



Fixed income Monthly Update | August 2020

Primary and secondary market yields on the rise

Highlights from last month

PFA's lead bond yields higher: After two consecutive months of declines, bond yields in the secondary market closed higher in August (+106bps to 7.57%, July: -160bps MoM). The increase over August really occurred over the first week; thereafter, yields hovered closely around that level with no sharp changes until the last day when it rose 12bps. The increase over the first week came following PENCOM's directive to PFAs to make refunds for contributions previously made by the regulator on behalf of the Government departments and agencies. This led to a sell-off in bonds to raise cash for said payments. Over the first 3 days of the week, bond yields rose 89bps to 7.40% before declining 20bps the next couple days to 7.20%. Further supporting higher yields in August was the release of the savings bond calendar which saw bonds at the short end repriced higher. The Jan-2022 (+206bps), April-2023 (+169bps) and the March-2024 (+144bps) were all up the week of that calendar release.

DMO misses out on full allocation again: Similar to what we saw in June, the DMO again in August did not fully sell what it offered at the monthly bond auction. At this auction, it offered ₦150 billion across the 4 bond instruments and received a total subscription of ₦241.83 billion. This translates to a subscription rate (total subscription/total amount offered) of 1.61x which is comfortably the lowest rate seen this. The total amount sold was ₦126.15 billion with ₦9.50 billion coming via non-competitive means. The decline in subscription rate could be attributed to a waning interest in NTBs, following the decline in stop rates (-273bps YTD). Though it is too soon to say whether this is the start of a trend. However, at this month's auction, average stop rate rose 11bps to 8.93%

Similar story with NTBs: The average NTB yield climbed 37bps MoM in August to 2.12% after a 40bps MoM decline in July.

Leading the uptick in August were increases in the 182-day (+58bps) and 364-day (+22bps) bills. There were two auctions held in the primary market and both times the DMO simply rolled over. At the first auction, ₦56.78 billion was offered and sold despite a total subscription of ₦118.19 billion (subscription rate of 2.08x) while the average stop rate declined 10bps to 1.93%. At the second and last auction, the DMO also offered and the sold exact amount that matured (₦197.6 billion). However, total subscription was just at ₦221.92 billion which gives a subscription rate of 1.12x, the lowest of the year. This means in the space of a week we saw year low subscriptions at both NTB and bond auctions which could have been a side effect of the low rates on offer. Similar to the bond auction, there was an increase in the average stop rate. It was up 11bps to 8.93%, marking the first increase since March.

OMO auctions return: After just the single OMO auction in July, the CBN held three auctions over August. However, the CBN continued to offer and sell a fraction of total OMO maturity at these auctions. Over August, ₦602.4 billion worth of OMO bills matured but the CBN only offered ₦230 billion (38% of total maturity) and sold ₦215.13 billion (36% of total maturity). These are slight improvements from July where the amount offered and sold represented 27% of total maturity. Total subscription in August was ₦321.83 billion, translating to a subscription rate of 1.39x (July: 1.77x). The one year stop rate declined 5bps at the first auction to 8.94% and remained there subsequently. To manage liquidity the CBN made use of other tools most commonly CRR debits on commercial banks.

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

	OMO Issuances	NTB 91-day	NTB 182-day	NTB 364-day	NTB Total	Bond 5-year	Bond 7-year	Bond 10-year	Bond 15-year	Bond 25-year	Bond 30-year	Bond Total	NTB & Bond Total
Aug-19	-347	-	-	-	0	14.05	17.68				27.8	59.53	59.53
Sep-19	174	-	-	-	0	20.33		71.16			55.12	146.61	146.61
Oct-19	-495	-	-	-	0	32.11		64.4			46.3	142.81	142.81
Nov-19	-710	-	-	-	0	59.87		96.7			96.36	252.93	252.93
Dec-19	-2,043	-	-	-	0	67.34		86.84			133.22	287.4	287.4
Jan-20	-807	-	-	-	73	29.3		106.4			276.13	411.83	484.83
Feb-20	-1,206	-	-	-	0	55		65			40	-444	-444
Mar-20	-561	-	-	-	0	15			30		25	70	70
Apr-20	-452	-	-	-	0	40.07			82.25		53.74	176.06	176.06
May-20	-525	-	-	-	109	87.37			143.23		160.1	390.7	499.7
Jun-20	-299	-	-	-	0	32.99			16.22		50.79	100	100
Jul-20	-736	-	-	-	0	25.00			42.00	75.00	36.52	178.52	178.52
Aug-20	-641	-	-	-	0	33.42			22.95	16.09	53.69	126.15	126.15

Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

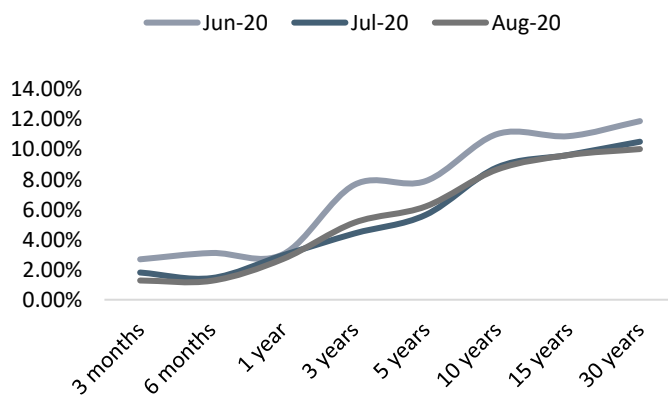
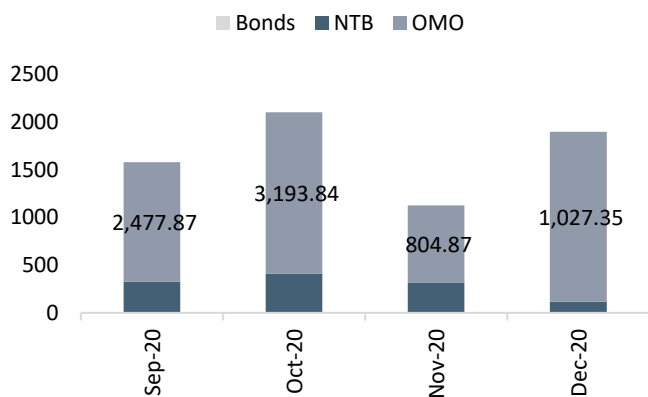
	Jun-19*	Jul-19*	Aug-19*	Sept-19*	Oct-19*	Nov-19*	Dec-19*	Jan-20*	Feb-20*	March-20*	April-20*	May-20*	June-20*	July-20*	Aug-20*
OMO	12.48%	12.25%	13.50%	13.48%	13.32%	13.30%	13.28%	13.09%	13.00%	12.99%	12.71%	9.90%	8.99%	8.99%	8.94%
NTB	11.17%	10.38%	11.86%	12.05%	10.48%	7.37%	4.83%	4.83%	4.23%	3.43%	2.73%	3.06%	2.53%	2.03%	2.10%
BOND	14.49%	13.70%	14.42%	14.49%	14.29%	12.77%	12.00%	11.18%	10.53%	11.83%	11.17%	11.17%	10.38%	8.81%	8.93%

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

Figure 1: 2020 Maturity profile (billion naira)

Source:

Figure 2: Trend in Naira yield curve



Outlook

Starting with the global picture, the US Fed announced that they would no longer be pre-emptively lifting rates to stave off higher inflation but rather will be following a policy of average inflation targeting above 2%. The effect of this policy is the new era of low rates in the US will likely persist for a while. On the domestic scene, the FG's borrowing plan over the rest of the year amidst large demand further implies that the low interest rate environment will remain over the rest of the year.

The recently released NTB issuance programme, for the three months ending in November, shows that the CBN intends to offer ₦918.45 billion which is less than the ₦1.06 trillion that is maturing; a surprising departure from their usual policy of simply rolling over in this space. This means that any new borrowings will be coming via the bond leg. The FGs last communicated borrowing schedule indicates planned domestic borrowing of ₦2.19 trillion for FY20 and so far, they have raised ₦1.94 trillion. This means they plan to raise at least an additional ₦25 billion which paints a picture of the minimum level of supply we expect to come into the system. However, as previously communicated in our NSR (*NSR H2 2020 - Fixed Income Strategy - Cloudy outlook, play short or medium term*) we believe some of the FG's revenue projections were quite optimistic and so there is a good chance of them borrowing more (circa ₦100 billion) than they indicated to meet the expected funding gap.

On the demand side, the first thing we need to consider is the maturity for the rest of the year which totals ₦6.71 trillion. There are no bond maturities left this year while the NTB issuance calendar highlights the CBN's plan to mop up just ₦918.45 billion from the ₦1.06 trillion maturing, thus net repaying ₦140 billion. On the OMO leg, if the CBN keeps its current trend of selling only ~c.30% of OMO maturities, it means ₦3.88 trillion can be expected to flow back into the system. Additional inflows to consider to get the full demand picture include ₦26.87 billion of corporate bond maturity, ₦354.33 billion worth of commercial papers maturing and ₦408.27 billion in bond coupon payments. Putting all these together means we are expecting inflows of ~₦4.8 trillion to hit the system over the next 4 months. System liquidity will also be boosted by FAAC payments that have averaged ₦667 billion this year.

The higher level of inflows compared to supply of fixed income instruments means that yields can be expected to remain low in the secondary market as demand outweighs supply. Further supporting our position on the future direction of yields is the CBN's recent decision to reduce the minimum rate on savings deposit from 30% of MPR to just 10% of MPR. This decision could see an increase in money market participation which in turn leads to higher demand in the FI market further depressing yields. The only deviation we see from this would be the introduction of a directive, similar to that of PENCOM's to PFAs; or a new policy from the CBN that would encourage selloffs or an upward repricing of yields. The latter,

however, would be a break from their current stance of keeping rates low to encourage the flow of funds into the real economy and as such is very unlikely. Additionally, with US rates likely to remain low for longer periods following the update to the Fed's policy there would now be less pressure on the CBN to raise rates to attract foreign investors.

Our recommended strategy remains the same. For the Hold till Maturity portfolio, we recommend having the NTBs and 1-4year tenor bonds while Hold for Trading portfolio we recommend splitting allocations between mid-tenor and long-tenor bonds.

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