What NOFR means for Nigeria's financial markets, and why it matters now

Financial Market Dealers Association (FMDA)

Summary

The Nigerian Overnight Financing Rate (NOFR) marks a significant step in improving how money is priced in Nigeria's financial system. Introduced by the Central Bank of Nigeria (CBN) in collaboration with the Financial Markets Dealers Association (FMDA) and supported by the European Bank for Reconstruction and Development (EBRD), NOFR provides a transparent, transaction-based benchmark derived from actual overnight secured lending. By reducing reliance on proxy rates such as Treasury Bills and bond yields, it improves pricing accuracy, strengthens risk management and monetary policy transmission, and aligns Nigeria with global benchmark reforms.

Introduction

Nigeria's financial market is undergoing a quiet but significant transformation with the introduction of the Nigerian Overnight Financing Rate (NOFR), a new benchmark designed to improve transparency, strengthen pricing, and align the system with global standards.

At the centre of this development is a simple concept, the benchmark rate. A benchmark rate is the base rate upon which other interest rates in the market are built. Think of it like fuel prices, when fuel prices increase, transport fares, food prices, and others adjust accordingly. In the same way, when benchmark rates move, loan pricing, asset valuation, and funding costs adjust across the financial system.

So, when a trader at a financial institution is pricing an asset or determining the appropriate rate to lend to another bank or a corporate entity, a benchmark like NOFR serves as a reference point, helping to reduce uncertainty and improve transparency.

However, as noted by the Central Bank of Nigeria (CBN), "NOFR does not determine loan margins or total borrowing costs, which depend on credit risk, tenor, and contractual terms".

In essence, while NOFR provides a reliable starting point, the final pricing of any transaction will still reflect the specific risk profile and structure of that deal.

Understanding Overnight rates

NOFR is Nigeria's official overnight benchmark rate. An "overnight" rate simply refers to the cost at which funds are borrowed today and repaid the next business day. For example, if a bank borrows money on Monday and repays it on Tuesday morning, the interest charged represents an overnight rate.

These transactions are central to how banks manage daily liquidity and are a key indicator of short-term funding conditions in the financial system.

How the market priced assets before NOFR

Before NOFR, determining the true cost of overnight money in Nigeria was not straightforward. Market participants, whether pricing derivatives, valuing collateral, or managing short-term funding, often relied on proxies such as Nigerian Treasury Bills or FGN bond yields to construct pricing curves.

While these instruments are useful, they are not designed to reflect pure overnight secured funding conditions. They typically embed liquidity dynamics, duration effects, and sometimes credit premia.

This created a gap between observed market instruments and the true cost of overnight funding. NOFR is designed to close that gap.

From proxies to precision

The Central Bank of Nigeria (CBN), working with the Financial Markets Dealers Association (FMDA) and supported by the European Bank for Reconstruction and Development (EBRD), introduced NOFR as a transaction-based benchmark derived from actual overnight secured repo trades.

According to the CBN, the benchmark is aimed at enhancing transparency, strengthening monetary policy transmission, and deepening the money market.

Unlike previous approaches, NOFR is based on real transactions rather than estimates, aligning Nigeria with global benchmark reform practices.

What happened in other markets

Nigeria's move is part of a broader global shift. After the global financial crisis, major economies moved away from benchmark rates that relied on estimates toward those based on actual transactions.

The United States replaced LIBOR with SOFR, a secured overnight rate based on repo transactions in 2022. The United Kingdom adopted SONIA, reflecting actual overnight funding costs. The Eurozone introduced €STR, also transaction based.

These changes were driven by objective of making benchmark rates reflect reality, not assumptions. Nigeria is now following that same path.

What NOFR means in practice

To understand the real impact of NOFR, consider how it affects key market participants.

1. A Bank managing overnight liquidity

Previously, a bank needing overnight funds relied on internal estimates or indicative rates. Now, it can reference NOFR to understand the actual market cost of secured overnight borrowing.

2. A Dealer pricing a Naira swap

Before NOFR, pricing required constructing a curve using NTBs and bonds. Discounting assumptions varied across desks. With NOFR, there is now a pathway toward more consistent pricing using overnight-based benchmarks.

3. A fund Manager valuing collateral

Previously, valuation depended on proxy rates, but now, NOFR provides a cleaner benchmark for mark-to-market of secured exposures.

4. A Corporate accessing structured funding

Over time, loan pricing may reference NOFR directly or indirectly, improving transparency in funding costs.

What the early signals show

Initial NOFR data already provides useful insights into market conditions.

Rates have remained relatively stable, around 22 percent.

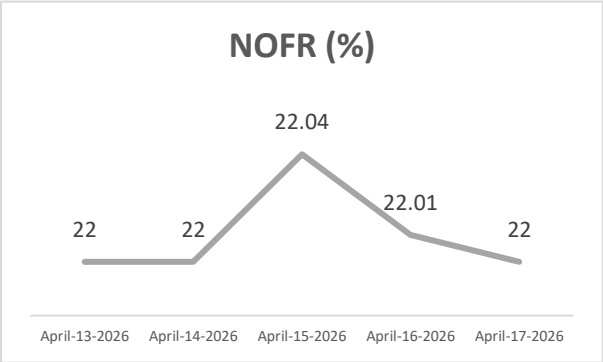
Transaction volumes are strong, running into an average of N4.4 trillion on daily.

There is some variation across trades, but the benchmark remains anchored.

This suggests that liquidity conditions are broadly stable, even as some participants face higher funding costs.

More importantly, it demonstrates that the methodology is functioning as intended, filtering out extreme values while capturing the true cost of funding in the market.

Note that NOFR is not the same as MPR. While NOFR is determined by interbank market liquidity (supply and demand for funds), MPR is determined by the vote of the Monetary Policy Committee.



Source: CBN, FMDA

FMDA