

Fixed income Monthly Update | September 2018

No change in sight

Highlights from last month

September MPC meetings: More hawkish than ever. The September monetary policy committee meeting saw retention of all policy parameters. However, unlike other meetings, the monetary policy committee's commentary produced its most hawkish rendition this year with three (3) members each voting for a 25bps hike in MPR and a 150bps increase in the Cash Reserve Requirement (CRR) while four (4) members voted to maintain status quo. The committee highlighted resurfacing inflationary pressures, capital flow reversals, likely liquidity concerns emanating from election related spending and FAAC distribution as well as the fragile state of Nigeria's economic growth as underpinning for leaving all policy parameters unchanged.

CBN raises OMO rates. In our August Fixed income monthly update, we outlined the possibility of a raise in OMO rates by the CBN, citing investors reach for higher yields as a driver. In lock step with our views, CBN raised OMO rates on its ~200-day paper and re-introduced the 1-year OMO bill at 13.5%, though it maintained its increasing tolerance for naira liquidity by net repaying ₦76.4 billion. To our minds, CBN's increasing tolerance for liquidity appears counterintuitive following MPC's lingering emphasis on naira liquidity and its rebounding effect on marring USDNGN stability.

Bond yields soars. Bond yields sustained their upward momentum into September as average bond yields rose 12bps MoM to 14.95%. This is largely driven by sustained sell-offs in the long end of the curve as well as higher stop rates at the September bond auction. Firstly, following the return of US 10-year yield near their seven highs of ~3% levels, foreign investors sold off FGN bonds and fled to safer havens. Bonds prices at the secondary market depressed further as FG continues to borrow more than planned. In September, FG's Bond sale of ₦96.7 billion is 7% higher than offer for the month. Also following elevated market liquidity in month (Average system liquidity: +38% MoM to ₦283 billion in September), the auction was 1.64x oversubscribed. Despite pent up demand, investors bids as high as 16.5% for the 10-year drove a 57bps MoM spike in stop rates to 15.13% in September.

Treasury bill yields nod higher. Average yields in the T-bills market edged up 64bps MoM to 13.94%. This was largely driven by higher stop rates at the NTB auction. This mirrored upward repricing of NTB at the secondary market following higher OMO stop rates in September. Specifically, despite pent up market liquidity (+38% MoM) which cascaded into higher subscription levels at the September NTB auction, investors reach for higher rates at the auction which saw bid range widened to as high as 20% translated into higher stop rates at the September NTB auction.

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

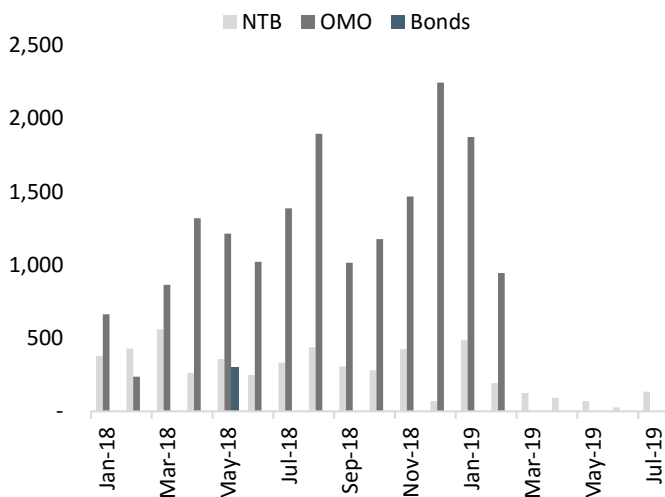
	OMO Issuances	NTB 91-day	NTB 182-day	NTB 364-day	Total	Bond 5-year	Bond 7-year	Bond 10-year	Bond 20-year	Total	Grand Total
17-Jul	369.8	13.8	-13.3	24	24.5	3.9	-	47	55.1	106	130.5
17-Aug	117.6	-38.5	-10.4	48.5	-0.4	9.2	-	17.5	29.4	56.1	55.7
17-Sep	-25.6	-21.4	26.2	118.7	123.5	35.3	-	76.9	131.6	243.8	367.3
17-Oct	180.3	-39.1	-35.8	118.4	43.5	3	-	118.1	-	121.1	164.6
17-Nov	13.9	-29.2	-38.5	234.4	166.7	14.6	-	73.2	-	87.8	254.5
17-Dec	918.8	-	-	-	-	24.8	-	61.5	-	86.2	86.2
18-Jan	1,003.30	-	12.7	-	12.7	45.1	-	64.9	-	110	122.7
18-Feb	129.2	-	30	-	30	27.2	-	52.4	-	79.6	109.6
18-Mar	-182.4	16.7	-2.5	94.5	108.7	10.05	8.9	45.1	-	64.1	172.8
18-Apr	-70.8	-6.7	23.6	-126.8	-109.8	38.3	12.8	38.9	-	90	-19.8
18-May	742.7	83.4	41.7	33.4	158.5	3.5	8.5	38.5	-	50.5	209
18-Jun	-529.8	11.6	70	139.3	220.9	8.8	7.9	21	-	37.7	258.6
18-Jul	-458.1	-	-	-139.6	-139.6	8.9	11.6	46.4	-	66.9	-72.7
18-Aug	-904.1	27.3	-46.2	28.5	9.6	40.2	48.5	21.4	-	110.1	119.7
18-Sep	-74.6	-9	-8.4	-164.8	-182.2	17.5	7.4	71.9	-	96.8	-85.4

Source: FMDQ, ARM Research

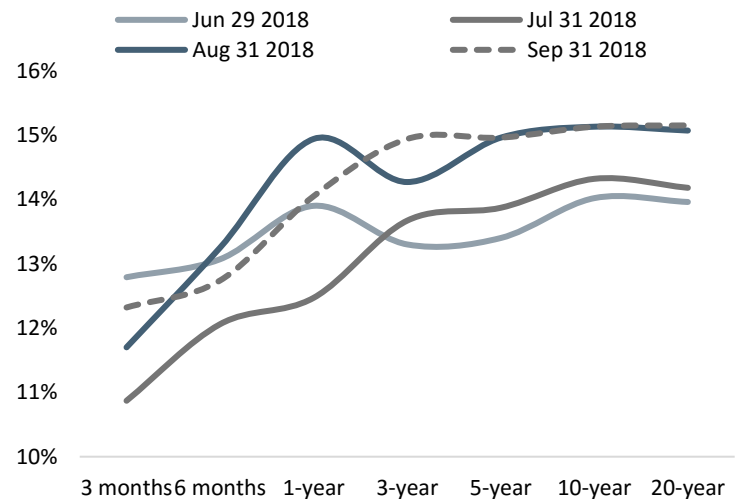
Table 2: Average OMO, NTB and Bond stop rates

	17-Aug	17-Sep	17-Oct	17-Nov	17-Dec	18-Jan	18-Feb	18-Mar	18-Apr	18-May	18-Jun	18-Jul	18-Aug	18-Sep
OMO	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%	11.90%
NTB	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%	12.27%
BOND	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%	15.13%

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

Certainly, the gradual collapse of base effects as well as prospects for elevated food prices provides scope for uptick in inflation over the rest of the year. Overlaying this with the recent depletion in FX reserves (dipped \$1.5 billion to \$44.3 billion in September) one might be tempted to think that the odds are in favor of higher yields over the near term. However, a closer look at recent activities in Nigeria's fixed income market where market liquidity has been on the front burner of determining naira yield curve trajectory provides a clearer lens for projecting the naira yield curve path over the near term. Particularly, given CBN's increasing tolerance for naira liquidity over the last four months (OMO net repayment: ~~~₦~~2 trillion), scope for higher demand for FGN paper persist at subsequent NTB and Bond auctions.

In our view, we think CBN's lukewarm attitude towards naira liquidity would continue over the near term, particularly given the much-improved revenue picture—owing to higher crude oil prices (+7% MoM to \$82/bl) the CBN less wary about naira stability. In the light of this, we are of the view that the CBN will keep OMO rates at current level over the near term. Furthermore, on the fiscal side, having borrowed ~~₦~~273 billion over Q3 18 we see scope for lower FG borrowings over the rest of the year. Particularly with prospect of the \$2.8 billion worth of Eurobond sale scheduled to come up later this year, we project a tamer FG borrowing of ~~₦~~164 billion over Q4 18. Overall, the confluence of higher tamer FG borrowings, elevated market liquidity and further stickiness in OMO rates at current informs our view that rates will remain at current level over the near term.

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