Ahead of Next Bond Auction

FGN Bond Auction Scheduled for 11th September 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, September 11, 2023. The total amount on offer is expected to be between NGN320bn and NGN400bn from four issues. The instruments include four re-opening issues (APR 2029, JUN 2033, JUN 2038, and JUN 2053).

14.55% FGN APR 2029	**NGN80bn – NGN100bn**
14.70% FGN JUN 2033	**NGN80bn – NGN100bn**
15.45% FGN JUN 2038	**NGN80bn – NGN100bn**
15.70% FGN JUN 2053	**NGN80bn – NGN100bn**

Current Yield Analysis

The Nigerian fixed-income market dynamics have continually been influenced by the same factor: system liquidity. At the Primary Market Auction (PMA) held in August, the demand for treasury instruments weakened, with the total subscription declining by 66.93% MoM to NGN312.56bn. We attribute the lower subscription level to tighter interbank liquidity during the period (NGN298.28bn vs. NGN440.52bn at the previous auction). As a result, the amount raised by the Debt Management Office decreased by 65.32% MoM to NGN227.76bn (vs NGN656.74bn at the previous auction). Consequently, the bid-to-cover ratio moderated to 1.37x vs. 1.44x at the July PMA. Further to the reduced demand, the marginal rates on the **APR 2029**, **JUN 2033, JUN 2038, JUN 2053** increased by 135bps, 140bps, 110bps and 155bps to 13.85%, 15.00%, 15.20% and 15.85%, respectively.

In the coming auction, we do not expect a different play in the market. We believe that the lower interbank system liquidity (NGN165.09bn) relative to the amount the Government has offered will drive marginal rates upward. This expectation is further supported by the Government's need to raise funds from the domestic debt market and investors' demand for higher rates. Thus, we expect rates to increase in the coming auctions.

The secondary market has been predominantly bearish since the last primary market auction, with the average bond yield rising to 14.10% from 13.55% as at the last auction. This bearish sentiment is expected to continue in the near term as system liquidity tightens.

SUMMARY OF PREVIOUS AUCTION

Marginal Rates:

14.55% APR 2029	13.85%
14.70% JUN 2033	15.00%
15.45% JUN 2038	15.20%
15.70% JUN 2053	15.85%

Amount:

14.55% APR 2029	NGN10.43bn
14.70% JUN 2033	NGN4.07bn
15.45% JUN 2038	NGN25.53bn
15.70% JUN 2053	NGN187.73bn

SUMMARY OF CURRENT AUCTION

FGN APR 2029

Auction Date	11/09/2023
Settlement Date	13/09/2023
Maturity Date	26/04/2029
Next Coupon Date	23/10/2023
Clean Price	101.93

FGN JUN 2033

Auction Date	11/09/2023
Settlement Date	13/09/2023
Maturity Date	21/06/2033
Next Coupon Date	21/12/2023
Clean Price	99.53

FGN JUN 2038

Auction Date	11/09/2023
Settlement Date	13/09/2023
Maturity Date	21/06/2038
Next Coupon Date	21/12/2023
Clean Price	100.74

FGN JUN 2053

Auction Date	17/07/2023
Settlement Date	19/07/2023
Maturity Date	23/06/2053
Next Coupon Date	23/12/2023
Clean Price	98.07

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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 **14.55% FGN APR 2029, 14.70% FGN JUN 2033**, **15.45% FGN JUN 2038** and **15.70% FGN JUN 2053** offer 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
14.55% FGN APR 2029	101.93	14.03%	14.20% - 14.50%
14.70% FGN JUN 2033	99.53	14.78%	14.60% - 14.90%
15.45% FGN JUN 2038	100.74	15.31%	15.40% - 15.60%
15.70% FGN JUN 2053	98.07	16.00%	15.97% - 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. Given the current yield environment, market liquidity, and a review of the recent auctions, we analyzed the issues on offer. We also introduced the 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 a 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 issues bonds at the primary market to raise domestic funds to meet 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 the 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, N100 or N1,000, as with Nigerian bonds. A 2-year bond issued at a 12% annual coupon with a par value of N1000 implies that the issuer will make three semi-annual payments of N60 and a final N1060 on the maturity date.

Bonds can be purchased at both the primary and secondary markets, 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. Therefore, an investor can trade bonds at the secondary market 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 conducted by the Debt Management Office, which serves as the Government's representative. An existing government instrument can also be re-issued at the primary market, wherein 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 them until maturity would mean the investor gets a fixed interest payment. However, there is a secondary market where investors can trade these bonds to meet their immediate liquidity needs.

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