



*Revolutionising the Nigerian Debt Capital Market*

## **FMDQ OTC Securities Exchange**

**Bringing Liquidity Back to the Nigerian Financial Market &  
the Immediate Hedging Opportunities Available to Investors**

*Presentation at the 2016 AACN Annual Investor Conference*

**Bola Onadele. Koko**  
**Managing Director/CEO**

**May 10, 2016**

# Outline

<b>Part 1</b>	<b>Fixed Income &amp; Currency Markets Overview</b>	<b>2 - 8</b>
<b>Part 2</b>	<b>Policy Reforms &amp; Responses</b>	<b>10</b>
<b>Part 3</b>	<b>Returning Liquidity and Price Formation to the FIC Markets</b>	<b>12 - 14</b>
<b>Part 4</b>	<b>Current Scope of Hedging</b>	<b>16 - 17</b>
<b>Part 5</b>	<b>Future Plans</b>	<b>19</b>

# Fixed Income & Currency (FIC) Markets Synopsis

## Background

- Decline in Crude Oil Prices
- Over-reliance on Imports
- Low Non-Oil Export Revenue
- Inadequate Foreign Reserves
- Political:
  - (i) Elections had sustained effect on portfolio investments due to uncertainty
  - (ii) Changes in Central Government at period of economic challenges

## Current Situation

- Opaque Autonomous /Inter-Bank FX Market
- Disequilibrium in Foreign Currency Supply and Demand
- High Devaluation Risk
- Significant Parallel Market
- Downward Sovereign Bond Ratings
- Increased Speculation
- Low Assets Yields
- Reduced Liquidity

## Impact on Economy

- Rising Inflation
- Unemployment
- Declining Government Revenue
- Reduced Business Operations

# Declining FIC Markets Liquidity

Turnover (US\$'mm)					
Product Category	2014	2015	2016 (YtD)	2016A**	% Δ (2014 - 2016A)
Foreign Exchange	202,030	140,355	24,665	73,995	(63.37)
Foreign Exchange Derivatives	40,965	35,616	9,695	29,085	(29.00)
Treasury Bills	164,349	244,975	59,339	178,017	8.32
FGN Bonds	48,339	54,514	19,308	57,924	19.83
Other Bonds*	1,422	663	114	342	(75.86)
Eurobonds	-	197	114	342	-
Repos / Buy-Backs	147,885	160,305	45,222	135,666	(8.26)
Unsecured Placements / Takings	42,014	60,808	3,618	10,854	(74.17)
Money Market Derivatives	318	514	2	6	(97.65)
<b>Total Turnover</b>	<b>647,321</b>	<b>697,947</b>	<b>162,077</b>	<b>486,231</b>	<b>(24.89)</b>
Average Daily Turnover	2,549	2,849	1,907	1,907	n/a
<b>Equities</b>	<b>8,705</b>	<b>4,781</b>	<b>903</b>	<b>2,709</b>	<b>(68.88)</b>
Average Daily Turnover	34	20	11	11	n/a
USD/NGN	160.00	196.90	198.40	198.40	(19.35)
No. of Business Days	254	245	85	255	n/a

Source: FMDQ Data Services

mm – million

YtD – Year-to-Date (Jan - Apr)

\*Other Bonds include Agency, Sub-national, Corporate & Supranational Bonds

\*\*A – Annualised values calculated with a multiple of 3 (i.e. YtD figures \* 3)

Δ - Change

Note: Figures may be subject to change due to potential adjustments from Dealing Member (Banks)

# Wake-Up Call!

## JANUARY - APRIL MARKET TURNOVER (US\$'mm)

Product Category	2016	2015	% Change YoY
Foreign Exchange	24,665	54,261	-54.54
Foreign Exchange Derivatives	9,695	16,550	-41.42
Treasury Bills	59,339	64,114	-7.45
FGN Bonds	19,308	15,117	27.73
Other Bonds*	114	42	171.58
Eurobonds	114	154	-25.59
Repurchase Agreements/Buy-Backs	45,222	65,615	-31.08
Unsecured Placements/Takings	3,618	23,859	-84.84
Money Market Derivatives	2	253	-99.01
	162,077	239,964	-32.46

USD/NGN	198.40	195.96
No. of Business Days	85	82
Average Daily Turnover	1,907	2,926

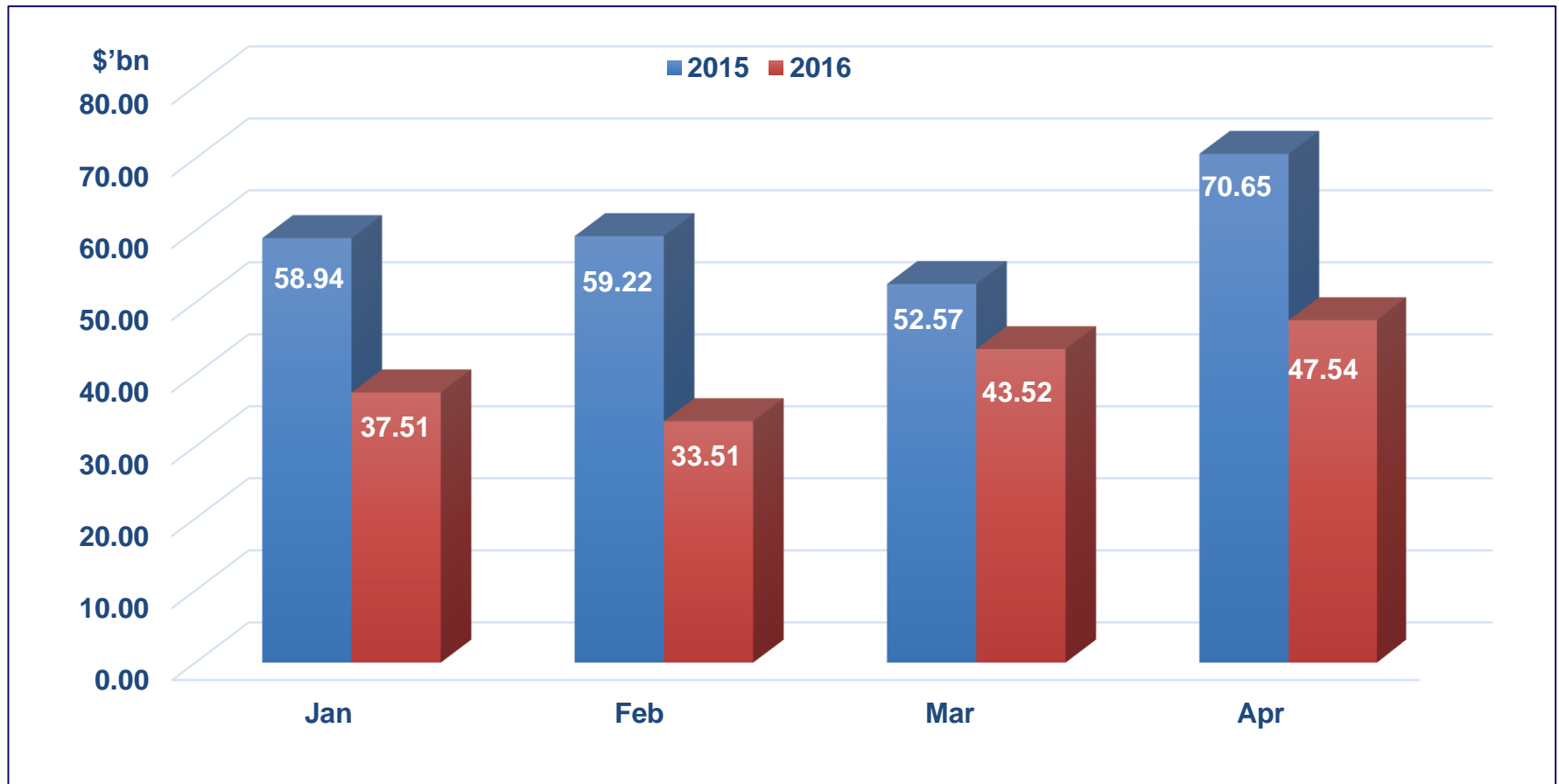
Source: FMDQ Data Services

mm – million

YoY – Year-on-Year

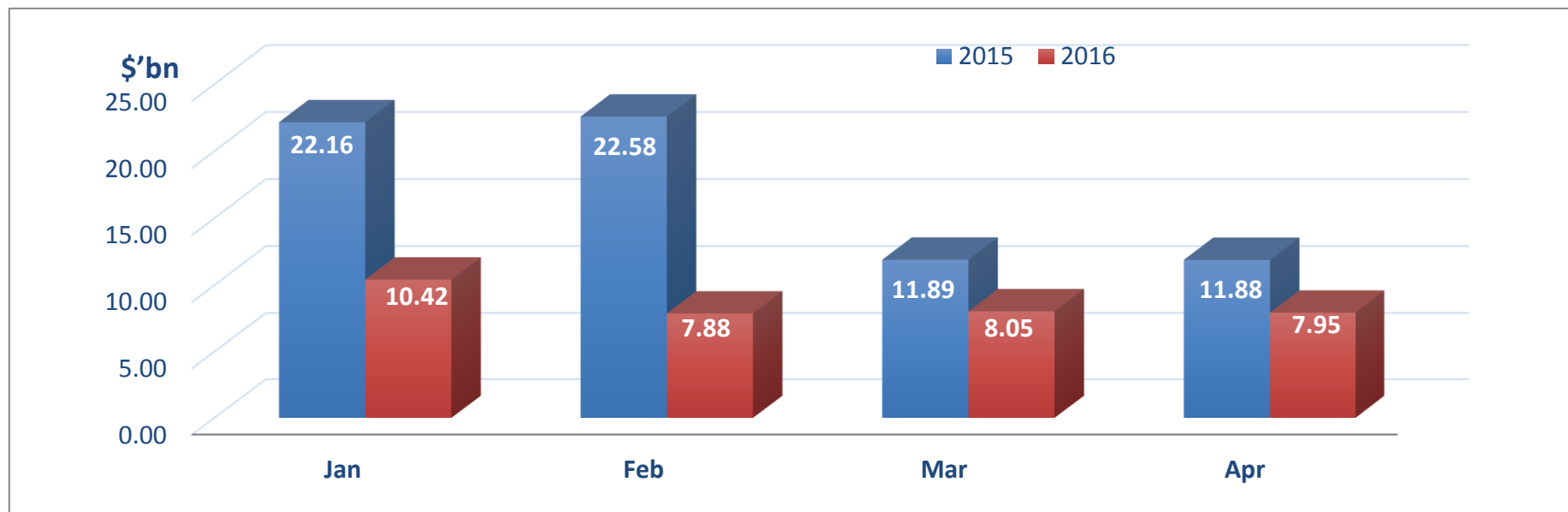
\*Other Bonds include Agency, Sub-national, Corporate & Supranational Bonds

# Monthly FIC Markets Turnover



- Turnover values have declined each month in 2016 when compared to monthly values traded the previous year

# FX Market Turnover Analysis



2016 FX TURNOVER BY PRODUCT TYPE (\$'bn)			
Month	FX Spot	FX Swap	Others
January	7.38	1.75	1.33
February	5.08	2.48	0.35
March	5.29	2.26	0.52
April	4.23	2.91	0.80

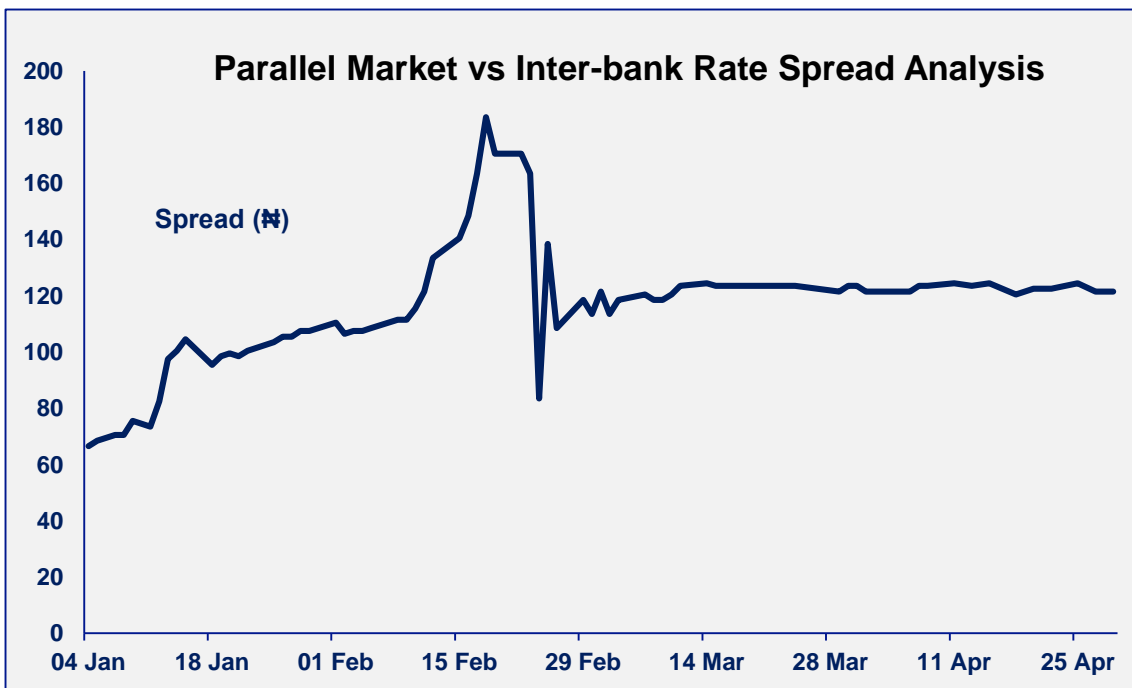
Others include Forwards, Cross Currency Interest Rate Swaps etc.

- 2016 YTD (April) turnover in the FX market (Spot and Derivatives) settled at \$34.36bn, a circa 50% (\$34.13bn) drop on YoY comparison
- The YTD (April) turnover value translates to an average daily turnover of \$430.00mm (2015 - \$835.00mm)
- FX Spot accounts for 64% of turnover

# Snake in the Tunnel

2016	Jan.	Feb.	Mar.	Apr.
Official (\$/₦)	196.50	196.50	196.50	196.50
Inter-bank (\$/₦)	198.26	198.26	198.67	197.86
Parallel Market (\$/₦)	287.05	326.19	317.90	318.67

- FX rates (across the three (3) market tiers) remained relatively flat in the months of March and April
- Volatility also tapered within the period, especially in the parallel market as rates ranged at an average of \$/₦318.00
- The CBN clearing (official) rate remained unchanged over the period, whilst inter-bank rates inched up by 60kobo
- Liquidity in the FX market remains very low, and funding business operations continues to pose a serious challenge for many businesses. Cost of doing business has risen, with firms heavily exposed to Dollar-denominated obligations and/or production costs having to cut back on production and size of their workforce





# Fixed Income Market Sizing & Trading Intensity

	FGN Bonds		Treasury Bills	
Year	Market Capitalisation (US\$'bn)	Trading Intensity	Market Capitalisation (US\$'bn)	Trading Intensity
2016	31.90	0.52	26.44	1.75
2015	24.33	2.10	25.70	8.06
2014	27.84	2.00	32.68	4.89
2013	23.35	2.37	34.33	2.72
2012	24.69	2.17	22.85	4.07
2011	19.35	2.93	12.05	5.85
2010	19.89	4.87	6.67	8.50
2009	15.25	9.17	5.20	13.64
2008	11.15	7.51	13.82	4.94

**Sources:**

Debt Management Office, FDHL Analytics

**Note:**

Average exchange rate used between 2008 and 2014  
Rates for 2015 and 2016 are weighted averages

# Outline

Part 1	Fixed Income & Currency Markets Overview	2 - 8
Part 2	Policy Reforms & Responses	10
Part 3	Returning Liquidity and Price Formation to the FIC Markets	12 - 14
Part 4	Current Scope of Hedging	16 - 17
Part 5	Future Plans	19

# Policy Reforms & Responses

The Federal Government of Nigeria and the Central Bank of Nigeria (CBN) have responded to the challenges in the FIC markets with a combination of fiscal and monetary policies with the aim of stimulating growth in the local economy. These include:

## Fiscal Policies:

- Increased Government spending on capital projects to build the infrastructure needed to support growth in the local economy
- Support for non-oil sectors of the economy, that contribute to real GDP growth amidst the global low oil-price regime

## Monetary Policies:

The sectors referenced above are also the focus of monetary policy via the following actions:

- Tightening of monetary policy
- Documentation and implementation of a new FX Management Framework
- Introduction of Yuan/Naira Liquidity via a currency Swap
- Boosting access to credit through various intervention funds and schemes

Note:

1. USD/NGN @197 (2016 Budget benchmark rate)

Opportunities - 2016 Spending Plans (\$'bn) <sup>1</sup>	
Acquisition of Computers & Softwares	0.11
Domestic Government Bonds Offerings	4.99
Social and Welfare Spending	2.54
Capital Allocation on National Security	1.20
Construction of 7,068 Housing Units	0.23
Procurement of Vehicles	0.13
Investments in Road Construction	1.14
Investments in the Railway Sector	0.46

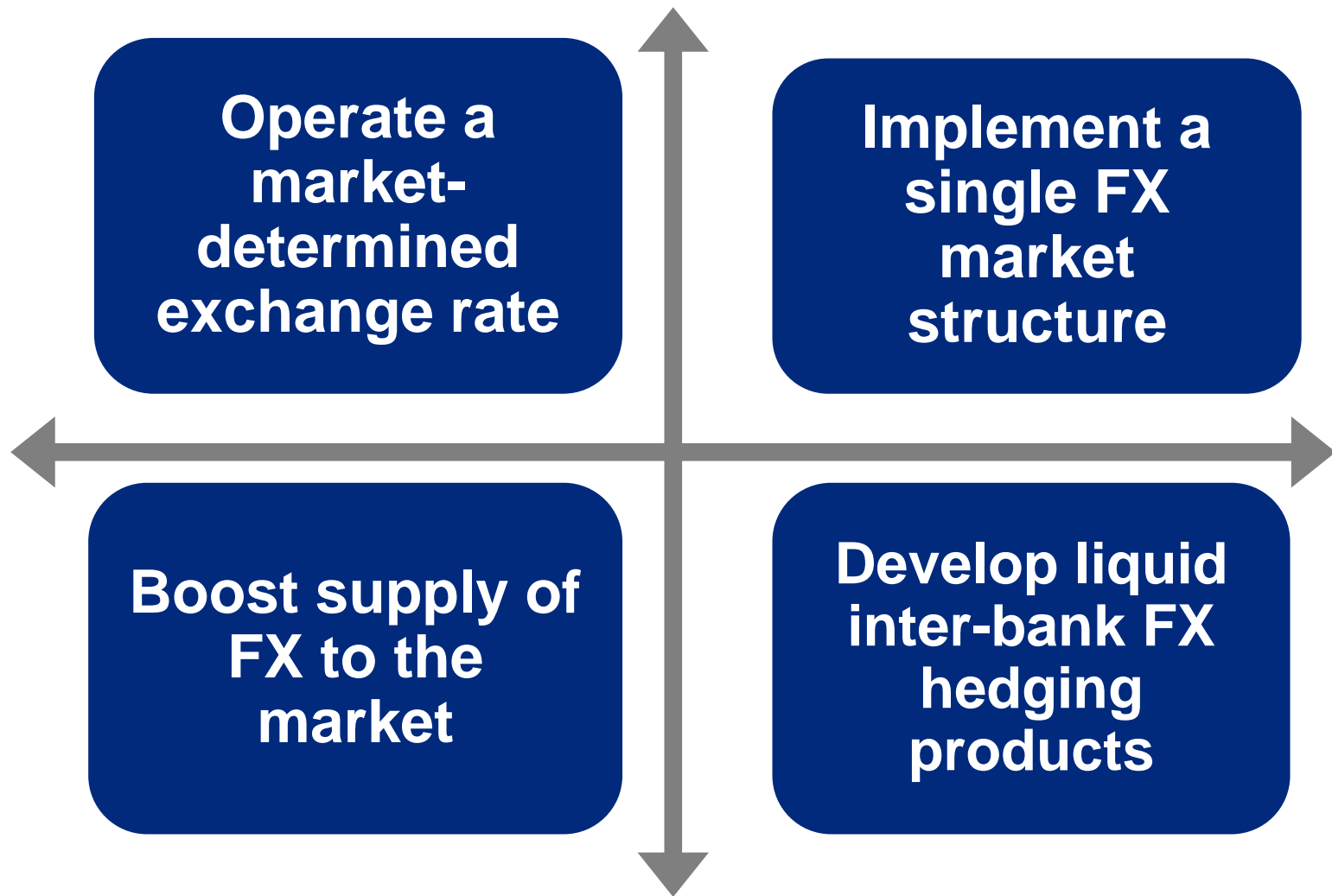
Source:

Unboxing FG's 2016 Proposed Budget | [yourbudgit.com](http://yourbudgit.com)

# Outline

Part 1	Fixed Income & Currency Markets Overview	2 - 8
Part 2	Policy Reforms & Responses	10
Part 3	Returning Liquidity and Price Formation to the FIC Markets	12 - 14
Part 4	Current Scope of Hedging	16 - 17
Part 5	Future Plans	19

# Returning Liquidity and Price Formation to the FIC Markets



# Returning Liquidity and Price Formation to the FIC Markets../2

Recommendation	Key Considerations
<b>Operate a market-determined exchange rate</b>	<ul style="list-style-type: none"><li>▪ For improved competitiveness of the economy, the forces of demand and supply should be allowed to determine the FX rate, via the inter-bank market. This will encourage efficient allocation of resources and bolster investments</li></ul>
<b>Implement a single FX market structure</b>	<ul style="list-style-type: none"><li>▪ The inter-bank market should become the recognised FX market</li><li>▪ The FX inter-bank rate to become the official reference rate for ALL transactions</li><li>▪ All Government-allowed imports to be funded in the inter-bank FX market. This will render the parallel market, which is without governance, transparency and credibility, insignificant</li><li>▪ Government to use punitive tariffs to discriminate against imports and promote local manufacturing efforts via rebates</li><li>▪ CBN to intervene in the market and end its burden of responsibility for exchange rate adjustment</li><li>▪ All administrative controls to be discarded to redirect energy towards the price stability mandate</li></ul>

# Returning Liquidity and Price Formation to the FIC Markets../3

Recommendation	Key Considerations
<b>Boost supply of FX to the market</b>	<ul style="list-style-type: none"><li>▪ Encourage foreign portfolio investors in the fixed income market by raising interest rates</li><li>▪ Federal Government and the private sector to articulate medium-term and long-term strategies to boost foreign currency supply and reduce import dependence</li><li>▪ CBN to present reform programs to the market to promote transparency and build confidence</li></ul>
<b>Develop liquid inter-bank FX hedging products</b>	<ul style="list-style-type: none"><li>▪ Inter-bank market to introduce hedging products to reduce the pressure on the FX spot market, improve business planning and inspire hope and stability</li><li>▪ CBN to support the inter-bank FX market and its development of hedging products</li></ul>

# Outline

Part 1	Fixed Income & Currency Markets Overview	2 - 8
Part 2	Policy Reforms & Responses	10
Part 3	Returning Liquidity and Price Formation to the FIC Markets	12 - 14
Part 4	Current Scope of Hedging	16 - 17
Part 5	Future Plans	19



# Risks and Possible Hedges

Risk Type	Hedge	FX	Interest Rate
<ul style="list-style-type: none"> <li>FX</li> <li>Interest Rate</li> <li>Liquidity</li> </ul>	Forwards	<ul style="list-style-type: none"> <li>Outright Forwards</li> <li>Non-Deliverable Forwards (NDFs)</li> </ul>	<ul style="list-style-type: none"> <li>Forward-Forward</li> <li>Forward Rate Agreements (FRAs)</li> </ul>
	Swaps	<ul style="list-style-type: none"> <li>Swaps</li> </ul>	<ul style="list-style-type: none"> <li>Interest Rate Swaps (IRS)</li> </ul>
		<ul style="list-style-type: none"> <li>Cross Currency Interest Rate Swaps (CCIRS)</li> </ul>	
	Options	<ul style="list-style-type: none"> <li>Calls</li> <li>Puts</li> </ul>	<ul style="list-style-type: none"> <li>Floors</li> <li>Caps</li> <li>Collars</li> </ul>
	Futures	<ul style="list-style-type: none"> <li>FX Futures</li> </ul>	<ul style="list-style-type: none"> <li>Interest Rates/ T.bills Futures</li> </ul>



- No counterparty selling

# Current Scope of Hedging

Product	Interest Rate			FX	Equities
	Money Market	T.bills	Bonds		
FRA	⊖⊖	⊖⊖	♣	♣	♣
Forwards	⊖⊖	⊖⊖	⊖⊖	Ω	⊖⊖
Futures	⊖⊖	⊖⊖	⊖⊖	⊖⊖	⊖⊖
Options	⊖⊖	⊖⊖	⊖⊖	⊖⊖	⊖⊖
Repo	♣	Ω	Ω	♣	♣
Swaps	Ω	♣	♣	Ω	♣
Securities Lending	♣	⊖⊖	⊖⊖	♣	⊖⊖
Margin Trading	♣	⊖⊖	⊖⊖	♣	H
Contract for Difference	♣	⊖⊖	⊖⊖	⊖⊖	⊖⊖

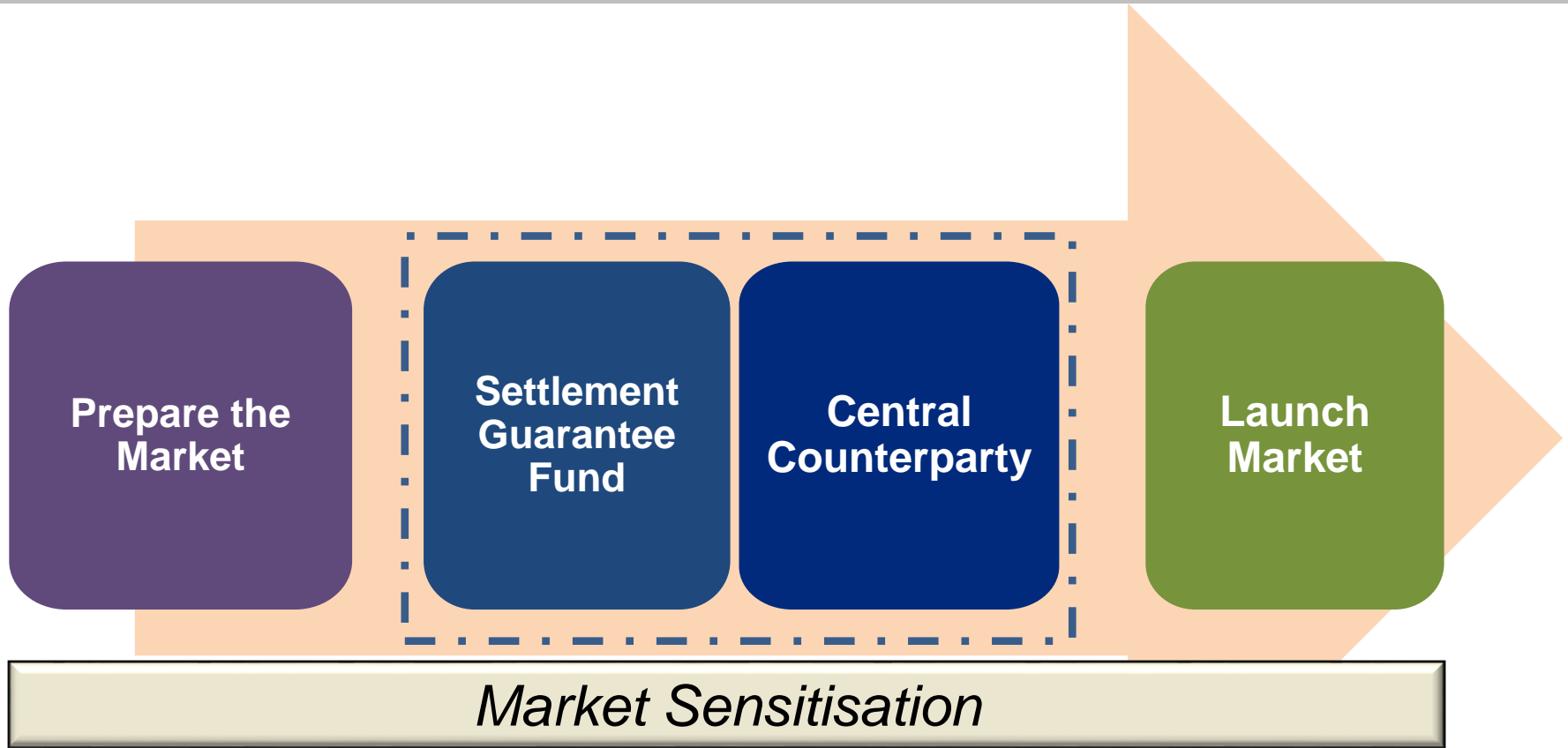
**T.bills:** Treasury Bills; **FX:** Foreign Exchange; **FRA:** Forward Rate Agreement; **Repo:** Repurchase Agreement

⊖⊖: Have Not Started Yet, ♣ : Not Applicable, Ω : Very Low, H: Used to be High

# Outline

Part 1	Fixed Income & Currency Markets Overview	2 - 8
Part 2	Policy Reforms & Responses	10
Part 3	Returning Liquidity and Price Formation to the FIC Markets	12 - 14
Part 4	Current Scope of Hedging	16 - 17
<b>Part 5</b>	<b>Future Plans</b>	<b>19</b>

# Someday, Sometime...



- Repo Market
- Unsecured Money Market Yield Curve
- Systems
- Regulatory Engagement
- Legal Framework
- Data Organisation

