

Fixed income Monthly Update | March 2019

Case for yield depression subsist

Highlights from last month

MPC springs a dovish surprise. While leaving other policy parameters unchanged, the Monetary policy committee voted to cut its benchmark interest rate (MPR) by 50bps to 13.5% at its March MPC meeting. The decision was reached by 9 out of 11 members voting for a rate cut, with 6 members opting for a 50bps rate cut. The committee expressed satisfaction with the relative stability in price level and as well as exchange rate following the resurgence of foreign portfolio flows into the country after the general elections. This paved way for MPC's decision to tilt its policy towards boosting economic growth by way of encouraging lending to the productive sectors of the economy. While this decision should ordinarily signal downward repricing to fixed income yields, we reiterate that the transmission mechanism of MPR on Nigeria's treasury yield is limited and OMO remains a more viable tool in setting the stage for interest rate movement. Hence, we view MPC's decision to cut MPR by 50bps as a signaling move that sets the stage for CBN's monetary focus over the near term.

CBN crosses the ₦1 trillion monthly OMO sale mark again. CBN continued its liquidity curbing tactics into March, albeit with a loose grip. While the apex bank net issued ₦1.09 trillion (vs ₦1.07 trillion in February), it lowered rates on its ~180-day OMO bill by 52 bps to 12.98% and reintroduced the 1year OMO bill at 13.04% (vs 15% at the last issuance). The dovish move by the CBN was in part fed by higher market liquidity emanating mainly from influx of offshore funds into the country. This alongside dissipating inflationary concern (February inflation: -6bps MoM to 11.31%) paved way for a more dovish CBN in March.

NTB yields fall further: Akin to February, the DMO rolled over its treasury bill maturity for the month of March (₦138.1 billion) at lower stop rates (Average stop rate: -111bps MoM to 11.82%). In line with the prior months, the March NTB auction was largely oversubscribed (six times). Although, when compared to February, subscription levels were 26% shy. Despite elevated demand and the lower stop rates over the last two months, FG's decision to keep borrowings muted in the face of higher fiscal need (fiscal deficit: ₦1.83 trillion) is surprising to us. To our minds, this confirms FG's commitment to reducing its cost of borrowings particularly at the short end. Over all, the confluence of lower stop rates at the NTB auction, monetary easing by the CBN and foreign interest in Nigeria's treasuries, NTB average yields at the secondary market dipped 89bps MoM to 13.44%.

Bond yields sinks: As expected, FG continue to ramp up borrowings at the long end of the curve. However, unlike other months, FG's bond issuance for the month of March towed an unusual path. For context, despite having subscription levels (₦148 billion) in excess of planned offer (₦100 billion), FG showcased its unflinching quest to bring rates lower by only borrowing ₦29.4 billion on competitive basis at 13.5% (vs 13.9% in the prior month) while it resorted to filling its confers on non-competitive basis (₦92.6 billion) at average rate of 13.14%. Consequently, following lower marginal clearing rates at the March bond auction, and dovish tilt in monetary policy by the CBN, average secondary market bond yields dipped 50bps MoM to 14.17%.

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-18	1,003.3	-	12.7	-	12.7	45.1	-	64.9	-	110	122.7
Feb-18	129.2	-	30	-	30	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
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

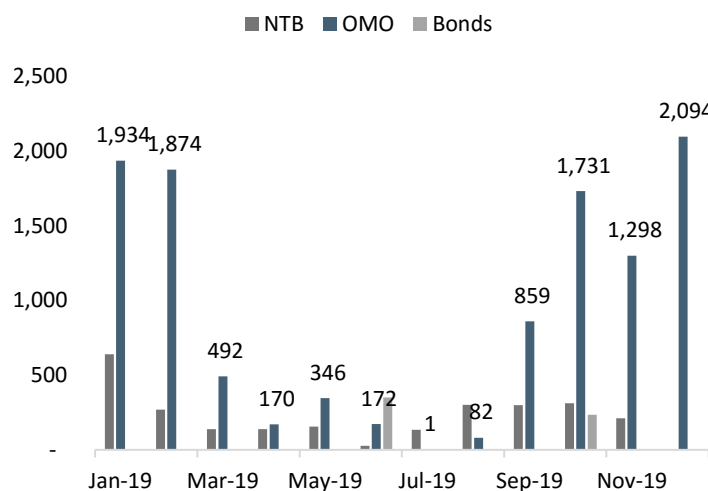
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18*	Oct-18*	Nov-18*	Dec-18*	Jan-18*	Feb-18*	Mar-18*
OMO	13.80%	13.73%	12.02%	12.15%	12.15%	12.15%	12.15%	13.40%	13.90%	14.50%	15.00%	15.00%	14.30%	13.04%
NTB	13.10%	12.77%	12.08%	10.40%	10.67%	10.67%	11.07%	12.27%	12.23%	12.88%	N/A	13.01%	12.93%	11.82%
BOND	13.84%	13.51%	12.83%	13.51%	13.70%	14.00%	14.56%	15.13%	15.16%	15.51%	15.42%	15.27%	14.75%	13.50%

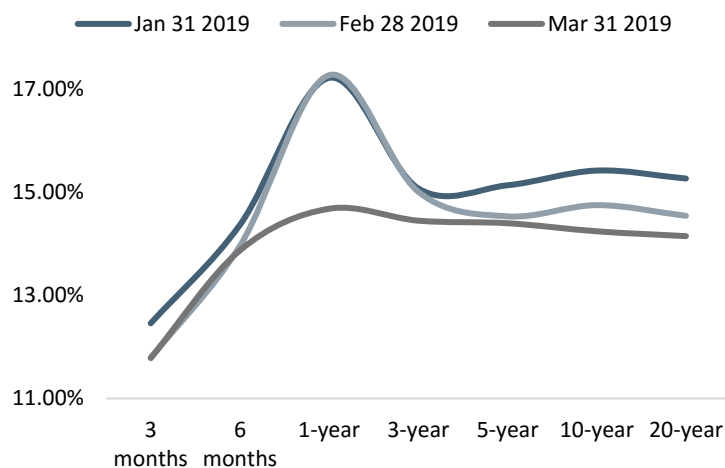
Source: FMDQ, ARM Research ** reflective of 1-year OMO bills

Figure 1: Maturity profile over 2018



Source: FMDQ, ARM Research

Figure 2: Trend in Naira yield curve



Outlook

In the near term, cross examination of various interlocking variables that anchors CBN's monetary policy direction suggests that there exist room for moderation in OMO rates. For context, barring fresh shocks to the core and food basket from a possible hike in PMS price, Nigeria's headline inflation seems to be on a downward spiral over 2019. With the steady flows at the IEW, at least before upsurge in maturity and possible reversal towards the end of the year, the case for naira stability remain strong. As such, the possibility of further cuts in OMO rates appears justified. However, we expect effective yield on OMO to bottom out at 14.2% (with a stop rate of ~12.4% for the one-year OMO bill) as further reduction to OMO rates would appear unattractive for foreign investors. Our view is premised on inflation differentials between Nigeria and US, credit default swap as well as alternative US return forgone. However, post the era of lower maturity (April – August), we see scope for upward adjustment in OMO rate by the CBN to stem possible shocks to the naira. Our view of further temperance in OMO rates provides room for lower NTB yields over the near term. This sits well with FG's quest of reducing its cost of debt service. Corroborating this with FG's recent apathy for short term debt which is reflective of its decision to at best rollover short term debts further entrenches this view. However, at the long end, while the pass-through effect of a loose monetary policy paves way for further downslide in bond yields, FG's preference for long end debt places a lid on bond yield downtrend. More so, the higher Bond Maturity this year (₦585 billion) and increased borrowings following passage of the 2019 budget, provides leeway for higher paper supply which weakens FG's bargaining power at subsequent bond auctions.

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