

Healthy liquidity on the horizon

Highlights from last month

FG delivers on its promise to raise \$3 billion Eurobond for refinancing maturing treasury bills. Last month, for the second time in barely three months, Nigeria closed out on its 5th Eurobond issuance raising \$2.5 billion to refinance maturing treasury bills. The issuance was split into 12-year and 20-year series of \$1.25 billion apiece with coupons of 7.14% and 7.69% respectively. The issue was largely oversubscribed with bid to cover of nearly 4.6x reflecting investors' confidence on Nigeria's upbeat macroeconomic fundamentals. Relative to levels at the last Eurobond issue in November 2017 (10yr 6.5%, 30yr 7.625%), the current pricing seems elevated. In our view, investors demanded a higher return for taking on Nigeria's debt following the rise in yields on US treasuries which climbed to four-year highs in February.

CBN soft pedal on liquidity mop up. After two consecutive months of aggressive liquidity mop-ups, which saw OMO sales touch its highest level in January (₦2.2 trillion), the apex bank slowed down the pace of its sterilization in February with net OMO sales of ₦129 billion. Particularly, the CBN refrained from mopping up excess liquidity for one week which cascaded into liquidity surfeit in the system. This reflects the relatively illiquid system in the early part of the month and its shift in monetary posture to a more dovish one as inflationary pressure dissipated further with headline sliding 80bps MoM to 15.13% in January.

Investors demand higher return for taking on FGN bonds. Similar to a rising trend in January, marginal rates at the February bond auction were higher for both 2021 and debut 2028 bond at 13.7% and 13.98% respectively. The higher rates mirrored lower subscription levels (-22% MoM to ₦118 billion) and rising secondary market yields following a mild sell off by offshore and local investors at the start of the month. However, reflective of an improved fiscal revenue profile and FGN optimism on its 2018 external borrowing plans, the DMO displayed sensitivity towards borrowing costs by electing not to fill up its coffers at the auction, trimming sales to ₦79.6 billion relative to ₦100 billion on offer. Given the foregoing, average yields at the long end of the curve rose 29bps to 13.7%.

Treasury bills yields track higher. After rising in January on account of aggressive CBN liquidity mop-ups, average treasury bills yield climbed further in February (up 68bps to average 15.16%) driven by a liquidity strain in the early part of the month and reduced offshore activity. For context in Mid-February average Treasury bills yields rose to a 2018 high of 15.57%. However, Treasury bill yields retreated temporarily to 14.65% after CBN failed to mop up excess liquidity in the succeeding week.

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 10-year	Bond 20-year	Total	Grand Total
Jan-17	700.5	22.7	(20.0)	133.0	135.7	35.0	74.9	105.1	215.0	1,051.2
Feb-17	91.8	45.2	-	120.0	165.2	60.0	30.0	70.0	160.0	417.0
Mar-17	141.1	(24.1)	(110.5)	305.1	170.6	30.0	50.0	80.0	160.0	471.7
Apr-17	212.7	(24.2)	(2.7)	(43.9)	(70.8)	(445.3)	34.0	56.3	(355.0)	(213.1)
May-17	(89.2)	(16.0)	23.4	96.0	103.4	10.0	35.0	65.0	110.0	124.3
Jun-17	(203.4)	65.2	28.3	33.6	127.1	4.2	30.3	64.8	99.3	23.0
Jul-17	369.8	13.8	(13.3)	24.0	24.5	3.9	47.0	55.1	106.0	500.2
Aug-17	117.6	(38.5)	(10.4)	48.5	(0.4)	9.2	17.5	29.4	56.1	173.2
Sep-17	(25.6)	(21.4)	26.2	118.7	123.5	35.3	76.9	131.6	243.8	341.7
Oct-17	180.3	(39.1)	(35.8)	118.4	43.5	3.0	118.1	-	121.1	344.9
Nov-17	13.9	(29.2)	(38.5)	234.4	166.7	14.6	73.2	-	87.8	268.4
Dec-17	918.8	-	-	-	-	24.8	61.5	-	86.2	1,005.0
Jan-18	2,213.5	-	12.7	-	12.7	45.1	64.9	-	110.0	2,336.2
Feb-18	374.0	-	30.0	-	30.0	27.2	52.4	-	79.6	404.0

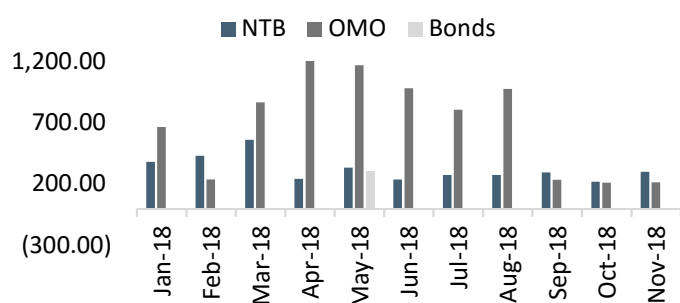
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18
OMO	18.3%	18.3%	18.5%	18.8%	18.3%	18.3%	18.3%	18.2%	17.3%	17.2%	17.0%	13.9%	13.7%	13.8%
NTB	16.7%	16.5%	16.5%	16.6%	16.5%	16.5%	16.5%	16.4%	15.9%	14.7%	14.6%	0.0%	13.4%	13.1%
BOND	17.0%	16.6%	16.3%	16.2%	16.3%	16.2%	16.2%	16.8%	15.9%	15.0%	14.8%	13.2%	13.4%	13.84%

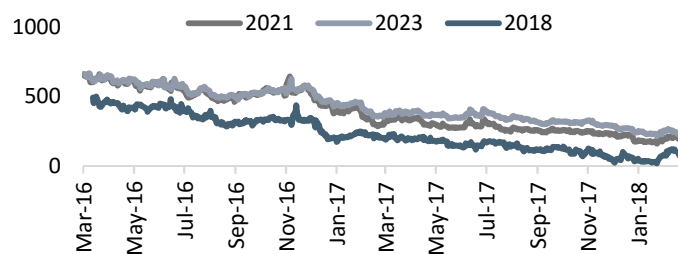
Source: FMDQ, ARM Research

Figure 1: Maturity profile over 2018



Source: FMDQ, ARM Research

Figure 2: Nigeria's sovereign z-spreads to comparable US treasuries



Source: Bloomberg, ARM Research

Outlook

Going forward, if recent trends in the fixed income market are anything to go by, then it is clear that the body language of the fiscal and monetary authorities is one that suggests further plunge in yields in the near term. Particularly on the fiscal side, the much-improved oil revenue picture alongside success on its external financing plan reduces scale of fiscal paper issuance over the near term. Meanwhile on the monetary side, considering the quantum of liquidity set to hit the system from refinancing of maturing treasury bills (₦763 billion), OMO maturities (₦11.9 trillion), Bond (₦300 billion) and NTB maturities (₦2.73 trillion), CBN is set to grapple with excess monies in the system. Overlaying this with our expectation for a further moderation in inflation, we see downward pressure on the yield curve over March with impact more pronounced at the short-end. However, to cultivate offshore interest in naira fixed income, we envisage a slow pace of easing by the apex bank. In the light of this, we see the FG sustaining its tamer FGN borrowings with lower marginal rates at subsequent auctions. For insight, at the auction on the 1st of March, CBN stunned the market by failing to fill its coffers despite higher subscription levels (bid to cover ratio of 2.79x vs 1.31x at prior auction) and even chopped off marginal rates (average marginal rates: -15bps to 12.95%) by its biggest magnitude this year.

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