
NTB	12.08%	10.40%	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%
BOND	12.83%	13.51%	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%

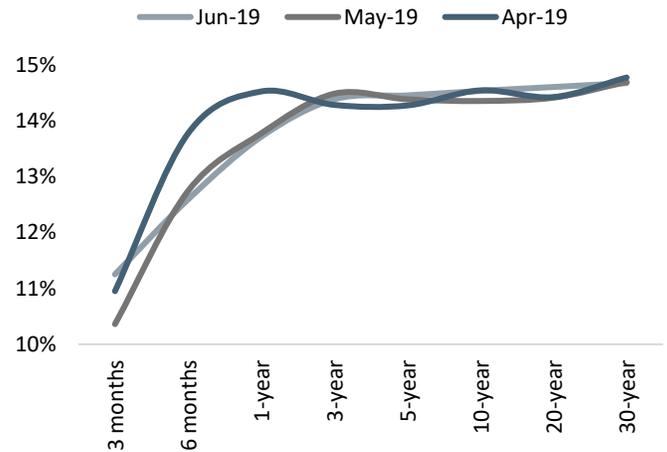
Source: FMDQ, ARM Research ** reflective of 1-year OMO bills

Figure 1: Maturity profile over 2018



Source:

Figure 2: Trend in Naira yield curve



Source: Source: FMDQ, ARM Research

Outlook

Going forward, with Emerging market assets receiving a boost from FED's gradual tilt towards dovishness, which has led to US treasuries losing their attractiveness (-72bps YTD to 1.96%), CBN appears to be in a position of comfort in its quest for currency stability. Thus, despite being faced with a burgeoning liquidity profile beyond August, we see less room for aggressive tightening over the rest of the year. Coupled with our expectation for dissipating inflationary worries in the coming months, the stage appears set for monetary policy easing by the MPC. In fact, the recent CBN circular which mandates banks to maintain a minimum of 60% loan to deposit ratio (LDR) in a bid to stimulate economic growth gives credence to our view. On the fiscal side, given that FG remains committed to trimming its cost of debt service, appetite for short end borrowings appears weak – thus paving way for downtrodden NTB yields over the near term. More so, given FG's open-endedness to part financing its fiscal deficit via CBN's overdraft, we rule out any sizeable ramp in FGN Bond supply this year. Tying it all together, the confluence of lower interest rate in the US, CBN's increasing comfort in its defence for the Naira, waning inflationary pressures and CBN's financing of FG's fiscal deficit via non-conventional means all point to lesser upside for fixed income yields over the near term.

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