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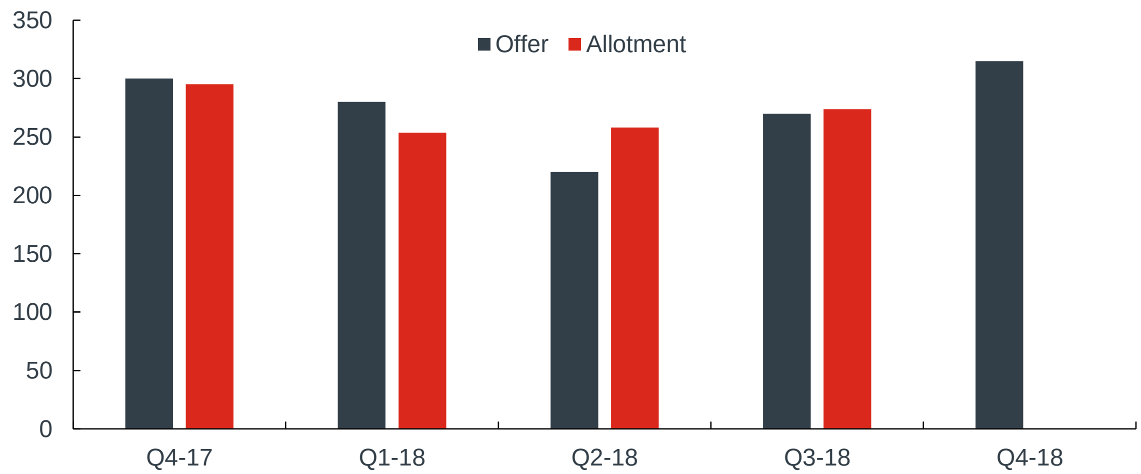
Bond auction calendar. *Q4-2018.*

Increased borrowing on the horizon

The Debt Management Office (DMO) recently released the Q4-2018 bond issuance calendar, and in line with our expectations, it indicates a NGN67 billion - NGN112 billion increase in planned borrowing, to NGN270 billion - NGN360 billion, compared to NGN203.34 billion sold in the previous quarter. The median amount planned (NGN315 billion) is 17% higher than the offering in Q3-18 and 5% higher than in Q4-17. It is also the highest quarterly offering since the NGN300 billion offered in Q4-17. Instructively, total net bond issuance, year-to-date, stands at NGN485.59 billion, with NGN307.41 billion left to complete the NGN793 billion budgeted domestic borrowing for 2018.

We reiterate our expectation for yield uptick in the bond market, albeit below 2017 highs of 17.12%. Our position remains anchored on the increased hawkish delineation of the monetary policy committee through the rest of the year, combined with expected weaker participation by foreign investors as the Fed continues its tightening stance, the impact of which will sustain foreign investors apprehension towards naira denominated assets. To add, we see scope for higher federal government borrowing over the rest of the year as the administration remains steadfast in implementing the 2018 budget to score political points ahead of the general election.

Figure 1: Bond auction offered & allotted (NGN'bn)



Source: DMO, Cordros Research

On the MPC, whilst the committee elected to leave policy parameters unchanged in its last meeting, its body language largely tilted towards hawkish stance. Specifically, aside from the three members voting for a rate hike, three more members elected to hike CRR rate suggesting that the committee is betwixt and between about the liquidity surfeit in the system, together with recent uptick in inflation. Although, CBN has net repaid a total of NGN2.06 trillion worth of OMO bills between June and September, which might signal loose policy, we highlight that year-to-date, CBN has net issued NGN787 billion and also mopped up excess liquidity via the second-order impact of FX sales to ward-off speculative tendencies on the naira. To our mind, CBN's tolerance for liquidity in recent months must have been necessitated by weak demand and investors' hunt for higher yield with CBN clearly aversive towards raising stop rates to support fiscal authority's quest to cut down on borrowing cost even as reserves continue to take the brunt. Evidently, CBN sold a total of USD5.7 billion across its different windows to keep FX market lubricated and equally mop up the liquidity build up. That said, we expect CBN hawkish rendition to reflect in OMO issuances through the rest of the year as increased foreign

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sell-offs of naira assets drives pent up demand for FX, with CBN stepping up paper issuances to arrest speculative tendencies on the naira.

Wider budget deficit

According to the Central Bank of Nigeria's August Economic Report, the federal government's fiscal deficit printed NGN1.13 trillion, 58% of the total budgeted deficit (NGN1.95 trillion) for 2018, and 87% when compared on a pro rata basis. This is due to the budget's late passage, with total expenditure implementation only at 39%. Specifically, capital expenditure, at 22% implementation, significantly lags recurrent expenditure at 49% implementation. FGN retained revenue, at 2.45 trillion YtD, is also only at 34% of the full year budgeted total, and 51% on a pro rata basis.

Figure 2: Federal Government fiscal operations (2018 budget vs. actual)

(NGN'billion)	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	YTD	2018E
FGN retained Revenue (B)	597.16	597.16	597.16	597.16	597.16	597.16	597.16	597.16	**4,777.25**	**7,165.87**
FGN retained Revenue (A)	349.70	274.20	278.70	315.40	299.10	282.20	306.70	344.30	**2,450.30**	**4,427.40**
Actual as % of budgeted									*51%*	*62%*
Gross FGN expenditure (B)	760.00	760.00	760.00	760.00	760.00	760.00	760.00	760.00	**6,080.00**	**9,120.00**
Gross FGN expenditure (A)	639.60	373.90	684.40	218.60	509.80	358.70	485.40	309.20	**3,579.60**	**6,821.60**
Actual as % of budgeted									*59%*	*75%*
Recurrent (B)	476.42	476.42	476.42	476.42	476.42	476.42	476.42	476.42	**3,811.33**	**5,717.00**
Recurrent (A)	470.80	233.30	570.90	175.30	426.20	297.00	346.00	287.20	**2,806.70**	5,717.00
Actual as % of budgeted									*74%*	*100%*
Capital (B)	239.42	239.42	239.42	239.42	239.42	239.42	239.42	239.42	**1,915.33**	**2,873.00**
Capital (A)	130.80	132.00	98.10	22.60	68.70	43.90	120.20	4.70	**621.00**	**574.60**
Actual as % of budgeted									*32%*	*20%*
Transfers (B)	44.17	44.17	44.17	44.17	44.17	44.17	44.17	44.17	**353.33**	**530.00**
Transfers (A)	38.00	8.60	15.40	20.70	14.90	17.80	19.20	17.30	**151.90**	530.00
Actual as % of budgeted									*43%*	*100%*
Deficit/Surplus(B)	-162.84	-162.84	-162.84	-162.84	-162.84	-162.84	-162.84	-162.84	**-1,302.75**	**-1,954.13**
Deficit/Surplus(A)	-289.90	-99.70	-405.70	96.80	-210.70	-76.50	-178.70	35.10	**-1,129.30**	**-2,394.20**
Actual as % of budgeted									*87%*	*123%*

Source: Budget Office, CBN, Cordros Research estimates

Assuming 75% budget implementation, we estimate a 23% increase in the planned budget deficit to NGN2.39 trillion, anchored on lower than expected government revenues, which have consistently lagged monthly estimates over the year. FGN initially planned to raise NGN793 billion domestically, and NGN872 billion externally, totalling NGN1.67 billion, to finance the deficit. However, based on our estimates, this now leaves a shortfall of NGN1.26 trillion.

So far, net-borrowing in the domestic bond market stands at NGN485.59 billion. Additionally, the President has requested approval to proceed with the USD2.86 billion (NGN872 billion) Eurobond issuance, although this may prove tricky amidst increasing political tensions within the National Assembly. The government also plans to offer 10 state-owned companies for sale to selected investors and the public in Q4 in order to raise NGN289 billion. All the aforementioned still isn't enough to plug the deficit, and thus, we expect to see increased borrowing, especially from the domestic leg c.360 billion. However, with CBN's claim on FGN now in excess of NGN837 billion as at March 2018, we do not expect all the borrowings to be sourced through the capital market.

Year-to-date, stop rates have climbed 193 bps on average at auctions, with rate on the 5-year and 10-year bonds expanding by 181 bps and 204bps to 15.00% and 15.25% respectively. Investor interest has strengthened recently, following the EM selloffs in May, with the September auction recording a NGN68.51 billion oversubscription, the highest since the April auction and the third most over-subscribed of the year.

In the near term, we expect the uptick in supply to drive bearish sentiments in the secondary market, in tandem with (1) strengthening signs of monetary tightening, (2) capital flight amid higher yields in safe haven assets, (3) political uncertainty stemming from the upcoming elections, and (4) sustained uptick in inflation rate.

Disclosures.

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