Fixed income note

16 Apr. 26

Domestic resilience, global headwinds

A challenging global backdrop

In Q1 2026, global fixed income markets were dominated by the resurgence of geopolitical risk following the US–Israel conflict with Iran. The sharp rise in energy prices, renewed concerns around global inflation, and heightened risk aversion have shifted investor focus away from policy easing expectations toward inflation risk and downside tail events. As a result, global rates volatility increased materially, particularly at the long end of the US Treasury curve.

Domestic bonds resilient on ample liquidity

Despite the challenging external environment, Nigeria's domestic fixed income market delivered a strong performance during the quarter, supported by abundant system liquidity, easing inflation, and resilient demand from domestic institutional investors. FGN bond yields compressed meaningfully across the curve, with total returns underpinned by both price gains and elevated carry. While supply risks remain given the DMO's ambitious funding targets, domestic liquidity conditions continue to provide a stabilising anchor for the market.

Eurobonds sell-off driven by global rates, not Nigeria risk

In contrast, Nigerian Eurobonds posted negative returns during the quarter, largely driven by the sell-off in US Treasuries and rising global risk premium. Yield widening was most pronounced at intermediate maturities, while higher coupons partly cushioned total returns. Importantly, Eurobond weakness was externally driven, with limited evidence of Nigeria specific credit stress. Medium term sentiment remains supported by Nigeria's planned FTSE Russell reclassification to Frontier Market status.

Position for domestic carry, remain defensive on Eurobonds

Looking ahead, we expect global inflation risks and cautious central bank policy to limit upside in global fixed income, while domestic bond yields remain broadly range bound. We recommend a constructive, carry led stance in FGN bonds, focused on the short end and belly of the curve, and a defensive, risk management approach to Eurobonds, favouring short-dated exposure until global conditions stabilise.

Central economic indicators

	2023	2024	2025	2026f
Real growth (in per cent)	2.7	3.3	4.0	4.3
CPI (in per cent; y/y Dec)	28.9	34.8	15.2	16.5
Monetary policy rate (%; year-end)	18.8	27.5	27.0	26.5
Current account/GDP (in per cent)	0.2	7.4	4.9	5.3
Bonny Light (end-period spot; USD/b)	79	75	63.4	75.0
Bonny Light (average spot; USD/b)	73	68	70.9	85.0
Official fx reserves (in USD bn)	33	41	45.5	50
NGN/USD (NAFEX/I&E; end-period)	907	1,536	1,429	1,410
NGN/USD (NAFEX/I&E; average)	659	1,485	1,520	1,390

Source: CBN; National Bureau of Statistics (NBS); IMF; Bloomberg; Quest MB Research

*2026F NGN/USD average: NGN1,410/USD, representing the midpoint of our NGN1,380–NGN1,440 forecast range

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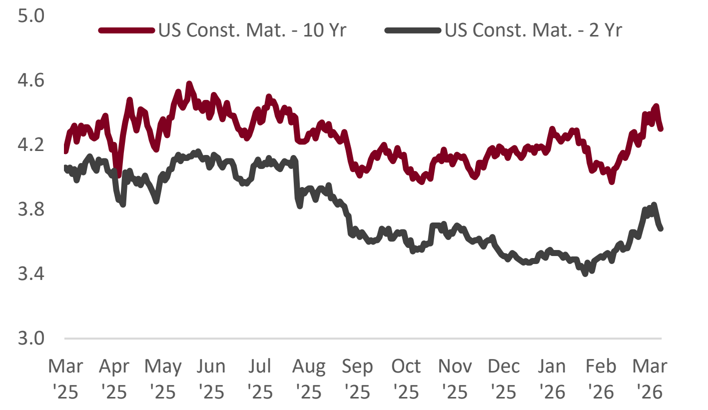
Global environment

In Q1 2026, global fixed income markets were dominated by heightened geopolitical tensions following the outbreak of the US–Israel war against Iran. Although the conflict only began at the end of February, it quickly overshadowed investors' earlier focus on interest rate expectations, particularly around the timing and scale of potential rate cuts by the US Federal Reserve and other major central banks, which had defined market sentiment during the first two months of the year.

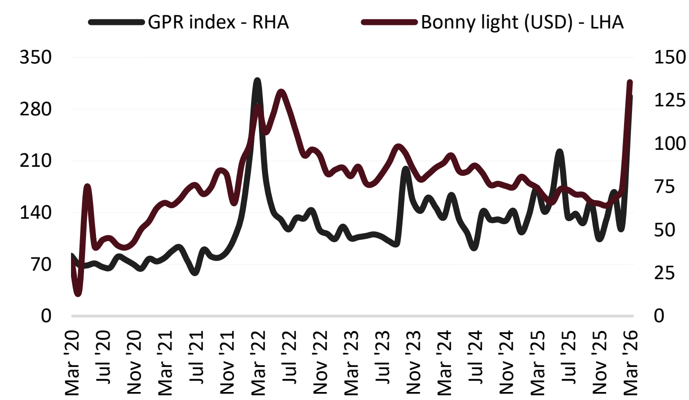
The escalation in the Middle East, including the closure of the Strait of Hormuz—an important maritime chokepoint accounting for around 20% of global crude oil and LNG flows, as well as a significant share of global fertilizer supply—along with damage to key regional energy infrastructure, triggered sharp volatility in energy markets. Crude oil prices surged beyond USD100 per barrel from around USD73 per barrel prior to the conflict, amplifying inflation concerns and weighing on global growth prospects.

US constant maturity 10 year vs. 2 yr (%)



Source: US Department of the Treasury; Quest MB Research

Bonny light (USD) and GPR index RHA



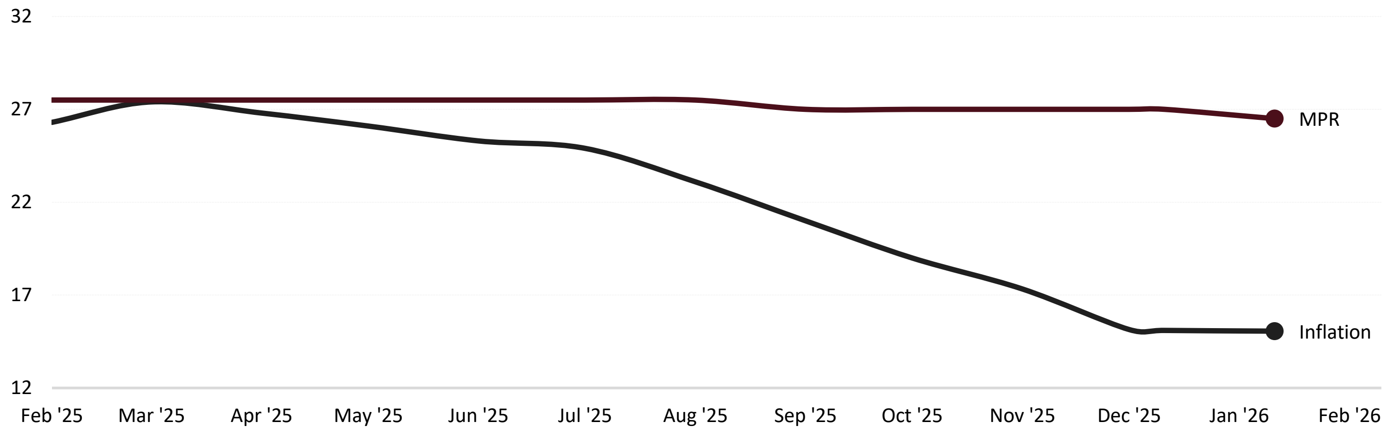
Source: Caldara & Iacoviello; Quest MB Research

Beyond energy markets, the escalation in geopolitical risk triggered broad risk off sentiment, marked by increased investor risk aversion and flight to quality flows into US dollar assets. This saw the US Dollar Index (DXY) gain 2.2% m/m in March. On the monetary policy front, the US Federal Reserve maintained its policy rate at 3.50%–3.75% at its March meeting, broadly around estimates of a neutral rate. However, amid rising inflation expectations stemming from the pass-through effects of the Middle East conflict and its anticipated drag on US economic activity, market expectations have shifted toward just one policy rate cut later in the year, compared with earlier expectations of two.

Nigerian fixed income landscape

On the domestic front, the Nigerian fixed income market was broadly bullish during the quarter, with the average bond yield contracting by -78bps to 15.78% q/q. This performance was driven mainly by robust system liquidity, which averaged around NGN1.8trn daily, supported by strong institutional and reinvestment flows from maturing securities. In addition, a sustained moderation in headline inflation – which declined for eleven consecutive months – reinforced market confidence that the policy tightening cycle had peaked, improving duration appetite and strengthening expectations of a gradual pivot toward monetary policy easing.

Inflation (y/y % change) and MPR (%)



Source: CBN, NBS; Quest MB Research

Money market developments

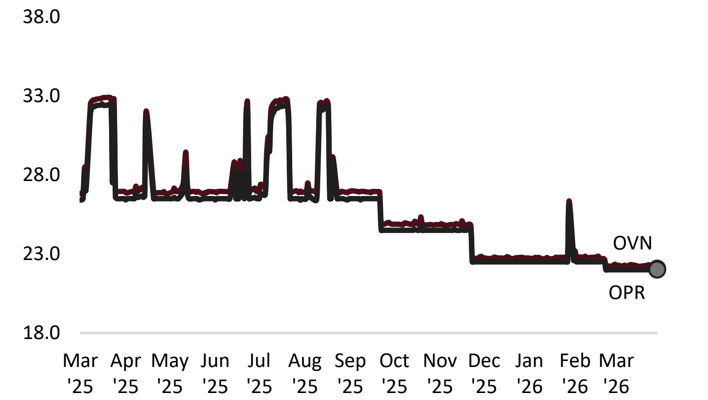
Liquidity conditions and short-term funding rates

In response to the favourable disinflation trajectory, the Monetary Policy Committee (MPC), at its February 2026 meeting -its first of the year - reduced the policy rate by 50bps to 26.5%. Although the magnitude of the cut was below market expectations of around 150–250bps, the decision nonetheless signalled the start of a cautious easing cycle.

Short term money market rates, however, remained relatively stable over the quarter, reflecting a measured policy shift alongside generally comfortable liquidity conditions. The overnight (O/N) rate eased modestly from around 22.5% at the start of the quarter to c.22.0% by quarter end, while the Open Repo (OPR) rate declined marginally from about 22.75% to 22.25%. The limited movement in these rates suggests that liquidity conditions were already well accommodated prior to the MPC action and that the initial policy adjustment had yet to materially alter funding dynamics in the interbank market.

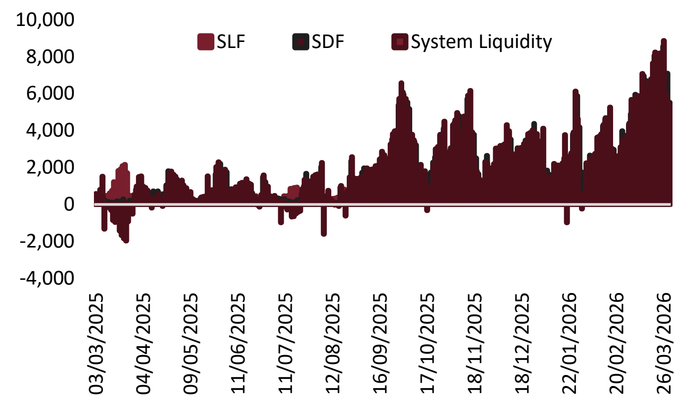
Beyond this, robust system liquidity – rather than policy easing – played a decisive role in anchoring rates. System liquidity remained elevated, supported by strong utilisation of the Standing Deposit Facility (SDF) window as banks placed excess funds with the CBN, complemented by sizeable inflows from OMO maturities, NTB redemptions, and FGN bond coupon payments. This ample liquidity conditions effectively held short-term money-market rates within a tight operating corridor. Consequently, the initial modest policy rate cut, and accommodative liquidity conditions did not materially alter funding dynamics during the quarter.

Funding rates – Overnight and OPR (%)



Source: FMDQ; Quest MB Research

System liquidity (NGN 'bn)



Source: CBN; Quest MB Research

NTB and OMO market developments

The NTB secondary market was relatively bullish during the quarter, supported by robust system liquidity and the MPC's modest 50bps rate cut in February. On average, NTB yields declined to 17.72%, from 17.80% recorded in the previous quarter. Yield compressions were particularly pronounced in February, when the average yield contracted sharply to 17.23% from 18.22% in January. This bullish activity was driven by the deceleration in headline inflation and the MPC's policy adjustment.

However, the trend reversed in March, as increased FGN borrowing requirements exerted upward pressure on yields. Overall, the average yield moderated q/q. Across the NTB yield curve, buying interest was concentrated at the short and long ends, while only mild yield compression occurred at the belly of the curve. The OMO secondary market also traded bullishly over the quarter. The moderation in yields was supported by a robust liquidity backdrop and a further decline in headline inflation to 15.06% y/y in February, which supported a 50bps rate cut. Consequently, the average OMO yield fell to 20.1%, from 21.9% in the previous quarter. The yield decline was broad-based, with contractions observed across the entire curve.

The ample liquidity conditions fuelled strong investor demand at primary market auctions in Q1 '26. For NTB auctions, the total offer size increased significantly to NGN8.0trn, up from NGN4.4trn in the previous quarter, reflecting our expectation of front-loaded government borrowing in Q1 '26. Investor appetite remained strong, with total subscriptions reaching NGN22.9trn, compared with NGN8.3trn in Q4 '25. Ultimately, total allotments stood at NGN8.2trn. Consequently, the overwhelming interest drove the marginal rates lower.

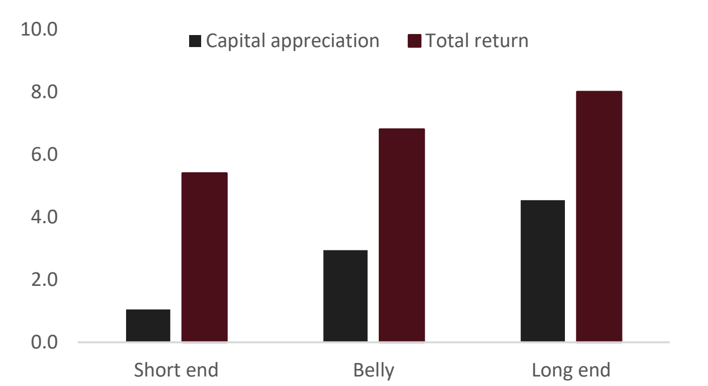
Stop rates exhibited a divergent trend. The 91-day and 182-day bills increased by 45bps q/q and 47bps q/q to 15.95% and 16.42%, respectively. In contrast, the 364-day bill declined by 108bps q/q to 16.43%, reflecting strong demand for the longer tenor. The CBN also ramped up OMO activity during the quarter, offering NGN800bn worth of OMO bills to both domestic and foreign investors. Demand was robust, with total bids reaching NGN33.2trn and final allotments amounting to NGN22.2trn. Beyond liquidity sterilisation, OMO remains significant for its role in attracting foreign portfolio inflows, which helps support naira stability.

FGN Bonds

From a FGN bond perspective, the Nigerian fixed-income space delivered a strong performance in Q1 2026, underpinned by broad-based yield compression across the curve. This trend was driven primarily by elevated system liquidity and resilient domestic demand. On average, yields declined by around 78bps across maturities, signalling strong and sustained investor buying interest. However, despite the strong q/q performance, market sentiment turned more cautious towards the end of the period. While gains in January and February were robust, sentiment turned bearish in March, leading to a sell-off that saw average yields expand by c. 22bps m/m.

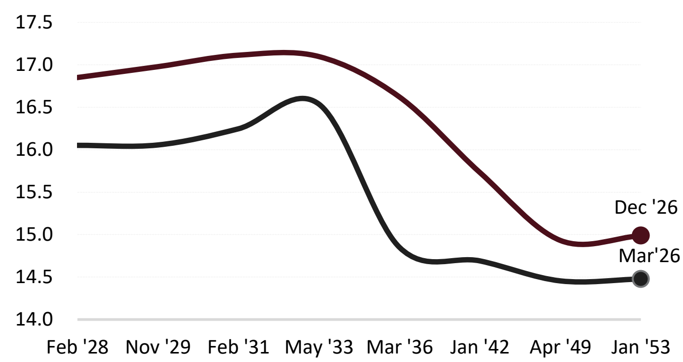
On a full-quarter basis, demand was evident across the curve, with yield compression most pronounced at the belly, where average yields fell by 82bps, reflecting strong participation from domestic institutional investors. Demand was also firm at both the long and short ends of the curve, with average yield declines of 79bps and 62bps, respectively.

FGN bonds total return by curve segment (%)



Source: FMDQ; Quest MB Research

FGN bond yields (%)



Source: FMDQ; Quest MB Research

Based on our estimates, the composite FGN Bond Index recorded a total return of approximately 6.8% over the quarter, underpinned by moderate price appreciation across maturities alongside coupon income, which provided a solid base return. From a segment perspective, however, the long end of the curve delivered the strongest performance, generating average total returns of around 8.0%, driven primarily by its significantly higher duration relative to the belly and short end. This compared with average total returns of 6.8% and 5.4% for the belly and short end of the curve, respectively.

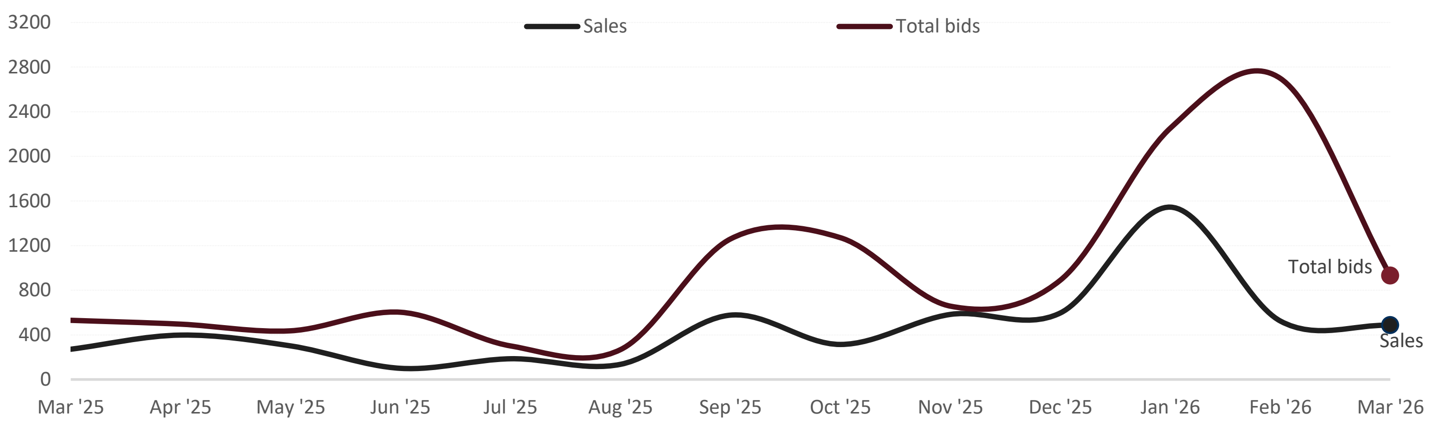
FGN Bond PMAs

Primary market dynamics were mixed during the quarter, with a clearly constructive auction in January followed by increased price discipline by the Debt Management Office (DMO) as the quarter progressed. January's bond auction reflected strong investor participation, with total sales of NGN1.5trn against an offer of NGN900bn -implying sales-to-offer ratio of 1.7x - supported by robust subscription of NGN2.3trn across all tenors.

Although the February auction continued to attract strong investor interest, as reflected in subscriptions of c. NGN2.7trn against an offer of NGN800bn, actual sales amounted to just NGN524bn, underscoring heightened price sensitivity on the part of the DMO. The agency opted to clear the auction at lower marginal rates, with the Feb '34 bond- the only tenor repeated in February - clearing at 15.50%, compared with 17.75% at the January auction.

Investor participation softened further in March, as significant liquidity absorption from an OMO bill auction weighed on appetite, resulting in sales of NGN486bn against the NGN750bn on offer and a lower bid to cover ratio of 1.2x (vs. 3.4x in February), alongside a modest uptick in marginal clearing rates. Overall, while the DMO's total sales of c. NGN2.6trn slightly exceeded its combined target offer of NGN2.4trn for the quarter, the agency still has significant distance to cover, given its 2026 domestic funding target of NGN14.3trn.

Sales and demand at FGN bond auctions (NGN bn)



Source: Debt Management Office (DMO); Quest MB Research

Sovereign Eurobonds

In contrast to domestic FGN bonds, sentiment in the Nigerian Eurobond market was largely bearish during the quarter, with average yields across the curve widening by c.50bps q/q to c.7.5%. This largely mirrored the sell-off in US Treasuries, with the benchmark 10-year yield rising by c.12bps q/q to c. 4.3%. Although US Treasuries performed strongly in February, supported by cooling inflation data, shifting Federal Reserve expectations, renewed duration demand, and episodic safe haven flows amid heightened global uncertainty, this rally reversed sharply in March following the escalation of the US-Israel versus Iran conflict.

The resulting surge in energy prices reignited inflation concerns and triggered a broad sell off across global rates markets, weighing on Nigerian Eurobond performance. As such, yield movements during the quarter were largely driven by external factors, with limited evidence of Nigeria specific credit stress influencing market outcomes.

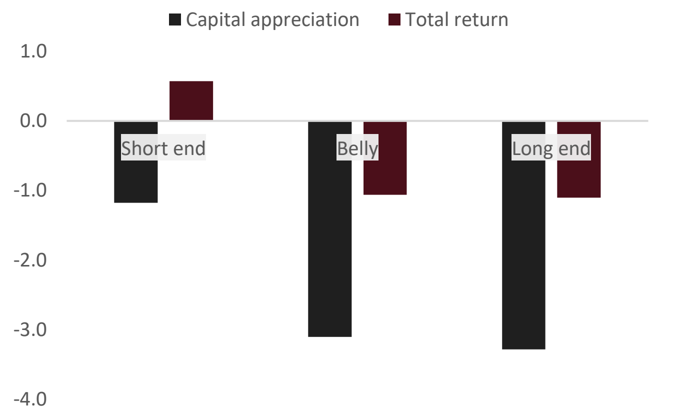
US constant maturity 10 year (%)

Source: US Department of the Treasury; Quest MB Research

Consistent with movements in US Treasuries, Nigerian Eurobond yields declined modestly in February, decreasing by an average of c.10bps m/m, reflecting a brief period of improved risk sentiment and moderate buying interest. This dynamic reversed in March, as heightened geopolitical risk and rising investor risk aversion drove a sharp sell-off, with average Eurobond yields widening by c.54bps m/m.

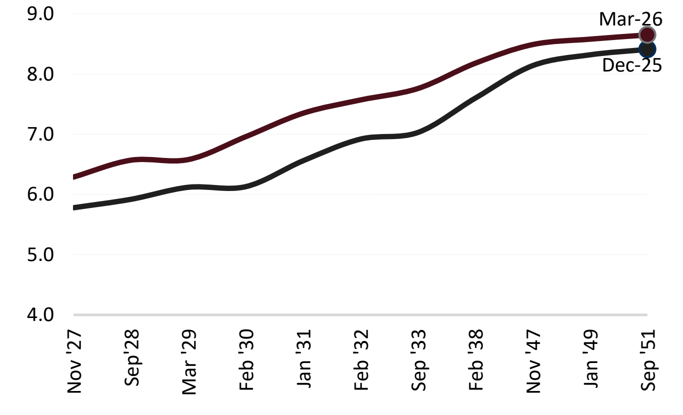
Overall, bearish sentiment during the quarter was most pronounced at the belly of the curve, where yields increased by c.68bps q/q, compared with an average widening of around 52bps at the short end, reflecting greater sensitivity of intermediate maturities to shifts in global risk sentiment. The underperformance at the long end of the curve was more modest, with average yields increasing by c.41bps.

FGN Eurobonds: total return by curve segment (%)



Source: FMDQ; Quest MB Research

FGN Eurobonds yield (%)



Source: FMDQ; Quest MB Research

On a composite basis, the Nigerian Eurobond curve posted an average price return of around 2.8% during the quarter. However, coupon income provided a partial offset, resulting in a less negative total return of 0.8% across the curve. At the segment level, short-dated maturities were more resilient, recording the least negative average price return of around 1.2% and a marginally positive total return of c.0.6% once coupon income is included.

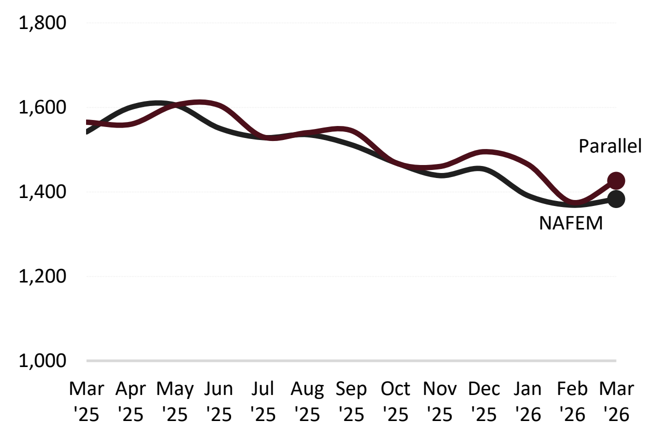
By contrast, bonds in the belly and long end of the curve generated estimated capital losses of around 3.1% and 3.3%, respectively; however, total returns for both segments converged at approximately 1.1%, reflecting the higher coupon income associated with longer dated tenors. The dispersion in returns across the curve underscores the dominant influence of duration and carry in shaping Eurobond performance during the quarter.

FX market

Nigeria's gross official reserves recorded a notable increase of USD3.8bn q/q, reaching USD49.3bn as of end-March 2026. This level provides 14.7 months of merchandise import cover (based on balance-of-payments data for the 12 months to September 2025), or 9.9 months when services imports are included.

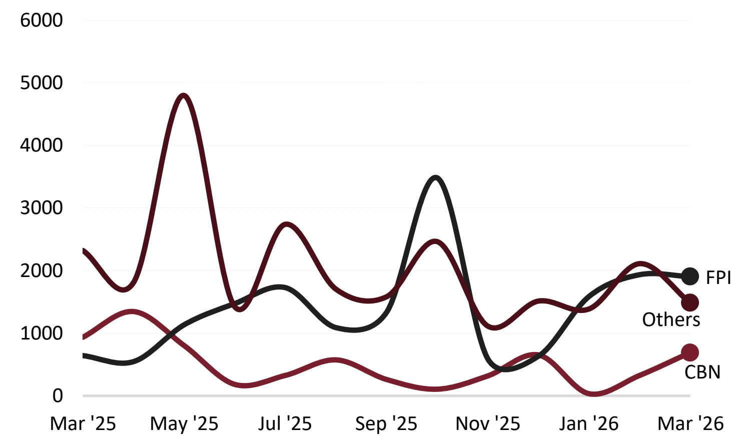
The strong quarterly accretion was supported by robust foreign capital inflows, driven by Nigeria's attractive carry-trade opportunities. Additional contributors included improved FX oil receipts and resilient remittance flows. The sustained rise in external reserves has underpinned the naira's stability in recent months, with the exchange rate appreciating by c.3% q/q to NGN1,387/USD.

Official and parallel market exchange rate (USD NGN)



Source: CBN; Quest MB Research

FX flows by outlets (USD 'm)



Source: FMDQ; Quest MB Research

However, renewed pressures emerged in recent weeks following escalating tensions in the Middle East involving the US-Israel–Iran conflict. The heightened geopolitical uncertainty has triggered a global risk-off shift toward emerging-market assets. Consequently, the naira weakened by c.1.3% m/m to NGN1,387/USD in March, reflecting persistent FX demand pressures and tight liquidity conditions.

This aligns with the m/m decline in gross official reserves, down USD398m to USD49.3bn in March 2026, bringing an end to the monthly reserve accumulation observed since July 2025. High-frequency indicators such as FMDQ FX market turnover also show a slowdown in capital flows. Total FX inflows into the exchange-rate market moderated by 7% m/m to USD 4.1bn in March 2026, while offshore investor inflows declined by 2% m/m to USD1.9bn.

Outlook & Recommendation

Global outlook

Looking ahead, we expect global and external developments, particularly heightened geopolitical tensions linked to the US –Iran conflict, to remain a key influence on global financial markets and, by extension, Nigerian fixed-income assets. These risks are likely to be felt more acutely in the sovereign Eurobond market, given its direct exposure to global risk sentiment and U.S. rates dynamics.

Against this backdrop, we anticipate renewed upward pressure on global inflation as rising energy prices, higher transportation costs, and potential disruptions to global supply chains begin to pass through to consumer prices. The risk of a re-acceleration in inflation underscores a more uncertain global policy environment than previously envisaged.

Consequently, we expect major central banks, particularly the US Federal Reserve, to adopt a more cautious and less accommodative stance than earlier anticipated. Rather than a broad easing cycle, we now expect only one modest policy rate cut later in the year, compared with earlier expectations of at least two cuts, as central banks' balance growth concerns against persistent inflation risks.

For Nigerian Eurobonds, we expect external factors to continue to dominate performance. Persistently elevated geopolitical risk, coupled with a cautious global monetary policy backdrop and volatile energy prices, suggests limited scope for sustained spread tightening in the near term. While Nigeria specific credit fundamentals remain broadly stable, global rates and risk sentiment are likely to remain the primary drivers of Eurobond pricing.

That said, Nigeria's planned reclassification by FTSE Russell from Unclassified to Frontier Market status, expected to take effect from September 2026, is supportive of the medium-term investment case for Nigerian assets:

Domestic fixed-income outlook

Within the domestic landscape, these external drivers are expected to remain a dominant consideration for the MPC, given the potential pass-through from higher global energy and food prices to domestic inflation. In this context, we expect the MPC to maintain a cautious, data-dependent approach to monetary policy and broadly hold the policy rate at current levels until global risk factors abate and greater clarity emerges on the inflation trajectory.

Despite elevated system liquidity, we do not see a meaningful decline in domestic market yields over the near term. Instead, yields are likely to remain broadly flat to slightly elevated, reflecting a combination of lingering inflation risks and potentially sizeable domestic bond supply, given the DMO's domestic funding target of c. NGN14.3trn for the year

Recommendations

Domestic Fixed income market

Given our expectation of a stable to slightly elevated yield environment, we recommend that investors maintain exposure at the short end and the belly of the FGN bond curve. This positioning allows investors to preserve carry while limiting duration risk and should help cushion portfolios against potential yield volatility or upward pressure.

Sovereign Eurobonds

For Nigerian Eurobonds, we expect global factors to remain the dominant drivers of performance in the near term. Persistently elevated geopolitical risk, a cautious global monetary policy environment, and volatile energy prices suggest limited scope for sustained spread tightening in the short run. We therefore recommend a defensive stance, with a preference for short-dated Eurobonds.

While the FTSE Russell reclassification should support foreign participation over the medium term, we would remain cautious on extending duration until there is improved visibility on global inflation dynamics and a more supportive US rates outlook.

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