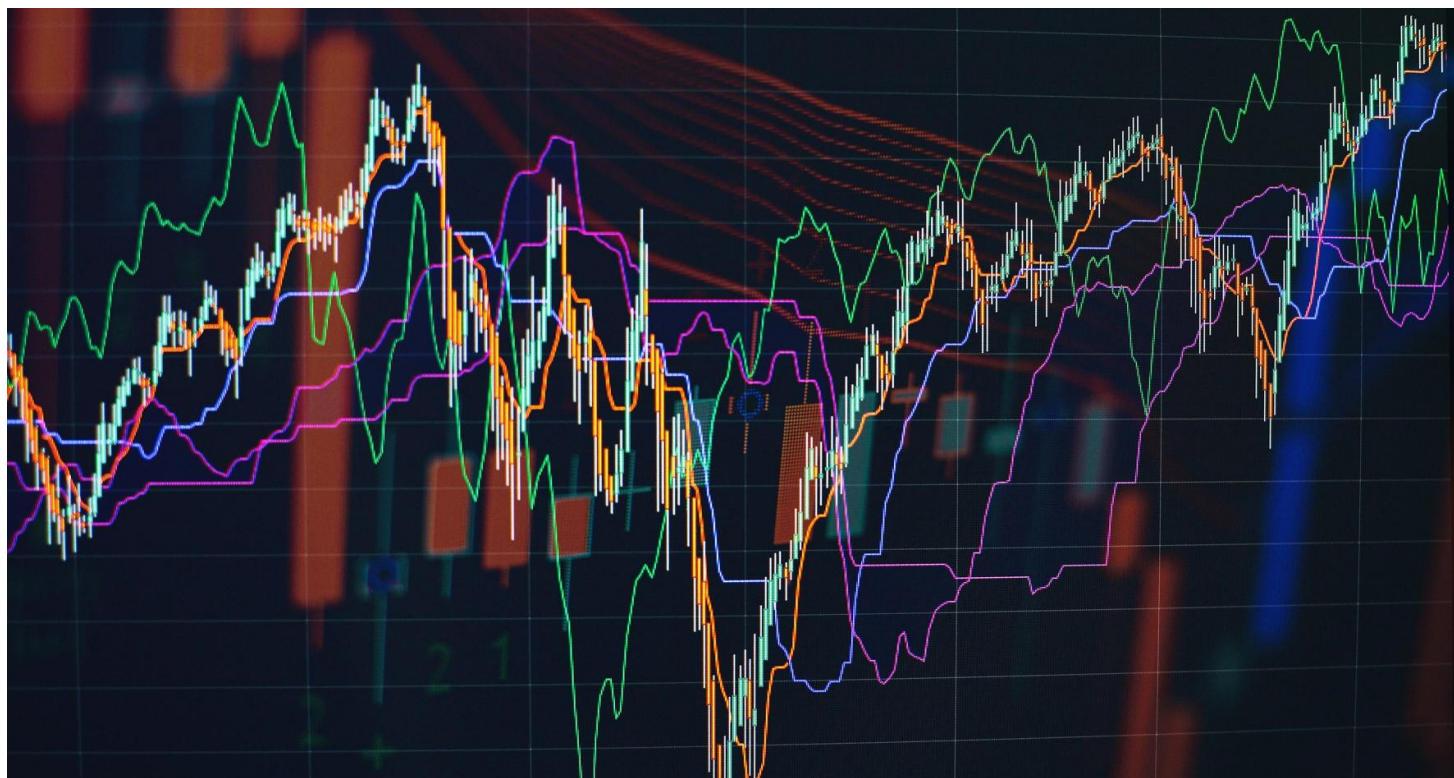


Fixed Income Research

Monthly Fixed Income Market Report August 2024

2nd September 2024



Breaking the Mold

Contrary to our bearish expectations, Nigeria's fixed income market exhibited remarkable strength in August 2024. Despite concerns about rising yields due to economic pressures, both the Nigerian Treasury bills (NT-bills) and FGN bonds segments witnessed robust demand.

The NT-bills market saw a significant decline in average yields, decreasing by 397bps month-on-month (MoM) to 21.21%. This was driven by increased investor interest and repricing across all tenors (short-tenor: -307bps MoM, mid-tenor: -430bps MoM and long-tenor: -349bps MoM). Similarly, the average yield in the FGN bond market fell by 80bps MoM to 18.96%. The decline in bond yields suggests a strong appetite for longer-term securities, possibly fueled by expectations of declining inflation and less hawkish CBN.

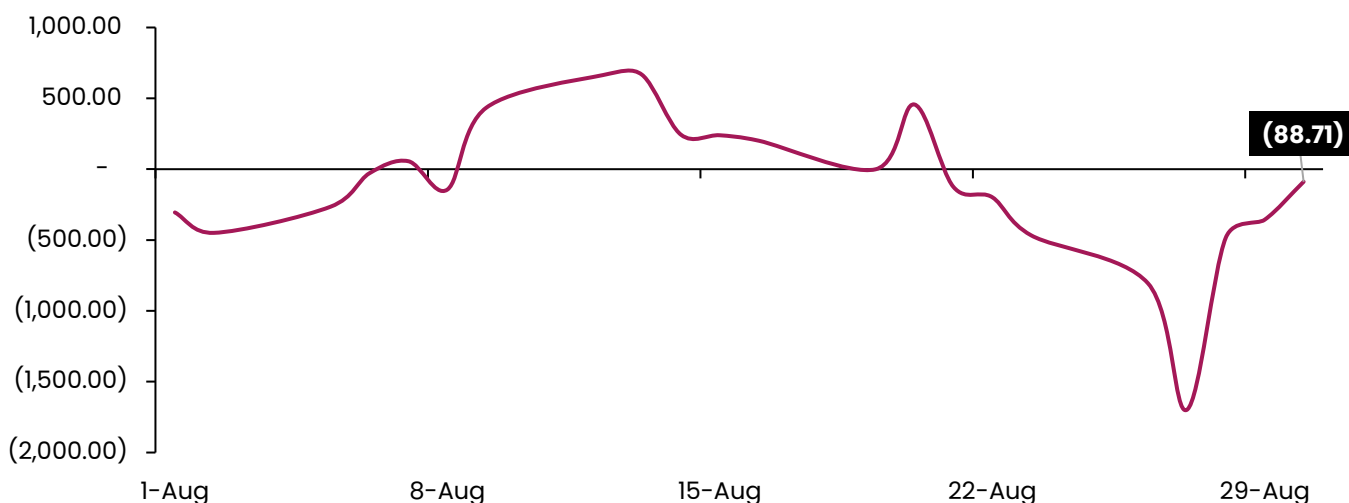
Overall, the Naira fixed income market concluded August on a positive note, with the average yield contracting by 239bps MoM to 20.08%. The strong investor appetite for government securities, as evidenced by the

significant drop in yields across the NT-bills and FGN bonds markets, also highlights the resilience of the fixed income market amid challenging economic conditions.

Additionally, Nigeria's financial system experienced a liquidity crunch in August 2024. System liquidity, which averaged a surplus of NGN810.73bn in July, shifted to a deficit of NGN111.49bn during the month. The primary driver of this liquidity decline was a significant decrease in the average Standing Lending Facility (SLF) utilization from NGN926.84bn in July to NGN148.05bn in August. Simultaneously, the average Standing Deposit Facility (SDF) balance increased from NGN95.61bn to NGN364.72bn.

These shifts can be attributed to the Monetary Policy Committee's (MPC) decision at their last meeting to tighten the asymmetric corridor around the Monetary Policy Rate (MPR) to +500bps/-100bps. This tightening made borrowing from the CBN more expensive, discouraging banks from relying on the SLF and incentivizing them to deposit more funds with the CBN at the higher SDF rates. However, to mitigate its cost, the CBN recently released a circular adjusting the SDF asymmetric corridor and cut the SDF rate on excess deposits above the NGN3.00bn limit for Commercial and Merchant banks to 19.00%, from 25.75%. Similarly, Payment Service banks have also seen their SDF rates on excess deposits above the initial NGN1.50bn limit lowered from 25.75% to 19.00%.

Chart 1: August 2024 System Liquidity (NGN'bn)



Source: CBN, ARM Research

FGN Bond Market

In August 2024, the Debt Management Office (DMO) issued FGN bonds at the primary market. The DMO offered NGN190bn worth of bonds across the reopening of the APR-2029 (NGN70bn), FEB-2031 (NGN70bn) and MAY-2033 (NGN50bn) instruments. The average bid-to-cover ratio surged by 149bps to 2.42x (vs. 0.93x at the previous auction). This was driven by an increase in investor's demand for the instruments but primarily by the MAY-2033 (+509bps to 7.50x) instrument. Consequently, the average stop rate declined by 6bps to settle at

20.90% down from 20.96% in the previous month's auction. Following the positive investors' appetite, the DMO sold NGN374.75bn worth of bonds, 1.97x the amount offered.

Moving on to the secondary market, the FGN bond market concluded on a bullish note as the average yield declined by 80bps MoM to close at 18.96%. This sentiment was propelled by buying interest in the second (-35bps WoW), third (-8bps WoW) and fourth (-67bps WoW) weeks in the month offsetting selloff in the first (+28bps WoW) week. Suggesting improved investors' confidence in the market.

Furthermore, the FGN corporate bond market experienced a positive sentiment in August 2024, with the average yield declining by 59bps MoM to 21.85%. Similarly, the FGN Eurobond market closed the month on a bullish note, with the average yield falling by 47bps MoM to 9.72%. This indicates increased investor interest in Nigerian Eurobonds compared to the previous month, which saw minimal activity and a flat yield curve.

Nigerian Treasury Bills Market

In August 2024, the Nigerian Treasury Bills (NT-bills) auctions experienced an uptick in the average stop rate, rising by 52bps MoM to 19.70% (vs. 19.18% in June 2024). The average bid-to-cover ratio surged to 2.42x from 1.54x in July, driven by a significant increase in investor demand. This heightened demand is reflected in the sharp rise in total subscriptions, which soared from NGN682.61bn in July 2024 to NGN1.51trn in August 2024.

In August 2024, the Central Bank of Nigeria (CBN) conducted two (2) NT-bill auctions, offering a cumulative NGN626.06bn in treasury bills, an increase from the NGN444.07bn offered in July, NT-bills valued at NGN507.12bn were sold. The reduced allotment in August NT-bills auction, despite robust subscription and offer levels, likely reflects the Central Bank of Nigeria's deliberate strategy to manage market liquidity and borrowing costs. By limiting the allotment, the CBN sought to maintain interest rate stability, mitigate inflationary pressures, and ensure alignment with broader monetary policy objectives.

At the first auction in August, the average stop rate declined by 7bps to 19.96% (vs. 20.03% at the previous auction). This decline followed a surge in demand, as evidenced by an increase in the average bid-to-cover ratio, which rose to 2.25x from 1.35x in the prior auction.

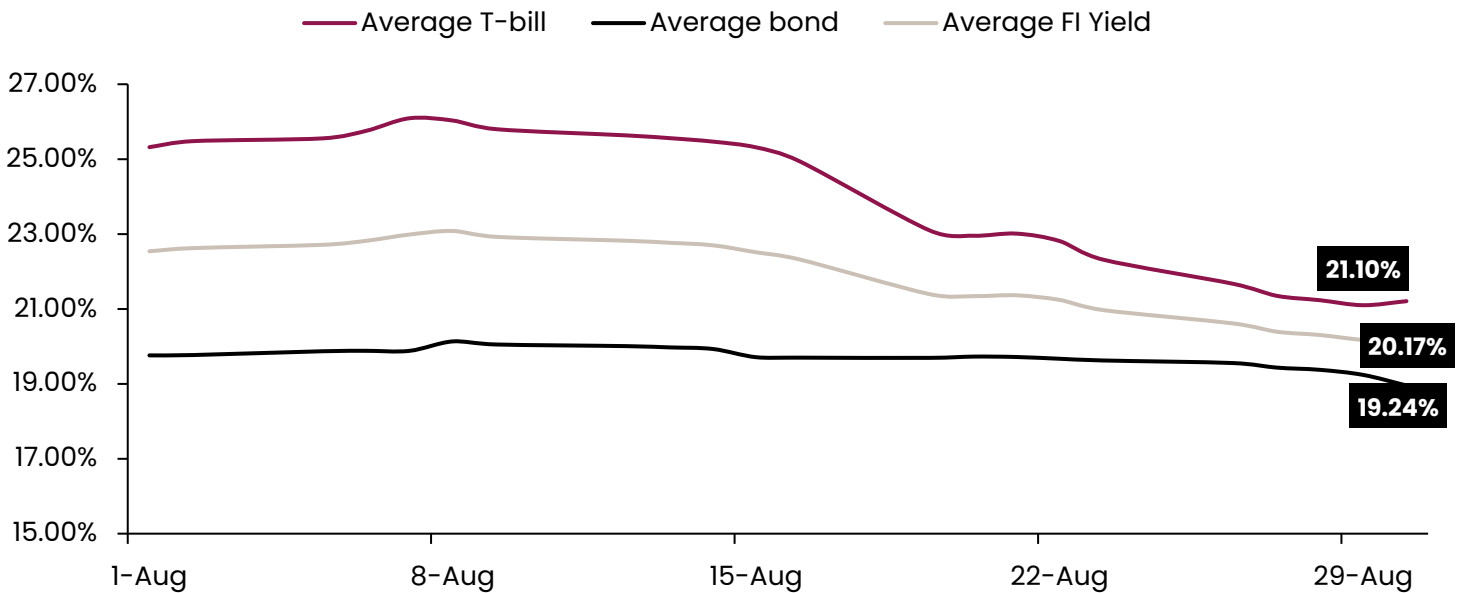
Similarly, at the second auction of the month, the average stop rate dropped by 53bps to 19.43% (vs. 18.33% at the previous auction). This occurred amidst higher demand, as evidenced by a significant surge in the average bid-to-cover ratio, which increased to 2.51x from 2.25x in the earlier auction.

The NT-bills secondary market ended the month positively, with the average yield increasing by 397bps MoM to 21.21% (from 25.18% in July 2024). Buying interest during the second week (-0.86%), third week (-2.63%), and fourth week (-1.11%) helped counterbalance the selloffs experienced in the first week (0.32%).

OMO

During the month in view, the Central Bank of Nigeria (CBN) held only one (1) Open Market Operation (OMO) auction, offering NGN500bn worth of OMO bills across the 91-day (NGN75bn), 175-day (NGN75bn) and 364-day (NGN350bn) bills. The average bid-to-cover ratio rose by 95bps to settle at 1.53x compared to 0.58x at the previous auction. This was primarily driven by a surge in demand for the 364-day bill, which saw its bid-to-cover ratio rise by 133bps to 2.18x. Due to insufficient demand, there was no allocation for the 91-day and 175-day bills. The stop rate for the 364-day bill was set at 21.87%. As a result of the high demand for the 364-day bill, CBN sold NGN758bn worth of the OMO bills which is 2.17x the amount offered for the tenor and 1.52x the total amount offered at the auction. The heightened demand for the longer-tenor bill indicates a strong investor appetite for higher returns amidst prevailing economic conditions.

Chart 2: Yields Trend in August 2024



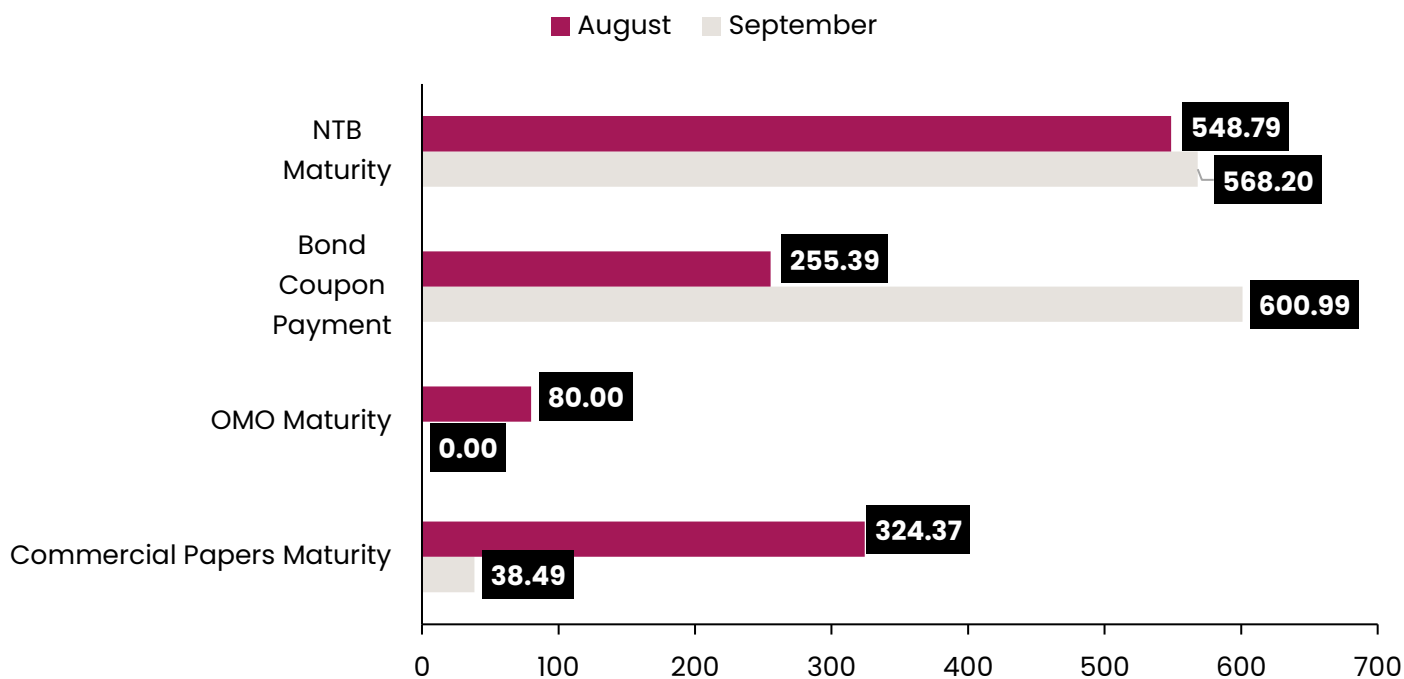
Source: FMDQ, ARM Research

Outlook

In September 2024, we anticipate a moderate increase in liquidity in the Nigeria fixed income market. This is primarily due to the maturity of NGN568.20bn in treasury bills and NGN600.99bn in bond coupon payments. Regarding market performance, investors' sentiment will likely be influenced by expectations surrounding potential interest rate changes ahead of the CBN MPC meeting.

While we expect the MPC to maintain rates at its next meeting on the 23rd and 24th of September 2024, there is a possibility of a 50bps hike if inflation resurges. If the MPC decides on a rate hike, it could impact investor sentiment and potentially lead to an increase in yields. However, given the overall positive market dynamics and the influx of liquidity from maturing securities, we expect the bullish trend in the fixed income market to persist.

Chart 3: Maturity Profile and Coupons in August and September 2024



Source: FMDQ, ARM Research

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