

Is this a good time to test the Eurobond waters?

Highlights from last month

Is this the best time to test the Eurobond waters? So far this year, Nigeria's Eurobonds have rallied 150bps YtD on average, higher than the JP Morgan EMBI spread over the same period (-70bps). For us, the bullish run in Nigeria's Eurobond market reflects Nigeria's improved macroeconomic fundamentals alongside accommodative monetary policy stance in developed markets. More importantly, we think the lower Eurobond yields and slimmer Z-spread between Nigeria's sovereign and comparable US treasuries presents ample opportunity for Nigeria to tap the Eurobond market, to fund part of the fiscal deficit (proposed external sourcing: \$2.8 billion). Especially given the successful Eurobond issuance at attractive rate by other African peers; Benin (6% for 7year), Ghana (7.875% for 7years) and Egypt (7.6% for 10 years), with combined issuance of \$9.8 billion this year we think this is a good time for the FG to test the Eurobond market.

CBN loses grip on liquidity. Contrary to trend over the last two months where CBN assumed a firm stance on liquidity with net OMO sale in February and March in excess of ₦1 trillion, April ushered in a looser grip on liquidity by the CBN. Over the period, net OMO sale of ₦397.7 billion by the CBN was 64% lower than the previous month. Furthermore, CBN also reduced stop rates on its ~180-day and 364-day OMO bill by 10bps and 1bp to 12.9% and 13.029% respectively. In our view, CBN's loose grip on naira liquidity mirrors lesser hurt to the naira emanating from lower near-term fixed income maturities which limits scope for sizeable FPI repatriation. More so, the absence of inflationary concerns (-60bps MoM to 11.31%) as well as MPC's quest to stimulate economic growth paves way for a dovish monetary policy by the CBN.

Mixed feelings at the short end. For the third consecutive month, FG rolled over maturing treasury bills in April. Notwithstanding higher demand (₦420.7 billion), FG only rolled over ₦154.1 billion staged to mature in the month. Surprisingly, despite FG's resolve to match its NTB maturities for the month, average stop rates rose 103bps MoM to 12.16%. While FG's decision to keep short end borrowings muted mirrors its quest to reduce its cost of debt service, the higher NTB stop rates reflects investors pricing in line with secondary market NTB yields. Also, the absence of FPI led demand at the April NTB auction which led to a 51% MoM reduction in subscription levels supported the case for higher NTB stop rate. Consequently, the confluence of tamer OMO issuances and muted short end borrowings pushed secondary market yields lower by 30bps MoM to 13.15%.

Bond yields retrace higher. FG slowed down its bond issuance this month, with April's issuance of ₦94.1 billion falling short of prior month's issuance and planned borrowings by 19.7% and 3% respectively. Bulk of the borrowings came from the newly introduced 30-year bond issue where subscription levels were the highest. For context, while FG offered ₦20 billion worth of 2049s, subscription levels for same was as high as ₦80.41 billion, giving FG leeway to borrow more (₦53.16 billion) at that end. However, despite lower FG borrowings this month, average marginal clearing rates at the auction rose 110bps MoM to 14.6%. Consequently, following higher marginal clearing rates at the April bond auction, average secondary market rates jumped 6bps MoM to 14.23%.

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
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
Apr-19	397.7	-	-	-	0	6.81	-	37.43	53.16	97.4	97.4

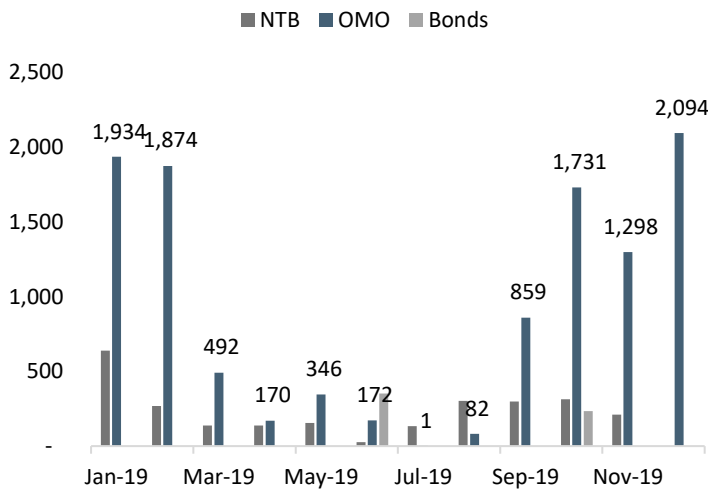
Source: FMDQ, ARM Research

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-19*	Feb-19*	Mar-19*	Apr-19*
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%	13.02%
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%	12.16%
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%	14.6%

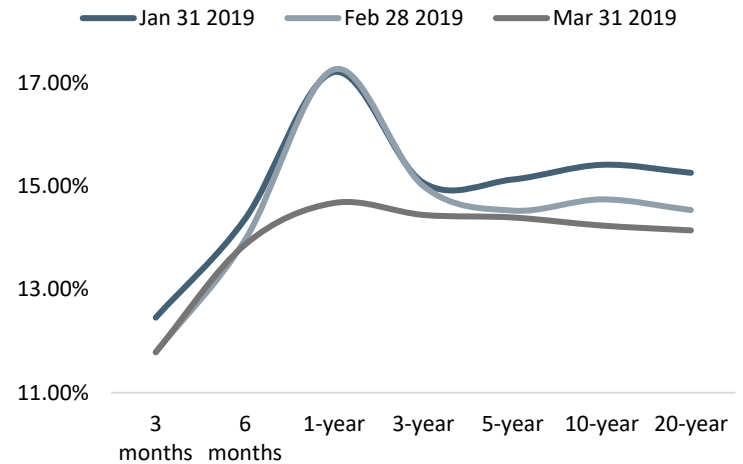
Source: FMDQ, ARM Research ** reflective of 1-year OMO bills

Figure 1: Maturity profile over 2018



Source:

Figure 2: Trend in Naira yield curve



Source: FMDQ, ARM Research

Outlook

Going forward, we retain our view of further downside in yields at the short end of the curve. This view is hinged on CBN's loose grip on naira liquidity alongside muted paper supply at the NTB leg. On the former, although FPI inflows at the IEW are receding, we see less hurt to the currency over the near-term emanating from lower maturity profile until August 2019 as well as sturdy macroeconomic fundamentals which is a cause for cheer for foreign investors. Although, downside to our expectation remains potential flight to safety from EMs following Trump's decision to reignite trade rift with China. That said, the possibility of further cuts in OMO rates appears probable. 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. Overlaying this with FG's decision to keep borrowings muted at the short end of the curve in a bid to keep cost of borrowings in check paves way for lower NTB yields over the near term. However, at the long end, while the pass-through effect of a loose monetary policy paves way for further downside in bond yields, the recent passage of the 2019 Appropriation Bill of ₦8.916 trillion by the National Assembly connotes that the stage is set for ramp up in borrowings to fund FG's 2019 fiscal outlay. In line with past trends, we think FG will continue to favor long end borrowings. More so, with the higher Bond Maturity this year (₦585 billion) we see scope for higher domestic borrowings relative to prior year. Thus, while we envisage lower short end yields, we think bond yields will remain sticky downwards.

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