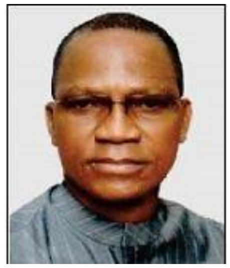
Is Nigeria's External Debt Of Investment Grade?

by



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As Nigeria reforms, restructures and strategizes towards pulling back the economy unto a path of inclusive and sustainable growth, it is useful to pay detailed attention to the sectors and subsectors. This is because while summary pictures succeed in showing the prevailing conditions, the secrets to the various pieces of the solution lie in the details. That is, **appropriate disaggregation** is good for effective diagnostics, analytics and strategics, as well as for understanding investor calculus.

In respect of Nigeria's public debt, it is important conceptually and practically, to recognize that the domestic and external components are conditioned and governed by dynamics that are considerably different. Indeed, it is pertinent to note that in spite of the drastic drop in the country's foreign exchange earnings, following the oil-price shock since mid-2014, the external debt liability hardly constitutes a source of vulnerability.

What are the sources of strength in Nigeria's external debt profile?

As Table I (Column (a)) shows, as at end-June 2016, external debt accounted for only 18.33% of the country's total debt stock of about N16 trillion (USD 61 billion) – compared to the optimal target of 40% established in the country's medium term Debt Management Strategy (2016-2019). Moreover, within that very small external debt, concessional debt (with average interest rate of about 1.25% per annum and average tenor of about 40 years) accounted for about 80% of the total. Similarly, the table (Column (b)) shows that the ratio of the external debt to the GDP was only about 2.24% as at end-June, 2016 – compared to the internationally defined threshold for external debt, of 40% for the applicable peer group. Correspondingly, the external debt service accounted for an insignificant proportion of the total public debt service expenditure: The annual external debt service expenditure for the last 5 years was always less than 6.5% of the total public debt service outlay.

These features reflect the strategic stance taken after the exits from the Paris and London Club debts in 2005 and 2006 respectively. Nigeria deliberately decided to develop and depend more on the domestic bond market as a reliable alternative source of borrowing by the government. This was to avoid compelled dependence on external sources.

Table I

NIGERIA: EXTERNAL DEBT RATIOS AFTER PARIS & LONDON CLUB DEBTS EXITS

Year	**(a) External Debt Stock as Percentage of Total Debt Stock (%)**	**(b) External Debt Stock/GDP Ratio (%)**	**(c) External Debt Stock/Export Ratio (%)**	**(d) External Debt Service/Export Ratio (%)**
2006	20.43	4.28	15.79	20.05
2011	13.64	3.10	8.40	0.50
June, 2016	18.33	2.24	23.37	0.74
Applicable Limit	40.00*	40.00	150.00	20.00

*Established in **Nigeria's Debt Management Strategy, 2016-2019**

Returning to policy and market indicators as shown in the table, we need to evaluate the ability of the country to service its external debt as and when due. The capacity to service external debt is defined in terms of the cover provided by export earnings of the borrower. As shown in columns (c) and (d) of the table, the external debt **stock** is currently about 23% of the export earnings, whereas the applicable threshold is 150%: this means that the indicator is 7 times stronger than it needs to be. Similarly, the external debt **service** is currently about 0.74% of total export earnings, compared to the applicable threshold of 20%: this means that this liquidity indicator is 27 times stronger than what is required to guarantee that the external debt can be serviced as and when due. In addition, there is an administrative safeguard: since 2005, Nigeria's prudential public debt management practice has been that debt service charge is the topmost item in the sequence of the line of expenditures in the budget. Only very few other developing economies could boast of such a healthy and attractive external debt condition.

Therefore, taken by itself, Nigeria's external debt is uniquely of top investment grade.

Empirically, this position is well supported by investors and the markets. That is why inspite of global economic, financial and foreign exchange tribulations, as well as local structural challenges which have manifested since mid-2014, Nigeria's Eurobonds have continued to trade creditably at stable low yields relative to the weight of the challenges and compared to other countries' Eurobonds.

For example, Nigeria's 10-year Eurobond (2013-2023), which traded at an average yield of about 6.945% for 2015 and at 8.680% for January 2016, has been trading at a daily yield of between 6.147% and 6.571% so far throughout the month of September 2016. Similarly, the current yields on both the 2013 – 2018, 5-year Eurobond and the 2011-2021, 10-year Eurobond are lower than their January 2016 figures by about 280 basis points and 215 basis points, respectively. In summary, Nigeria's Eurobonds are substantially in greater demand and are more highly priced than they were about a year ago.

What do these market statistics show?

One, they show that after the initial distraction and exhibition of historically-ingrained pessimistic tendency, investors and the markets have had to realign to the reality that Nigeria's external debt is, indeed, of a top-class grade – it is adequately insulated from shocks, even deep ones.

Two, they show that investors are confident that Nigeria has the capacity to move, and is moving, from economic downturn to turnaround and prosperity – in spite of initial glitches.

Three, they show that no matter how much the speculative invasion unleashed against Nigeria's economy by unimaginative and analytically-static credit rating and news agencies (for examples, Standard & Poors and Bloomberg News, on September 16, 2016), the boundless investment opportunities, market resilience and positive dynamics of ongoing reforms, which characterize Nigeria's economy, are well-known to, and usefully digested by, real investors – local and foreign.

Four, and finally, they show that investors have substantial appetite for new Eurobond issues from Nigeria – an appetite which, in spite of acknowledged alternative investment destinations, only Nigeria can satisfy.

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