

Nigeria Weekly Update

T-bill rates heading towards 10.0%

Recent auctions in the Nigerian Treasury Bill (T-bill) market have reached yields of 5.5% (for 1-year paper), trending upwards and trading much higher than yields in the secondary market (see sidebar). We think that T-bill yields can reach 10.0% per annum, if not higher, by mid-year. There is also a complex connection with rising US dollar bond yields. See pages 2 & 3 for details.

FX

Last week the exchange rate in the Investors and Exporters Window (I&E Window) weakened by 0.17% to N410.48/US\$1. In the parallel, or street, market the Naira depreciated by 0.42% to close last week at N482.00/US\$1. With the two rates 17.4% apart we believe that the World Bank may continue to insist on the unification of Nigeria's exchange rates, despite changes made during the past year. On the other hand, the most recent exchange rate adjustment to the I&E Window rate (in February) was by 7.0%. So, in our view, a few more such adjustments could easily close the gap between the NAFEX market and the I&E Window on the one hand, and the cash parallel market on the other, if the Central Bank of Nigeria (CBN) permits this.

Bonds & T-bills

Last week, the secondary market yield for an FGN Naira bond with 10 years to maturity declined by 2bps to 10.77% and at 7-years declined by 12bps to 10.33% while at 3-years the yield declined by 110bps to 6.84%, making the yield curve steeper (see page 2). What has happened is that long-dated FGN bonds have been selling off while maturities of 5-years and under are being bought. The annualized yield on a 335-day T-bill remained unchanged at 2.07% in the secondary market, while the yield on a 333-day open market operation (OMO) bill of the CBN declined by 64bps to 8.96%. At last week's Primary Market Auction for T-bills, on the other hand, the stop rates closed higher by c.133bps on average across the three tenors, closing at 2.00%, 3.50%, and 5.50% for the 91-, 182- and 364-day offers respectively. Although there is noticeable rotation in the bond market from long-dated to short-dated maturities, we believe that the overall trend in rates is upwards and will remain so for at least several weeks.

Oil

The price of Brent crude rose by 1.36% last week, closing at US\$66.13/bbl, a 27.66% increase year-to-date. The average price to year-to-date is US\$58.80/bbl, 26.49% higher than the average of US\$43.22/bbl in 2020. The combination of accelerating vaccination drives, government stimuli, and continued supply discipline on the part of producers have lifted oil prices recently. It is noticeable that among OPEC+ members (OPEC plus Russia) compliance with scheduled production cuts reached 103% in January, higher than the 101% recorded in December. However, OPEC+ is meeting this week to discuss its agreement and expectations are that some members may push for moderate production increases. Press reports indicate that Saudi Arabia and Russia are once again at odds over production policies, especially in the light of the oil price rally so far this year and the return of US shale to international markets. We believe there is there exists potential for oil prices to moderate after this meeting.

Equities

The Nigerian Stock Exchange All-Share Index (NSE-ASI) fell by 0.96% last week with a loss of 1.17% year-to-date. Oando (+12.38%), Guinness Nigeria (+4.54%), and Stanbic IBTC (+3.36%) closed positive last week, while Nigerian Breweries (-11.86%), Honeywell Flour Mills (-9.77%) and Lafarge Africa (-7.60%) closed negative. Despite the effect of rising market interest rate yields, there's the likelihood of investors taking positions in dividend-paying stocks as companies like Zenith Bank and MTN Nigeria release their full-year 2020 corporate earnings. However, our overall sense is that interest in the market is weak. See Model Equity Portfolio on page 4.

- ◆ T-bill rates head towards 10%
- ◆ The US bond connection
- ◆ Model Equity Portfolio

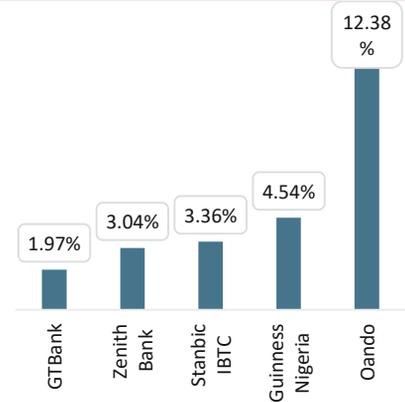
Naira Sovereign Yields

Spot

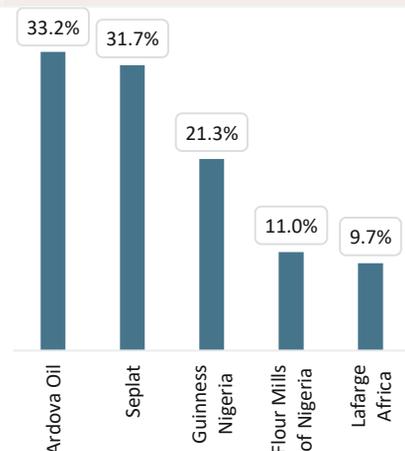
347-day (OMO)	8.96%
349-day (T-bill)	2.07%
3 Year	6.84%
7 Year	10.33%
10 Year	10.77%
Inflation	16.47%

Quotes at 26 Feb 2021

WoW Performance of C-30



Best Performing in 2021, YTD



Source: NSE, FMDQ

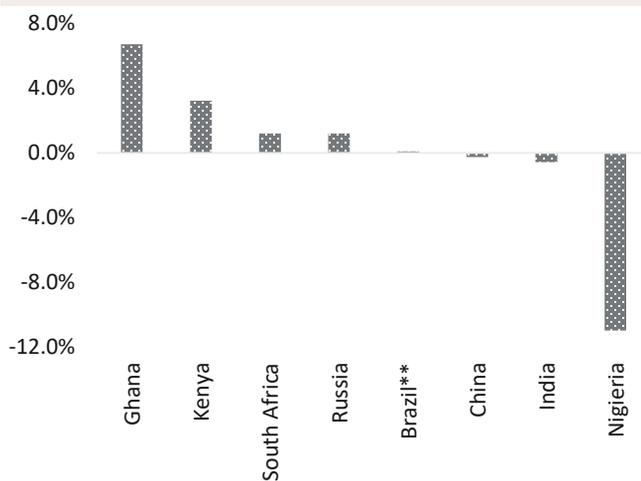
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T-bill rates heading towards 10.0%

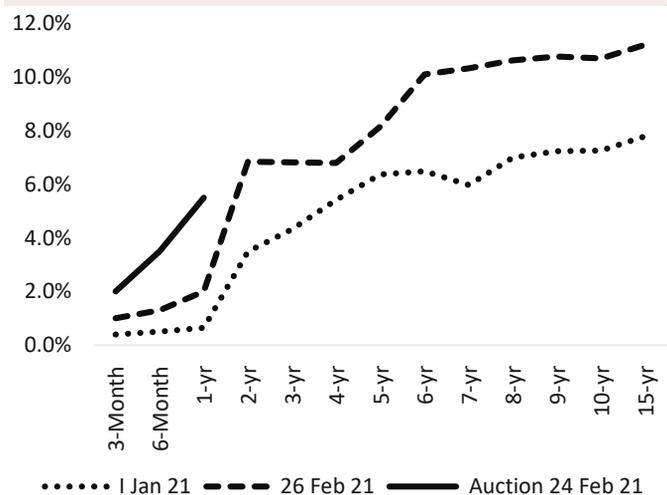
Yields in the Nigerian Treasury Bill (T-bill) market are rising and last week we received several clues as to their future direction. In recent weeks trading has focused on the primary market auctions. Last week a T-bill with 364 days to maturity was sold at 5.5%: two weeks prior that it had sold at 4.0%. If we are correct in thinking that the primary auctions accurately reflect supply and demand (more so than the secondary market) then: a) it follows that investors are pushing rates up; and b) it suggests that the Debt Management Office (DMO) and the Central Bank of Nigeria (CBN) tolerate these developments.

The CBN issued open market operation (OMO) bills in February at just over 10.0% per annum (pa). These sales are only available to foreign investors and Nigerian banks. OMO bill yields, therefore, do not translate into the secondary market for T-bills where pension funds, insurance companies, mutual funds and others are active. However, as we argued on these pages two weeks ago, the CBN may be sending a signal to all the fixed income markets with its OMO rates.

A long way back to normal: 1-yr risk-free rate* minus inflation



Moving up: Nigeria Government T-bill and bond yield curve



Source: Bloomberg, National Bureau of Statistics (NBS), Debt Management Office (DMO), FMDQ, Coronation Research *in local currency ** the percentage for Brazil is +0.09%

One solid argument for allowing rates to rise is that Nigeria's T-bill yields are out of step with interest rates in other nations, which inhibits foreign portfolio investment (FPI) reaching Naira-denominated securities. When international investors look at local currency yields, they usually compare yields with local inflation, with a simple inflation adjustment (1-yr risk-free rate minus inflation) being a sufficient guide (which is often seen as a proxy for upcoming devaluation). On this comparison Sub-Saharan African countries like Ghana and Kenya score well and so too, to some degree, does South Africa. Large nations like Brazil, Russia, India and China currently have 1-year risk-free rates close to inflation. Nigeria is a significant outlier.

When it comes to inflation, interest rates are a contributory factor. Other key factors include effective exchange rates; external input prices (notably the price oil as reflected in petrol and diesel prices); structural factors (in other words, efficiency); money supply (including financing of government). Clearly, it is difficult for policy makers in any country to address all these variables at the same time. However, interest rates can be addressed quite straightforwardly. And when headline inflation increases from 15.75% y/y in December to 16.47% in January, then the case for allowing market interest rates to rise is easy to make.

How does this square with what the CBN is saying? We are fortunate in that the Governor of the CBN, Godwin Emefiele, made his opinions clear in an address to the Vanguard Economic Summit last week (Thursday 16 February) organised by the Vanguard Newspaper. He voiced his concerns that: "the economy still remains on a fragile recovery path. It is therefore imperative that we do all we can in 2021 to ensure that we build on the positive momentum and strengthen our efforts at stimulating growth." The answers to the question of how to keep the economy growing include measures to: "Sustain the accommodative fiscal and monetary policy measures aimed at improving access to finance to households and businesses," and "Improving Foreign Exchange inflows into the country."

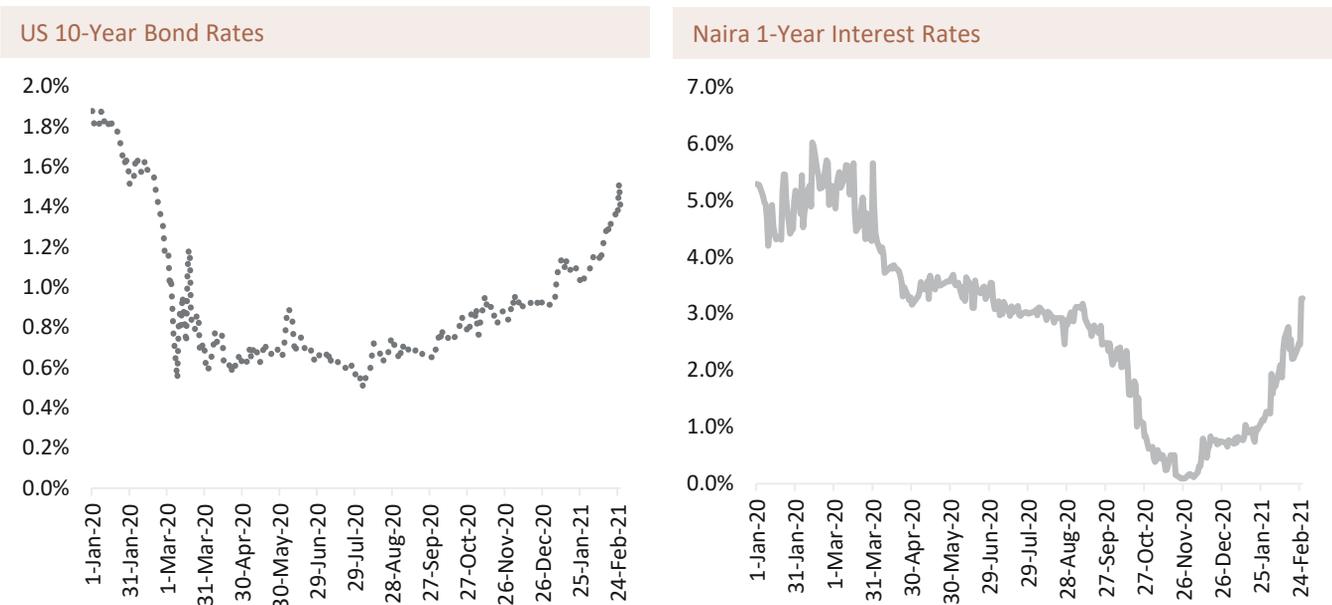


T-bill rates heading towards 10.0%

Do accommodative fiscal and monetary policy measures necessarily mean a continuation of 2020's policies of low interest rates? We do not think so. Accommodative fiscal policy can mean helping government to reach its budget targets, which does not have a direct bearing on interest rates. Accommodative monetary policy measures do not necessarily imply low interest rates, especially when one considers that the CBN makes a priority of targeted lending to strategic sectors such as agriculture in its efforts to support the economy. These can be considered accommodative measures, not just market interest rates. And allowing market interest rates to rise squares with the Governor's stated desire to improve foreign exchange inflows.

The US bond connection

It is not often that the US bond market appears to have an influence on Nigerian rates. They are usually quite separate. Yet we cannot help noticing that US 10-year bond yields are rising just at the same time as Nigerian Naira 1-yields are rising. (Note that we are talking about 1-yr Naira yields and 10-year US bond yields: short-term rates in the US are still trending downwards.) Is there a connection?



Source: Bloomberg, FMDQ, Coronation Research

The narrative behind the rise in US 10-year bond yields is as follows: the US is introducing an enormous fiscal package to stimulate the economy; this implies that economic growth will pick up; some models link rates directly to growth; in any case, growth could imply rising inflation in which case the US Federal Reserve system would be obliged to raise rates at some point in future. The narrative in Nigeria is somewhat different: inflation is already rising even though growth is slow (the economy grew by 0.11% in Q4 2020); interest rates needs to rise if these will help contain inflation; attractive interest rates are needed for foreign investment.

So, the similarities between the two markets are not obvious. On the other hand, the rise in US 10-year government bond rates is having some significant effects: the advance in commodity prices has paused; the US Nasdaq market of technology stocks corrected by 6.9% in the second half of February; the yields of emerging market sovereign Eurobonds have begun to rise, after 10 months of relentless yield compression. This year began with a the 'global hunt for US dollar yield ' thesis intact: now it has a question mark over it. For the issuer and for the holders of Nigerian sovereign Eurobonds it is important to consider the implications. We will return to this topic next week.



Model Equity Portfolio – 26 February 2021

Last week the Model Equity Portfolio fell by 0.03% compared with a fall in the Nigerian Stock Exchange All-Share Index (NSE-ASI) of 0.96%, therefore outperforming it by 93 basis points. Year to date it has lost 0.73% against a loss in the NSE-ASI of 1.17%, outperforming it by 44bps.

Last week our notional positions in five bank stocks did well, with a combined contribution of 49bps. The notional position in Stanbic IBTC, which cost us dear the week before (62bps) partly redeemed itself last week with a contribution of 13bps.

Model Equity Portfolio for the week ending 26 February 2021

Security	February 19, 2020	February 26, 2020	Security weighting	Weekly change	Change since purchase	Performance attribution (bps)	
	position, N	position, N				Past Week	ytd
FBNH	175,200,000	176,400,000	1.1%	0.7%	2.8%	1	3
Zenith	1,197,950,000	1,234,325,000	7.9%	3.0%	2.6%	23	20
UBA	290,500,000	285,250,000	1.8%	-1.8%	-5.8%	-3	-11
GT Bank	1,200,800,000	1,224,500,000	7.9%	2.0%	-4.2%	15	-34
Stanbic IBTC	599,850,000	620,000,000	4.0%	3.4%	-9.2%	13	-40
MTN Nigeria	3,060,000,000	2,592,600,000	16.6%	-3.3%	2.4%	-59	54
Airtel Africa	2,604,000,000	2,602,140,000	16.7%	0.0%	9.2%	-0	146
Dangote Cement	2,024,000,000	1,804,000,000	11.6%	0.0%	-10.2%	-1	-172
BUA Cement	1,123,200,000	1,123,200,000	7.2%	0.0%	-6.9%	0	-53
Nestle Nigeria	14,500,000	14,500,000	0.1%	0.0%	-3.7%	0	-0
Okomu Oil	575,670,000	575,670,000	3.7%	0.0%	2.2%	0	8
Presco	676,574,500	689,521,000	4.4%	1.9%	1.3%	8	6
Cash	2,053,546,653	2,648,831,201	17.0%	0.0%	0.0%	0	0
Total	15,595,791,153	15,590,937,201	100%	-0.03%	-0.73%	-3	-73

Source: Coronation Research

Last week we forewarned our readers that we would make sales among our industrial stocks in order to raise our notional cash position by up to five percentage points, in the event making notional sales to bring the notional cash position up from 13.2% to 17.0%. We made notional sales in MTN Nigeria, Dangote Cement and Airtel Africa (which, frustratingly, is a very illiquid stock at the moment). We intend to continue with these tactics this week with the aim of reaching a notional cash position of 20.0%.

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Coronation Asset Management,
10 Amodu Ojikutu Street,
PO Box 74853, Victoria Island
Lagos, Nigeria.