

## Ahead of Next Bond Auction

## SUMMARY OF PREVIOUS AUCTION

## Marginal Rates:

12.50% JAN 2026	11.50%
13.00% JAN 2042	13.00%

## Amount:

12.50% JAN 2026	NGN81.72bn
13.00% JAN 2042	NGN88.92bn

## SUMMARY OF CURRENT AUCTION

## FGN JAN 2026

Auction Date	16/02/2022
Settlement Date	18/02/2022
Maturity Date	22/01/2026
Next Coupon Date	22/07/2022
Clean Price	104.05

## FGN JAN 2042

Auction Date	16/02/2022
Settlement Date	18/02/2022
Maturity Date	21/01/2042
Next Coupon Date	21/07/2022
Clean Price	105.14

FGN Bond Auction Scheduled for 16<sup>th</sup> February 2022

## Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Wednesday 16<sup>th</sup> of February 2022. The total amount on offer is expected to be between NGN140bn and NGN160bn from two issues. The two instruments (Jan 2026 and Jan 2042) are re-opening issues.

**12.50% FGN JAN 2026** **NGN70bn – NGN80bn**

**13.00% FGN JAN 2042** **NGN70bn – NGN80bn**

## Current Yield Analysis

In January 2022, there was high system liquidity from maturities of different Nigerian Treasury instruments as well as coupon payments. This contributed to the high investors' participation at the Primary Market Auction (PMA) conducted during the month. Thus, overall bid-to-offer ratio was 2.17x (vs. 1.33x in December 2021). Eventually, the amount allotted was NGN81.72bn and NGN88.92bn for the 2026 and 2042 instruments, respectively. Also, the marginal rate on the re-issued 2026 instrument was 11.50% (15bps lower than the December 2021 rate), while the newly issued 2042 was offered at a yield of 13.00%.

With the high system liquidity in January contributing to keeping the marginal rates low, there is still a case for a lower rate in the current auction given that system liquidity remains high. On the other hand, the prolonged regime of negative real rates as inflation rate remains elevated will continue to motivate investors to demand higher rates. In the medium term therefore, we maintain our uncertain outlook for yield given that factors exist that could sway yield in either direction.

In the secondary market, investors have been benefitting from price return as yield has been declining. As at 14<sup>th</sup> February 2022, average bond yield was 10.32%, 41bps lower than the rate on the last auction date (and 60bps lower than the closing rate on 31 December 2021). We think that the contributory factors to the bullish sentiment include the high system liquidity mentioned earlier, as well as the direction of yields at the Primary Market Auctions. We expect the downtrend in yield to persist in the medium term.

**Please see the table below for our recommended bid rates based on our analysis of the current yield environment.**

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### Bond Absolute and Relative Valuation

In valuing the **12.50% FGN JAN 2026** and **13.00% FGN JAN 2042** offers with the current yield curve as the basis for discounting, we arrived at the following fair value, implied yield and advised bid rates for the instruments:

Instrument	Fair Value	Implied Yield	Advised Bid Rates
<b>12.50% FGN JAN 2026</b>	104.05	11.19%	11.20% - 11.60%
<b>13.00% FGN JAN 2042</b>	105.14	12.30%	12.95% - 13.10%

Our valuation gives a fair-trading price ex coupon payment, the expected return on the bond considering its periodic interest payments and the expected return on the bond's periodic payments. We analysed the issues on offer given the current yield environment, market liquidity, as well as a review of the recent past auctions, whilst also introducing market sentiment factor into our valuation, on which we advise bid yield ranges for both issues on offer.

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## About Bonds

**A bond is a fixed income debt instrument issued by the government (federal or state government) or corporate institutions with a definite date of maturity and a fixed interest payment (known as coupon) payable either semi-annually or annually. Unlike equities, bonds are issued with a guarantee of the initial investment and can have tenors as long as 20 years.**

A treasury note refers to a government bond instrument with a term to maturity of 1 to 10 years while a treasury bond has a maturity of 10 years and above. Bonds issued by state governments of a country are referred to as municipal bonds while those issued by organizations are corporate bonds.

The government usually issue bonds at the primary market to raise domestic funds to meet its fiscal responsibilities. This can be done from time to time as the need arises. Nigerian FGN bond instruments are named by their maturity, coupon, tenor etc. such as 13.05% FGN AUG 2016 instrument.

## How is Return Determined?

Bonds are mostly issued with a coupon otherwise known as **the periodic interest payable**. Bond instruments are usually issued at par; that is, N100 or N1,000 as is the case with Nigerian bonds. A 2-year bond issued at 12% annual coupon with a par value of N1000 implies that the issuer will make 3 semi-annual payments of N60, and a final N1060 on the maturity date.

Bonds can be purchased at both the primary and secondary markets, they are either quoted in price or yields. **There is an inverse relationship between the price of a bond and its yield to maturity (YTM)**. At issuance, the yield on a bond instrument is most likely the coupon on that instrument. At the secondary market therefore, an investor can trade bonds by quoting a yield that reflects the variance between the par value and the current price based on the current market dynamics.

## How does the Auction Process work?

**Bond instruments are issued through a competitive bidding process at auctions as conducted by the Debt Management Office which serves as the representative of the government. An existing government instrument can be re-issued also at the primary market in which case the DMO re-issues based on the current market yield to maturity.**

**Bonds are auctioned at established rates which determine the return to investors.**

Purchasing these instruments in the primary market and holding it till maturity would mean that the investor gets a fixed interest payment, however, there is a secondary market in which investors can trade these bonds to meet their immediate liquidity needs.

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