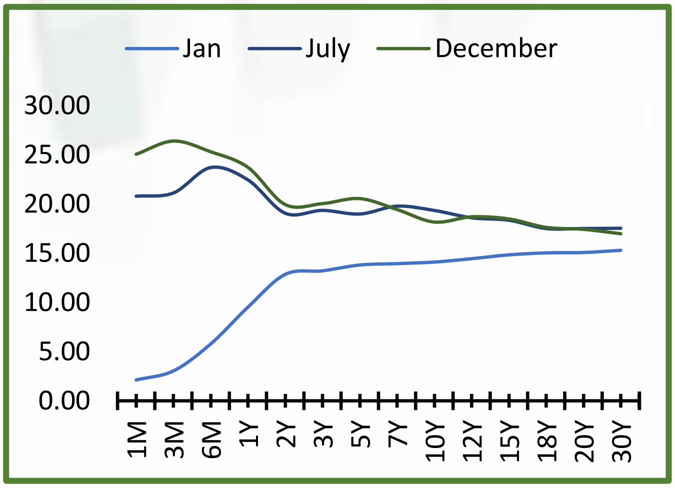
MERISTEM

# Nigeria’s Yield Curve in Focus for 2025

# A New Shape to Bonds

The Nigerian fixed income market in 2024 showed a marked steepening through the year, owing to major alterations in monetary policy. Since the onset of this administration, the monetary authorities have embarked on an aggressive hawkish path (contractionary monetary policies), which has seen the Monetary Policy Rate (MPR) raised by a cumulative 875 basis points (bps) to 27.50% and adjusted the asymmetric corridor (to +500bps/-100bps) and the cash reserve ratio (to 14.00%).
The monetary authorities also took steps to depart from unconventional measures preferred by the previous administration (like Anchor Borrowers' program, intervention funds, and several credit facilities) .
The policy tightening in 2024 was instituted in the face of rising inflation and spiraling Naira depreciation and aimed to stabilise the Naira. These measures thus redefined the slope of the yield curve.

Chart 1: Yield curve & MPR across various instruments (By months, 2024)




**Source:** FMDQ, Meristem Research

Table 1: Bond Yield Trajectory

| Bond | Dec-2023 | Jan-2024 | Feb-2024 | Nov-2024 | Dec-2024 |
|---|---|---|---|---|---|
| 2-year | 12.15 | 12.50 | 16.57 | 23.64 | 25.22 |
| 3-year | 13.30 | 12.44 | 16.79 | 20.05 | 20.61 |
| 4-year | 13.04 | 14.86 | 17.20 | 19.99 | 20.10 |
| 5-year | 13.80 | 13.72 | 16.85 | 20.11 | 20.12 |
| 7-year | 14.51 | 15.48 | 17.49 | 19.78 | 21.18 |
| 10-year | 14.58 | 15.16 | 17.59 | 21.26 | 21.75 |
| 20-year | 15.40 | 15.20 | 17.23 | 18.71 | 19.08 |
| 30-year | 16.02 | 14.88 | 17.96 | 16.99 | 16.02 |

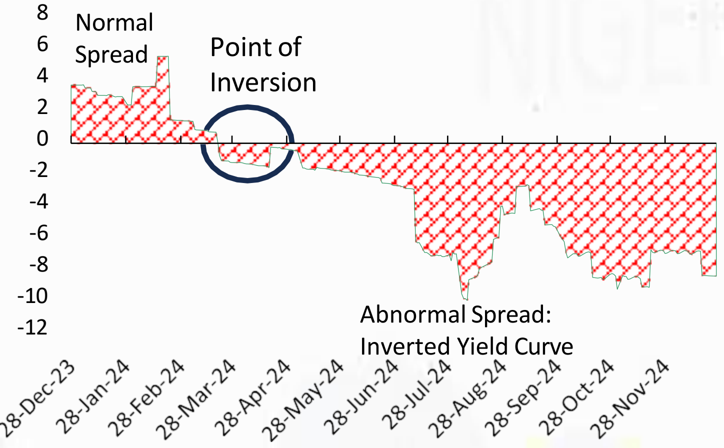
**Source:** Bloomberg, Meristem Research

## Yield curve inverts...

The table above provides a clearer illustration of the bear flattening of the yield curve (where short-term yields rise significantly faster than long-term yields) which started in 2024. The shorter end of the curve, specifically the 2-year maturity climbed by as much as 1307bps from 12.15% in December last year to 25.22% in December 2024. On the other hand, yields at the long end of the curve largely stayed flat and slightly fluctuated for most of the year.

Throughout the year, yields have risen across all maturities, with the front-end rising by 1203basis points (12.03%), the middle by 704bps, and the long-end by 106bps, between January and year-end. At the close of the year, the yield on the 30-year government bond was 16.99%, up from 15.93% in January, while the yield on the 5yr maturity increased to 20.12% from 13.72%. Therefore, we conclude that the Nigerian yield curve is inverted. Empirical studies have shown that inversion, where short-term yields are higher than long-term yields, signal market expectations of a recession but this is not always the case.

Chart 2: Staying in an Inversion




**Source:** Bloomberg, Meristem Research

The current slope of the yield curve is attributable to a number of factors.
First, aggressive borrowing by the DMO in Q1:2024 (T-Bills: NGN5.64trn, 43.70% of total t-bills allotment in the year and Bonds: NGN5.41trn, 44.19% of total bonds allotment in the year) has resulted in a significant increase in the supply of government securities, as this has continued to put upward pressure on yields.

Second, by reintroducing frequent Open Market Operations (OMO) bills, the CBN's liquidity management strategy has worked to tighten the liquidity in the market and drive up short yield rates even more.

**...as in the US**

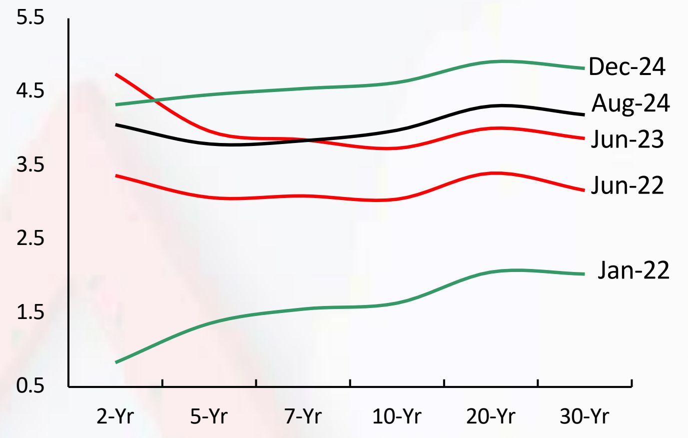
This inversion is not unique to Nigeria, as there was also a similar pattern in the US, where the yield curve was inverted for 27 months (the longest in more than 60 years). This long term inversion defied widespread predictions of a looming recession as the US....

However, the inversion came to an end in September, following the Federal Reserve's shift to an ease cycle, with rate cuts totalling 100bps to 4.25% as of December.

The reversion is driven by a "bull steepening", indicating that yields have fallen across the curve but it is more pronounced at the shorter end. Currently, yields on the 2yr and 10yr US treasury instruments are 4.33% and 4.63% (vs 4.25% and 3.87% a year ago).

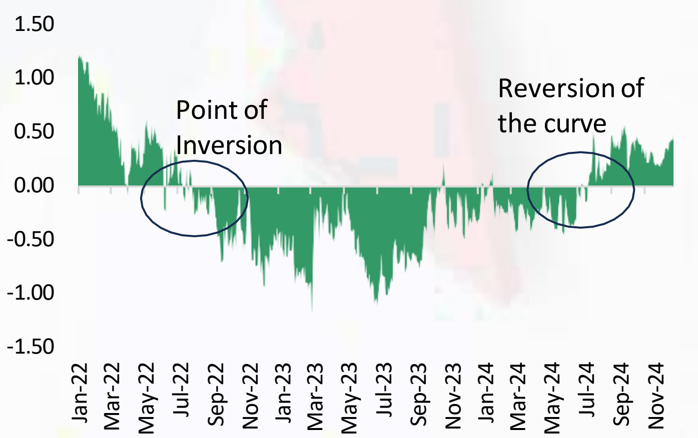
The current yield curve inversion has also proven to be a false recession signal, as the US has remained resilient with GDP growing to 3.10% in Q3:2024 from -1.00% in Q1:2022. This is also a sign that the US is headed for a soft landing.

Chart 3: US Yield Curve Progression




**Source:** Bloomberg, Meristem Research

Chart 4: US 2-30Yr Spread




**Source:** Bloomberg, Meristem Research

## The CBN's Liquidity Maneuvers

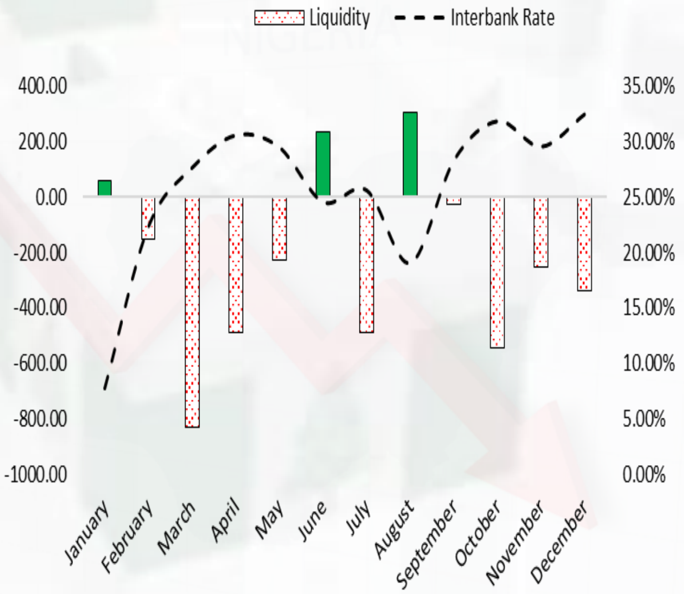
The CBN has remained committed to liquidity management, leveraging orthodox monetary tools to achieve their mandate. At the start of 2024, the CBN outlined its proactive stance on regulating liquidity, particularly through the issuance of OMO bills.

By Q4:2024, system liquidity averaged -NGN337.00bn (vs –NGN49.57bn in Q3:2024 and –NGN240.83bn in Q2:2024). This squeeze was as a result of several liquidity-draining exercises, including Standing Lending Facility (SLF) withdrawals, CRR debits, Open Market Operations (OMO) sales, Nigerian Treasury Bills (NTBs) issuances, and FX-OMO swaps. As of December 2024, average system liquidity further declined to –NGN336.46bn, compared to NGN56.70bn at the beginning of the year.

The widened asymmetric corridor of +500/-100bps around the MPR has anchored the SLF rate at 32.25% and the standing deposit facility (SDF) rate at 26.25%. Both facilities saw marked increases in activity, with SLF transactions growing to NGN552.31bn in Q4:2024 (up from NGN477.07bn in Q3:2024 and NGN185.87bn in Q2:2024) and daily averages growing to NGN695.40bn (vs NGN433.09bn in Q3:2024). Short-term rates, such as the Open Buy Back (OBB) and Overnight (O/N) rates, also rose to 32.29% and 32.79%, respectively, from 28.03% and 28.72% in the previous quarter and 15.33% and 15.95% in January.

Although still lower, SDF transactions more than doubled to NGN215.01bn in Q4:2024 due to excess system liquidity. This can be related to the expansion of money supply, as reserve money (RM) went from NGN24.16trn in January to NGN30.80trn in November due to an increase of NGN4.31trn in currency-in-circulation (CIC) and liabilities to other depository corporations (LODCs) of NGN23.83trn. Broad Money (M3) also increased from NGN94.61trn in January to NGN108.9trn in November, boosted by rise in NFA and growth in other deposits.

Chart 5: Relationship between Liquidity and Interbank Rates in 2024




Source: CBN, Meristem Research

## The Comeback of OMO Auctions in Nigeria

The use of OMO auctions rose significantly in this administration compared to previous years. There were 25 OMO auctions in 2024, a much higher number in comparison to just 4 in 2023. For context, there were 19 auctions in 2022 and 36 in 2021, with the reduction in activity largely attributed to the exclusion of non-residents from OMO auctions.

In 2024, the CBN offered a total of NGN10.18trn in OMO bills, dwarfing the NGN900bn and NGN850bn offered in 2023 and 2022, respectively. Subscriptions surged to NGN16.55trn from NGN1.49trn in 2023 and NGN4.49trn in 2022. A preference for longer-tenor instruments was evident, with several instances of “no sale” on shorter-tenor bills, reflecting market appetite and contributing to the yield curve inversion. Yields on OMO instruments rose sharply from 17.65% at the end of 2023 to 31.54% by the close of 2024.

It has been noticed that, even in the liquidity squeeze, banks have been depositing excess liquidity at record levels and have increasing participation in treasury auctions. What this indicates is risk aversion amongst banks and it also indicates that lending activities to the real sector are reducing due to higher borrowing costs. The more important question is how this will affect Nigeria’s ambitious objective of becoming a USD1trn economy within the next 6 years.

## How long more?

The yield curve has been inverted for 253 days, and it is a reflection of persistent market concerns over broad economic conditions, inflation, growth prospect, and the implication of an aggressive monetary environment.

As we enter 2025, there is a growing possibility that the curve could normalise, especially if the effects of previous rate hikes begin to materialise and if the CBN adopts a less aggressive stance. However, the question remains whether the expected reversal in monetary policy will result in a sustained steepening or if we could see a prolonged inversion.

A yield curve correction, typically referred to as a "steepening," would occur if the yield on longer-dated securities—such as the 10-year and 30-year FGN bonds—begins to rise, while the short-term yields gradually moderate. This process could result in the yield curve moving back into its normal upward-sloping shape. To quantify this relationship, we usually employ a price-yield relationship: ***the price of a bond moves inversely with its yield***.

In a steepening scenario, prices for short-term bonds would fall as yields rise, while the prices for long-term bonds would rise as yields fall. This relationship is expressed mathematically as:
$\Delta P = -D \times \Delta Y$

Where:
$\Delta P$ = change in price,
$D$ = bond's duration, and
$\Delta Y$ = change in yield.

With longer-term bonds typically being more responsive to changes in interest rate, investors may experience substantial price gains on long-dated bonds if the yield curve steepens.

## Scenario 1: Yield Curve Normalisation

Assumptions:

- Normalisation implies short-term yields fall while long-term yields rise.
- Expected yield adjustments:
  - Short-term bonds: Yield decreases by -100 bps.
  - Long-term bonds: Yield increases by +150 bps.

Table 2: Scenario 1 (Yield Curve Nomalisation) & Positioning Advice

| Bond Description | Current Yield (%) | Expected Yield (%) | Modified Duration | Price Impact (%) | Current Price (NGN) | New Price (NGN) |
|---|---|---|---|---|---|---|
| 13.53 23-MAR-2025 | 24.72 | 23.72 | 0.17 | +0.15 | 97.29 | 97.46 |
| 16.2884 17-MAR-2027 | 20.10 | 21.60 | 1.67 | -2.33 | 93.34 | 91.01 |
| 13.98 23-FEB-2028 | 20.12 | 21.62 | 1.97 | -2.89 | 86.07 | 83.20 |
| 18.50 21-FEB-2031 | 21.97 | 23.47 | 3.09 | -4.10 | 88.47 | 84.36 |
| 15.70 21-JUN-2053 | 16.99 | 18.49 | 5.38 | -7.46 | 92.50 | 85.04 |

| Bond Category | Strategy | Positioning Advice | Initial Portfolio Allocation | Recommended Allocation |
|---|---|---|---|---|
| Short-Term Bonds (Yield Decreases) | Increase Exposure | Focus on short-term bonds to take advantage of price appreciation from falling yields. | 40% | 50% |
| Medium-Term Bonds | Neutral Position | Maintain a balanced exposure as the yield changes moderately. Adjust based on specific bond characteristics | 35% | 30% |
| Long-Term Bonds (Yield Increases) | Increase Exposure | Reduce long-term bonds to avoid significant price declines due to rising yields. | 25% | 20% |

Source: FMDQ, Meristem Research

***To position effectively, investors can utilise a laddered strategy that includes purchase of bonds across a range of maturities to match short-term liquidity with long-term capital appreciation. A laddered portfolio enables investors to reinvest maturing bonds at higher yields as rates increase, and to benefit potentially, from long-dated FGN bonds or corporate bonds, as the curve steepens. This approach, combined with a barbell strategy, will help address interest rate risks and capitalise on potential yield curve movements, especially as the CBN's monetary tightening begins to take effect in 2025.***

## Scenario 2: Prolonged Inversion

Assumptions:

- Continued inversion means short-term yields rise, while long-term yields fall marginally.

Expected yield adjustments:

- Short-term bonds: Yield increases by +150 bps.
- Long-term bonds: Yield decreases by -50 bps.

Table 3: Scenario 2 (Prolonged Inversion)

| Bond Description | Current Yield (%) | Expected Yield (%) | Modified Duration | Price Impact (%) | Current Price (NGN) | New Price (NGN) |
|---|---|---|---|---|---|---|
| 13.53 23-MAR-2025 | 24.72 | 26.22 | 0.19 | -0.25 | 97.29 | 97.04 |
| 16.2884 17-MAR-2027 | 20.10 | 19.60 | 1.69 | +0.78 | 93.34 | 94.13 |
| 13.98 23-FEB-2028 | 20.12 | 19.62 | 2.26 | +0.97 | 86.07 | 87.04 |
| 18.50 21-FEB-2031 | 21.97 | 21.47 | 3.20 | +1.41 | 88.47 | 89.88 |
| 15.70 21-JUN-2053 | 16.99 | 16.49 | 5.99 | +2.77 | 92.50 | 95.27 |

**Source:** CBN, Meristem Research

In the event of a protracted inversion, which depicts that the market continues to price in near-term risks (inflation, currency depreciation, and fiscal concerns), the spread/differential between short- and long-term instruments will remain negative.

That is,

*Spread* (Negative) = *Yield on Long-Term Bond – Yield on Short-Term Bond*

***In such an environment, investors could focus on shorter-duration instruments such as NTBs and commercial papers, which currently offer higher yields with less exposure to interest rate risk. A barbell strategy–combining a core holding of short-term instruments with a small allocation to longer-term bonds–can help manage risk while maintaining yield opportunities. Furthermore, active duration management is crucial, as investors should adjust their portfolios in response to shifts in monetary policy and inflation expectations.***

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