Ahead of Next Bond Auction

FGN Bond Auction Scheduled for 20th March 2023

Issue on Offer/Summary

The Federal Government of Nigeria (FGN), through the Debt Management Office (DMO), will be conducting a bond auction on Monday, March 20, 2023. The total amount on offer is expected to be between NGN320bn and NGN400bn from four issues. The instruments include four re-opening issues (FEB 2028, APR 2032, APR 2037, and APR 2049).

13.98% FGN FEB 2028	**NGN80bn – NGN100bn**
12.50% FGN APR 2032	**NGN80bn – NGN100bn**
16.25% FGN APR 2037	**NGN80bn – NGN100bn**
14.80% FGN APR 2049	**NGN80bn – NGN100bn**

Current Yield Analysis

At the last Primary Market Auction (PMA) held in February 2023, demand for the instruments on offer remained strong. While subscription on the Apr 2032 instrument was lower by 14.42% MoM, the total subscription at the auction was 23.34% MoM higher than the last auction (NGN993.11bn vs NGN805.17bn in January). The increase in subscriptions was majorly driven by robust system liquidity (c.NGN456.91bn as of the auction date). Equally, total allotment rose by 9.51% MoM to NGN770.56bn (vs NGN703.62bn in the previous auction). Consequently, the total bid-to-cover ratio was 1.29x (vs 1.14x in January). Nonetheless, the marginal rates of the 2037 and 2049 bonds increased by 10bps each to 15.90% and 16.00%, respectively, while that of 2032 remained flat at 14.90%. However, the marginal rate of 2028 declined marginally by 1bps to 13.99%.

In the upcoming auction, we expect the marginal rates across tenors to hover around their current levels. This outlook is hinged on robust system liquidity - spurred by coupon payments (c. NGN185.82bn before the auction date) – expected to prompt higher investors' demand. However, we do not rule out a marginal uptick in the rates of long-dated instruments owing to investors' expectation of Monetary Policy Rate hike at the Monetary Policy Committee meeting.

The sentiment in the secondary market has increased negligibly since the previous primary market auction, as the average bond yield increased to 13.07% as of March 16 (1bps higher than the last auction date). In the near term, we expect the sentiment to persist as investors continue to trade sideways.

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

13.98% FEB 2028	13.99%
12.50% APR 2032	14.90%
16.25% APR 2037	15.90%
14.80% APR 2049	16.00%

Amount:

13.98% FEB 2028	NGN257.41bn
12.50% APR 2032	NGN51.12bn
16.25% APR 2037	NGN220.56bn
14.80% APR 2049	NGN241.47bn

SUMMARY OF CURRENT AUCTION

FGN FEB 2028

Auction Date	20/03/2023
Settlement Date	22/03/2023
Maturity Date	23/02/2028
Next Coupon Date	23/08/2023
Clean Price	100.96

FGN APR 2032

Auction Date	20/03/2023
Settlement Date	01/02/2023
Maturity Date	27/04/2032
Next Coupon Date	27/04/2023
Clean Price	92.72

FGN APR 2037

Auction Date	20/03/2023
Settlement Date	01/02/2023
Maturity Date	18/04/2037
Next Coupon Date	18/04/2023
Clean Price	104.80

FGN APR 2049

Auction Date	20/03/2023
Settlement Date	01/02/2023
Maturity Date	26/04/2049
Next Coupon Date	26/04/2023
Clean Price	95.41

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

Bond Absolute and Relative Valuation

In valuing the **13.98% FGN FEB 2028, 12.50% FGN APR 2032**, **16.25% FGN APR 2037** and **14.80% FGN APR 2049** 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
13.98% FGN FEB 2028	100.96	13.70%	13.90% - 14.00%
12.50% FGN APR 2032	92.72	13.93%	14.70% - 14.90%
16.25% FGN APR 2037	104.80	15.40%	15.50% - 15.85%
14.80% FGN APR 2049	95.41	15.52%	15.80% - 16.00%

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.

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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