

## Fixed income Monthly Update | October 2018

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### *Headroom for lofty heights*

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#### Highlights from last month

##### **National Assembly approves \$2.8 billion Eurobond request.**

In October, the National Assembly (NASS) approved President Muhammadu Buhari's request to issue \$2.8 billion Eurobond to part finance Federal Government's (FG) fiscal deficit of ₦1.96 trillion for the 2018 fiscal year. This sits well with FG's plan to trim its debt service cost via skewing its borrowings towards external sources. However, unlike February 2018, when the FG raised \$2.5 billion from the international market – a time when international conditions appear favorable – the recent interest rate hikes in the US which pushed US 10-year treasury to multi year high of 3.2% in October now portends a more hawkish pricing for Eurobond issuances. In fact, after the approval by NASS, Nigeria's Eurobond yields ticked higher with 2027 note touching an all-time high of 7.8% in October, as rising U.S. rates continue to dampen investor appetite for high-yielding assets. However, given Nigeria's position as an exporter of crude oil – particularly in the wake of higher oil prices (+2% MoM to \$80.6/bbl in October) we expect investors to be receptive to Nigeria's Eurobond sale if we hit the market this year.

**CBN strikes again.** Contrary to trends over the past four months where CBN has been net repaying at its OMO auction, the apex bank net issued ₦87 billion worth of OMO bills in October. In addition, for the second consecutive month, CBN raised rates on its one-year and 182-day OMO bill by 100bps and 50bps to 14.5% and 13% respectively. To our mind, this reflects CBN unease about resurfacing inflationary pressure (+6bps MoM to 11.28%) and the unabated plunge in FX reserves with October's decline (-5% MoM) marking the highest drawdown since March 2015.

**Bond yields ticks higher.** Bond yields sustained upward trend into October as average bond yields rose 28bps MoM to 15.23%. This was largely driven by higher stop rate at the October auction following upward repricing of the 2028 bond (+7bps to 13.32% in October) in line with yields at the secondary market a day before the auction. As a result, average bond stops rates at the auction rose slightly by 3bps MoM to 15.16% in October. The higher bid rate at the auction influenced FG's decision to borrow lower (-23%) than its planned offer of ₦115 billion for the month. For us, FG's depressed appetite for naira denominated paper stems from the much-improved revenue picture as well as FG's recent plan to approach the Eurobond market to raise \$2.8 billion worth of Eurobonds which provides alternative funding sources.

**Treasury bill yields nod higher.** Akin to trends in the past three months, FG rolled over its maturing treasury bills for the month of October. This cascaded into lower stop rates at the October NTB auction as average stop rates dipped 4bps MoM to 12.23%. However, average NTB yields at the secondary market edged up 29bps MoM to 13.95% following spike in OMO rates as well as CBN's quest to rein on naira liquidity via net issuing OMO bills in the period.

**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
<b>Oct-18</b>	180.3	-39.1	-35.8	118.4	<b>43.5</b>	3	-	118.1	-	<b>121.1</b>	<b>164.6</b>
<b>Nov-18</b>	13.9	-29.2	-38.5	234.4	<b>166.7</b>	14.6	-	73.2	-	<b>87.8</b>	<b>254.5</b>
<b>Dec-18</b>	918.8	-	-	-	<b>-</b>	24.8	-	61.5	-	<b>86.2</b>	<b>86.2</b>
<b>Jan-18</b>	1,003.30	-	12.7	-	<b>12.7</b>	45.1	-	64.9	-	<b>110</b>	<b>122.7</b>
<b>Feb-18</b>	129.2	-	30	-	<b>30</b>	27.2	-	52.4	-	<b>79.6</b>	<b>109.6</b>
<b>Mar-18</b>	-182.4	16.7	-2.5	94.5	<b>108.7</b>	10.05	8.9	45.1	-	<b>64.1</b>	<b>172.8</b>
<b>Apr-18</b>	-70.8	-6.7	23.6	-126.8	<b>-109.8</b>	38.3	12.8	38.9	-	<b>90</b>	<b>-19.8</b>
<b>May-18</b>	742.7	83.4	41.7	33.4	<b>158.5</b>	3.5	8.5	38.5	-	<b>50.5</b>	<b>209</b>
<b>Jun-18</b>	-529.8	11.6	70	139.3	<b>220.9</b>	8.8	7.9	21	-	<b>37.7</b>	<b>258.6</b>
<b>Jul-18</b>	-458.1	-	-	-139.6	<b>-139.6</b>	8.9	11.6	46.4	-	<b>66.9</b>	<b>-72.7</b>
<b>Aug-18</b>	-904.1	27.3	-46.2	28.5	<b>9.6</b>	40.2	48.5	21.4	-	<b>110.1</b>	<b>119.7</b>
<b>Sep-18</b>	-74.6	-	-	-	<b>0</b>	17.5	7.4	71.9	-	<b>96.8</b>	<b>96.8</b>
<b>Oct-18</b>	86.96	-	-	-	<b>0</b>	12.7	20.1	55.3	-	<b>88.1</b>	<b>88.1</b>

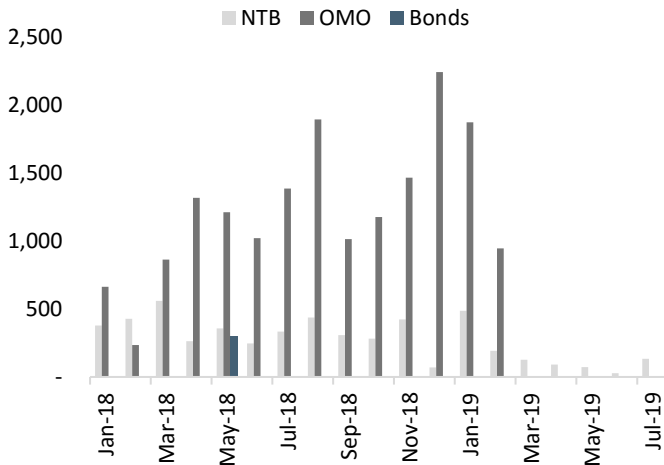
Source: FMDQ, ARM Research

**Table 2: Average OMO, NTB and Bond stop rates**

	Oct-18	Nov-18	Dec-18	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18*	Oct-18*
<b>OMO</b>	17.20%	17.00%	13.90%	13.70%	13.80%	13.73%	12.02%	12.15%	12.15%	12.15%	12.15%	13.40%	13.90%
<b>NTB</b>	14.70%	14.60%	0.00%	13.40%	13.10%	12.77%	12.08%	10.40%	10.67%	10.67%	11.07%	12.27%	12.23%
<b>BOND</b>	15.00%	14.80%	13.20%	13.40%	13.84%	13.51%	12.83%	13.51%	13.70%	14.00%	14.56%	15.13%	15.16%

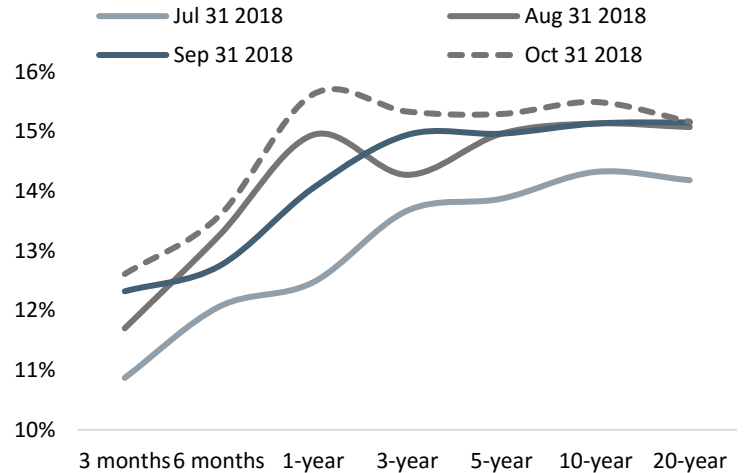
Source: FMDQ, ARM Research \*\* reflective of 1-year OMO bills

**Figure 1: Maturity profile over 2018**



Source: FMDQ, ARM Research

**Figure 2: Trend in Naira yield curve**



Source: FMDQ, ARM Research

## Outlook

Going forward, 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 sharp pace of reserves depletion witnessed in October and prospect for further depletion over the rest of the year (ARM 2018 Y/E est: \$38.4 billion), we could see CBN continue its tight lid on naira liquidity by net issuing at subsequent auction and keeping OMO rates elevated over the rest of the year in a bid to allay inflationary and currency pressures. This is expected to keep short term secondary NTB yields high over the near term. That said, the prospect for one more rate hike in the US incites the possibility of further sell-off in Nigeria's fixed income market, with knock on driving yields higher.

However, with concern over approval for the \$2.8 billion Eurobond by the NASS been laid to rest, the funding of FG's 2018 fiscal deficit could receive a big boost – particularly if the FG go ahead with planned issuance this year. The effect of this could temper FG's appetite for naira debt over the rest of the year. Notwithstanding, after factoring the Eurobond, our prognosis which guides to a domestic borrowing of ₦388 billion over 2018 implies that the FG will need to borrow ₦215 billion over the rest of the year (after deducting YTD FG borrowings of ₦172.5 billion). Consequently, given scope for higher paper supply, we see room for higher FGN bond stop rate over the rest of the year. Overall, the intertwining effect of subsisting inflationary pressures, further depletion in the reserves, higher yields in the US and higher FGN paper supply is expected to keep fixed income yields elevated over the rest of the year.

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