A Drop in the Nigerian Treasury Bills Yield Imminent

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The yields on the Nigerian Treasury Bills (NTBs), particularly on the 364-day tenor, are likely to drop with the plan of the Debt Management Office (DMO) to refinance the NTBs through foreign debt. The DMO hinted recently that the Federal Government of Nigeria (FGN) plans to issue about US$3bn in foreign debt of longer tenor, to refinance the domestic debt particularly the high-cost NTBs. The plan is in line with the debt management strategy of the FGN for 2016-2019, with the overall objective of reducing its total cost of borrowing to achieve the country's strategic target of an optimal debt mix of 60% and 40% for domestic and external debts respectively. The debt management strategy also sets a target of domestic debt mix of 75% and 25% for long and short-tenored debts respectively. Our analysis of the data from the DMO on the debt structure of Nigeria as at March 2017 shows that the total public debt stood at N19.16trn, made up of N14.93trn (78%) and N4.23trn (22%) in domestic and foreign debts respectively. Although the external debt component at 22% as at March 2017 is far from the optimal mix of 40%, it is an improvement from 14% as at 2013. **If the DMO were to move the debt position as at March 2017 to the planned optimal level, it means that it would have to refinance about N3.43trn of the local debt in favour of the external debt. Thus, we expect the external borrowing to grow faster than the domestic borrowing in the medium to long term.**

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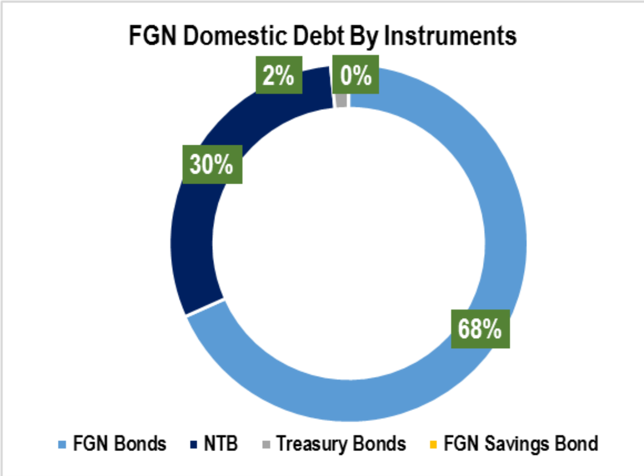
The FGN could be issuing more of FGN Bonds than NTBs going forward.

The FGN's component of the domestic debt stood at N11.97trn as at March 2017. NTB, which is the short-term debt, accounted for 30% or N3.60trn of the domestic debt of the FGN. This is higher than the target of 25% under the debt management strategy, meaning that the FGN could be issuing more of FGN Bonds than NTBs going forward. This strategy will achieve two things:1) reduce the weighted average cost of borrowing for the government because the interest rate on the 364-Day NTB is higher than the interest rate on the FGN Bonds; 2) extend the tenor of the FGN debts. Many corporate and individual borrowers have criticized the crowding out effect of the NTBs due to their high yields. The average yield on the 364-Day NTB in 2016 stood at 16.15% while the average yield between January 2017 and August 2017 stood at 22.91%.



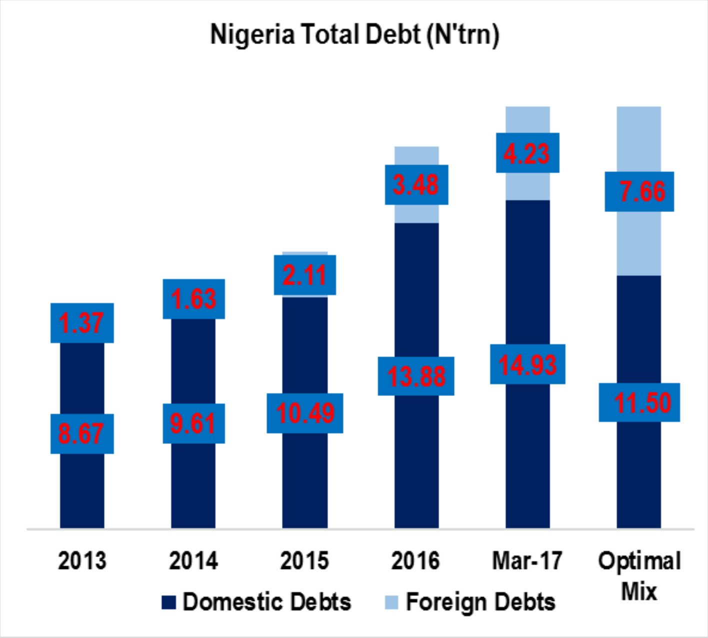
Source: Debt Management Office (DMO)

The DMO 2016 Debt Sustainability Report notes that the debt service-to-revenue ratio (for FGN only) breached the country's specific threshold of 28%.

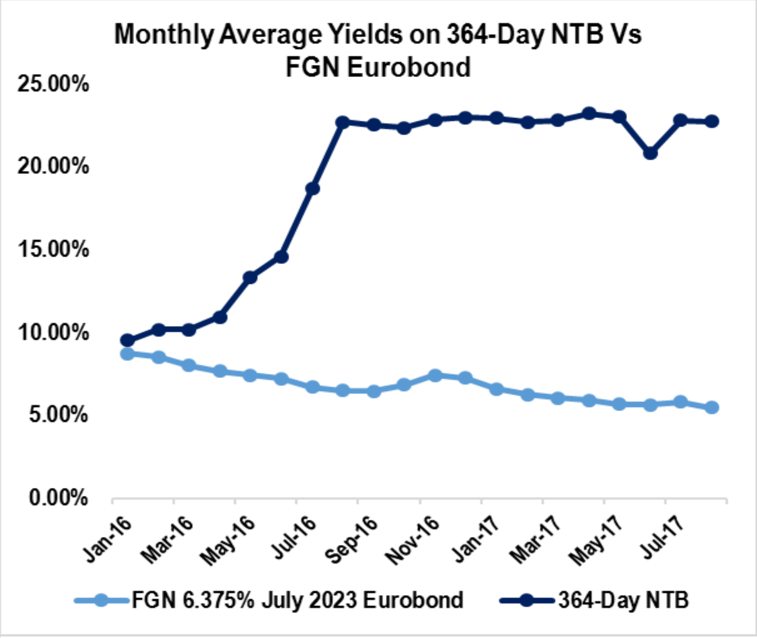
From the monetary policy perspective, the high yields may be necessary to tame high inflation and protect the value of the local currency - it however constitutes a drain on the inadequate revenue of the FGN. The International Monetary Fund (IMF) noted earlier in August 2017 that preliminary data for the first half of 2017 indicates significant revenue shortfalls, with the interest-payments to revenue ratio remaining high, at 40% as at the end of June 2017, and projected to increase further under current policies. **The DMO in its 2016 Debt Sustainability Analysis (DSA) report notes that the debt service-to-revenue ratio (for FGN only) breached the country's specific threshold of 28%. The DSA report added that the FGN debt portfolio still remains highly vulnerable to persistent shocks in revenue, indicating a potential challenge in maintaining debt sustainability.**

The total amount of debt service in 2016 and as at March 2017 represented 58% and 82% of the federal allocation disbursed to the FGN respectively.

The total amount of debt service in 2016 stood at N1.20trn and represents 58% of the federal allocation disbursed to the FGN. As at March 2017 the total debt service stood at N449bn representing 82% of the total FGN allocation of N549bn for the period. We note that FGN revenue has been challenged in the last two years on account of a drop in oil revenue. Thus, the plan of the FGN is to use the refinancing to lower debt service figures taking advantage of the relatively lower interest rate in the international financial markets. The FGN will have to put in place strategies to manage the currency risks associated with foreign borrowing. The average yield on the FGN 6.375% July 2023 Eurobond from January till August 21, 2017 is 5.94% compared with 364-Day NTB of 22.91%. The various efforts of the government should also increase revenue accruable to the country and the FGN.



Source: Debt Management Office (DMO)



Sources: Central Bank of Nigeria and Bloomberg

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