

Fixed Income Update and Outlook | April 2020

Worsening fiscal picture makes its impact felt

Highlights from last month

Bond yields spike as investors flee: The coronavirus induced fall in global oil demand coupled with the price war between former OPEC+ allies – Russia and Saudi Arabia – has seen average oil prices decline 39% over the course of this month. With oil being the major source of FX receipts to the country, the significant decline in the price of crude and invariably risk to reserves led to S&P downgrading the country's credit rating from stable to negative thus making our securities less attractive. Consequently, we saw massive sell offs in the bond space – with average bond yields rising by 259bps over the month to 11.64% (February: -57bps). The issuances that faced the most pressure were the March-2025 (+477bps), the March-2024 (+378bps) and the April-2023 (+365bps). The July-2021 (-19bps) was the only issuance that received any consistent demand over the month.

Changes aplenty in the primary bond market: At the start of the month, as oil prices were plummeting and making a mockery of the FG's revenue projections, the FG shocked the market by downwardly revising its bond borrowing for March to ₦65 billion from ₦170 billion. Additionally, they removed the 2029 and 2049 from the auction (understandably so as their combined outstanding value was high at ₦1.5 trillion) and introduced 2 new issuances – March-2035 and March-2050. At the auction itself the FG offered ₦50 billion and sold exactly that via competitive means. An additional ₦20 billion was sold via non-competitive means to bring total sales to ₦70 billion. Overall subscription was strong at ₦181.2 billion, a rate of 3.62x, with majority (88%) of that subscription seen for the new issuances. This means that despite the reduction in March's sales the FG still issued ₦641.82 billion in Q120, more than the ₦510 billion they said they would do in their Q120 issuance calendar

Much of the same in the NTB space: In contrast to bonds, average NTB yields in the secondary market closed lower compared to the previous month. Yields declined slightly by 28bps (February: +28bps) to 3.73% led by higher interest for short tenor bills (-69bps). In the two NTB primary market auctions this month the FG offered a combined ₦133.86 billion which matched the amount due to mature. Subscription was at ₦372.13 billion giving an average subscription rate of 2.76x which makes March the month with the highest subscription so far this year. Following the stronger subscription, average stop rate for the month declined 72bps MoM to 3.65%, with the average at the last auction at 3.43%. These are both the lowest levels for over two years.

OMO subscription dries up: We might not have seen the effect of low oil prices in the NTB space but we definitely saw it in the OMO market. At February's last auction ₦400 billion was offered with subscription at ₦545.63 billion, a rate of 1.36x. But in the first auction of March ₦100 billion was on offer but subscription was only slightly higher than this at ₦112.11 billion (1.21x) and was all for the 365-day bill. The total sales at this auction were ₦110.51 billion with the 1year stop rate down 1bp to 12.99%. At the last auction ₦150 billion was on offer but subscription was pitiful ₦18 billion which translates to a subscription rate of 0.12x, the lowest rate we have on record. Unsurprisingly, there were no sales at this auction. This paints a picture of investors, particularly foreign, staying away as the decline in oil prices dampens Nigeria's outlook.

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 30-year	Bond Total	NTB & Bond Total
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
Mar-19	1,094	-	-	-	0	39.8	62.15	20	-	-	121.95	122
Apr-19	397.7	-	-	-	0	6.81	-	37.43	-	53.16	97.4	97.4
May-19	367.12	-	-	-	0	27.38	-	35	-	48.93	111.31	43.91
Jun-19	49.6	-	-	-	0	28.99	-	36.36	-	31.49	96.84	96.84
Jul-19	484.5	-	-	-	0	28.19	7.23	-	-	51.4	86.82	86.82
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	-	-	-	0	29.3	-	106.4	-	276.13	411.83	411.83
Feb-20	-1,206	-	-	-	0	55	-	65	-	40	-444	-444
Mar-20	-561	-	-	-	0	15	-	-	30	25	70	70

Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

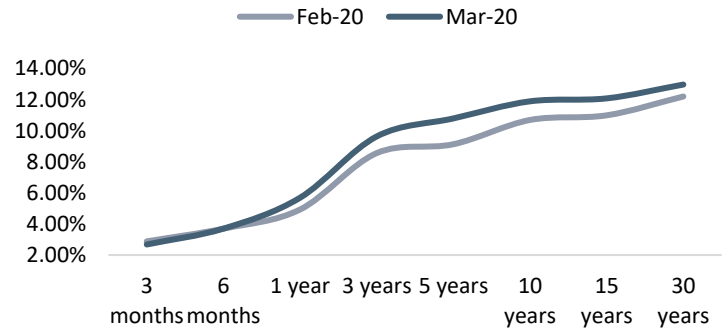
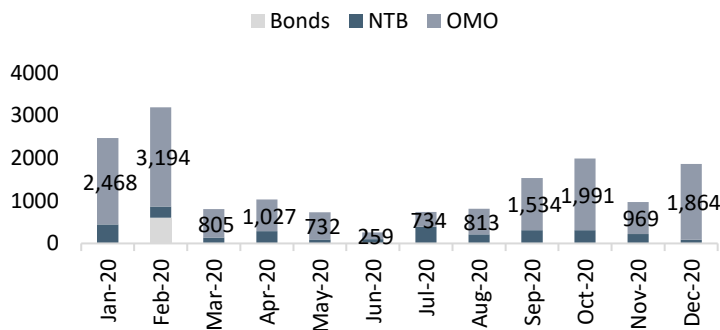
	Jan-19*	Feb-19*	Mar-19*	Apr-19*	May-19*	Jun-19*	Jul-19*	Aug-19*	Sept-19*	Oct-19*	Nov-19*	Dec-19*	Jan-20*	Feb-20*	March-20*
OMO	15.00%	14.30%	13.04%	13.02%	12.78%	12.48%	11.84%	12.12%	12.29%	13.32%	13.30%	13.28%	13.09%	13.00%	12.99%
NTB	13.01%	12.93%	11.82%	12.16%	11.58%	11.29%	10.87%	11.13%	12.05%	11.34%	8.15%	5.43%	4.51%	4.23%	3.65%
BOND	15.27%	14.75%	13.50%	14.60%	14.28%	14.49%	13.70%	14.42%	14.49%	14.29%	12.77%	12.00%	11.18%	10.53%	11.83%

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

Figure 1: Maturity profile over 2020

Source:

Figure 2: Trend in Naira yield curve



Source: FMDQ, ARM Research

Outlook

Based on the details we have been given for the FG's revised budget – lower average oil price of \$30 p/b (from \$57 p/b) and cuts in capital and recurrent expenditure to the tune of 20 and 25% respectively – oil revenue should now print at ₦1.34 trillion while expenditure would be at ₦7.64 trillion. Even if we keep the other revenue lines unchanged, although it is very unlikely they too would not be downwardly revised, total revenue comes in at ₦6.56 trillion which leads to a budget deficit of ₦1.08 trillion (ARM estimate: ₦3.96 trillion total revenue and ₦3.38 trillion deficit) from an initial deficit of ₦1.85 trillion.

The major question now with a revised budget is how the government plans to fund it. In the initial budget, the FG indicated they would be borrowing a total of ₦1.6 trillion – ₦745 billion domestically and ₦850 billion via foreign means. But with Nigeria's credit rating cut to negative and current outstanding Eurobond yields at the end of March ranging between 12% and 15% (from 3-8% as at the end of February) the FG has had to suspend any plans for Eurobond issuances indefinitely. This means it is likely that domestic borrowings would be increased to compensate for the lack of foreign borrowings and this would be despite the potential reduction in the deficit. Given the FG's propensity to simply rollover at the NTB space, we feel majority of this extra borrowing will come in the form of bonds, to extend the maturity profile. And supporting this view was the Q220 bond issuance calendar which made reference to the FG seeking approval to switch the ₦850 billion originally scheduled as foreign borrowing to domestic borrowings. If approved in full this would increase total domestic borrowing by 2.14x to ₦1.6 trillion leading to a substantial increase in the supply of bonds.

Given the current lockdown, we do not see this getting approved in time for any revisions to the April auction, where ₦60 billion is on offer. And as such we see yields over April decline from the previous month as foreign selloff eases off and domestic demand becomes the main driving force. Moving into the rest of the quarter, however, the additional domestic borrowing should kick in thus increasing supply which would cause bond yields rise relative to Q120 (average: 10.30%). It is worth stating that should the switch in borrowing sources not get approved at all (which we think is unlikely), domestic demand is likely to keep yields low over Q220.

Based on the foregoing, we recommend investors stay short until more clarity is provided on the FG's borrowing plans. However, there is scope for higher yields, should the switch to increase domestic borrowings pan out as expected.

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