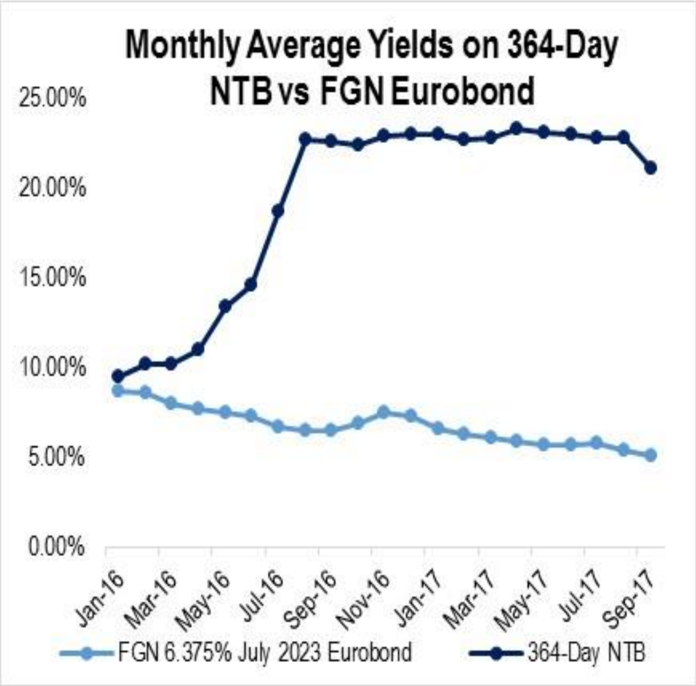
Moving Towards Debt Sustainability

The drop in government's revenue in the face of the rising government expenditure has led to an increase in Nigeria's public debt (external and domestic debt). Consequently, the ratio of debt service-to-revenue has reached unsustainable levels. The Debt Management Office (DMO) in its 2016 Debt Sustainability Analysis (DSA) report notes that the debt service-to-revenue ratio (external and domestic debt service) of the Federal Government of Nigeria (FGN), excluding states and local governments breached the country's specific threshold of 28%. However, the FGN is taking steps towards debt sustainability by diversifying its debt profile through the issuance of the FGN Savings Bond, Diaspora Bond and Sukuk. Additionally, the DMO disclosed that the FGN plans to refinance domestic debt, particularly the high cost Nigerian Treasury Bills (NTB) by issuing US$3bn in foreign debt of longer tenor. The planned refinancing 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 FGN is taking steps towards debt sustainability by diversifying its debt profile through the issuance of the FGN Savings Bond, Diaspora Bond and Sukuk.

Our analysis of the data from the DMO as at June 2017 shows that Nigeria's total debt stock stood at N19.64trn, representing an increase of 13.12% from the December 2016 figure of N17.36trn. A breakdown of the debt stock shows that external debt accounted for 23.44% (N4.60trn), while domestic debt stock accounted for 76.56% (N15.03trn). If the DMO were to move the external debt position as at June 2017 to the planned optimal level of 40%, it means that it would have to refinance N3.25trn of the local debt in favour of the external debt.



The DMO may refinance N3.25trn of the local debt in favour of the external debt.

Looking at the FGN's debt structure, the domestic debt component stood at N12.03trn as at June 2017. NTB, which is the short-term debt, accounted for 30.77% or N3.70trn of the domestic debt of the FGN. This is higher than the target of 25% under the debt management

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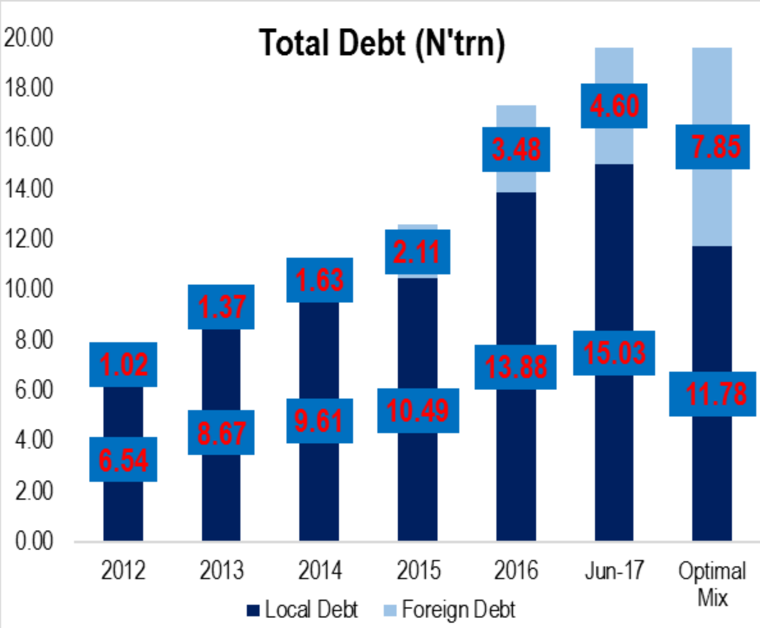
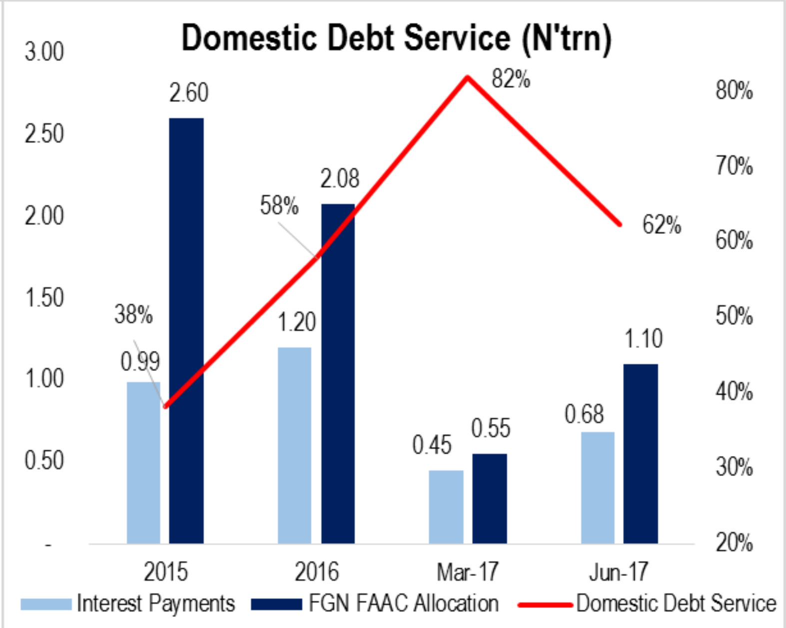
strategy. Consequently, the FGN is likely to replace the short-term debt with long-term debt to achieve its debt structure target. The planned restructuring of the debt stock of the FGN will result in a reduction in the average weighted cost of borrowing. This reduction in the cost of borrowing will be as a result of lower interest rates in the international market and a reduction in the holdings of high cost NTBs. The average yield on the 364-Day NTB from January till September 20, 2017 is 22.50% compared with the average yield on the FGN 6.375% July 2023 Eurobond of 5.85%. Following the FSDH Research report issued on August 28, 2017 titled "A Drop in the Nigerian Treasury Bills Yield Imminent" the yield on the 364-Day NTB dropped from 22.72% in August 30, 2017 to 20.47% on September 21, 2017. The yield on the FGN Bond has also dropped in the market.

The fact that a significant part of government revenue goes towards interest payments means that little revenue is left for the government to undertake capital projects.

The total amount of domestic debt service in 2016 stood at N1.20trn and represents 58% of the federal allocation disbursed to the FGN. As at June 2017, the total domestic debt service stood at N684.45bn, representing 62% of the total FGN allocation of N1.10trn for the period. This represents an improvement from total domestic debt service as at March 2017, which stood at N449bn representing 82% of the total FGN allocation for the period. We note that FGN revenue has been challenged in the last two years on account of the drop in oil revenue. Furthermore, the fact that a significant part of government revenue goes towards interest payments means that little revenue is left for the government to undertake capital projects. **The FGN needs to improve critical infrastructure in the country to increase the competitiveness of the economy to attract investments and maintain economic growth. This effort coupled with the current tax reform of the FGN, will increase revenue accrued to the government and improve the debt service-to-revenue ratio. As the yields on the FGN securities continue to drop there will be opportunities for more activities in the corporate bond market.**





Source: Debt Management Office, Nigeria (DMO)

Source: Debt Management Office, Nigeria (DMO) and National Bureau of Statistics

For enquiries please contact us at our offices:

Lagos Office: 5th-8th floors UAC House, 1/5 Odunlami Street, Lagos. Tel: 234-1-2702880-2; 234-1-2702887

Port Harcourt Office: 2nd Floor, Skye Bank Building (Former Mainstreet Bank Building) 5 Trans Amadi Road, Port Harcourt. Tel: 234-8024081331

Abuja Office: Leadway House (First Floor), Plot 1061 Herbert Macaulay way, Central Business District, Abuja-Nigeria. Tel.: 234-9-2918821

Website: www.fsdhgroup.com **email: research@fsdhgroup.com**

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