



## DEBT MANAGEMENT OFFICE

# **NIGERIA'S DOMESTIC DEBT: THE CURRENT SITUATION**

**AUGUST 9, 2007**

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## **1.0 INTRODUCTION**

1.1 The purpose of this report on Nigeria's public domestic debt is:

- (a) To give an overview of the overall domestic debt portfolio and its characteristics, so as to put the efforts being made in managing it in the last four to five years in their proper context;
- (b) To clarify the use being made of domestic debt instruments to contribute towards economic growth, development and poverty reduction;
- (c) To outline the efforts of the DMO towards addressing the inherent historical defects of the domestic debt portfolio; and,
- (d) To chart the way forward by highlighting the role and uses of government domestic borrowing for generating growth and development in the economy, through a carefully configured government debt market.

## **2.0 THE DOMESTIC DEBT PORTFOLIO**

### *2.1 DOMESTIC DEBT STOCK*

At the time of the inception of the Debt Management Office in 2000, the nation's domestic debt stock (securitized public debt of the Federal Government) stood at ~~N~~898.2 billion. As at March 2007, the figure stood at around ~~N~~1, 866.37 billion, representing a mere 3.6 per cent of the Gross

Domestic Product (GDP). The composition of the domestic debt stock, as at end-December 2000 and end-March 2007 is as shown in Tables 1a and 1b.

**Table 1a: Composition of Domestic Debt Portfolio (End-December, 2000)**

<b>Security Type</b>	<b>Amount (#'billion)</b>	<b>% of Total</b>
NIGERIAN TREASURY BILLS	465.5	51.8
TREASURY BONDS	430.61	47.9
FRN DEV STOCKS	2.11	0.23
FGN BONDS	0.0	0.0
<b>TOTAL</b>	<b>898.254</b>	<b>100.00</b>

**Table 1b: Composition of Domestic Debt Portfolio (End-March, 2007)**

<b>Security Type</b>	<b>Amount (#'billion)</b>	<b>% of Total</b>
NIGERIAN TREASURY BILLS	698.11	37.40
TREASURY BONDS	413.59	22.16
FRN DEV STOCKS	0.720	0.04
FGN BONDS	753.94	40.40
<b>TOTAL</b>	<b>1,866.37</b>	<b>100.00</b>

2.2 Although the extent of domestic indebtedness of the state governments has not been ascertained due to data constraints, the DMO recognises that borrowing activities of the States constitute a significant part of the national debt portfolio. This has necessitated a detailed inventory of domestic debt and contingent liabilities of the States for a full appreciation of Nigeria's domestic debt portfolio. Accordingly, the DMO has initiated a work plan that would enable it address the domestic debts of States. In line with this commitment, the DMO in conjunction with its stakeholders, including the State Governments, recently organised a brainstorming session on *Assessment of Sub-national Borrowing in Nigeria*, which took place on Monday, July 30, 2007 in Abuja. The outcome of the deliberations during the brainstorming session will serve as input into the DMO's programme for addressing the domestic debts of the states in a comprehensive and

sustainable manner. A particular goal of the initiative is the building of accurate debt database of the States.

### 2.3 REASONS FOR THE GROWTH OF THE DOMESTIC DEBT STOCK

2.4 It is pertinent to underscore the reasons for the upward trend in the domestic debt stock over the years. While the ₦1.8 trillion domestic debt stock may seem a fairly large amount, its size largely reflects the cumulative effects of financing Nigeria's budget deficits in the past, including public sector capital expenditure needs.

2.5 The increases between 2005 and 2007 are accounted for by different sets of factors, reflecting a shift **towards market-based funding of government deficits**, as well as **productive uses of domestic borrowing**. For example, in 2005 the domestic debt stock increased by ₦155.6 billion bringing the total to ₦1, 525.9 billion. This increase was accounted for by the issuance of 2<sup>nd</sup> FGN Bonds to **fund capital expenditure** of ₦108.3 billion, and 2005 budget deficit of ₦70 billion. But it should be noted also that in the same period, there was a decline of ₦16 billion in NTBs, ₦0.27 billion in Development Stocks and ₦5 billion in Treasury bonds due to maturity and redemption of these instruments.

2.6 In 2006, the domestic debt stock increased to ₦1, 753,259 million mainly due to the issuance of ₦45 billion under the 3<sup>rd</sup> FGN Bonds to **finance budget deficit**; N15 billion as Agency bonds **to support 3 Development Finance Institutions**, namely: the Bank of Industry (BOI), the Federal Mortgage Bank, as well as the Nigerian Agricultural and Rural Development Bank; and ₦75 billion and ₦91.6 billion as **Special Bonds to**

**settle the lingering Pension Arrears and Local Contractor's debts,** respectively, after thorough verification exercises by the National Pensions Commission and the Budget Office of the Federation (BOF).

2.7 The ~~₦~~110.5 billion increase recorded as at end-March 2007 is directly attributed to the ~~₦~~80 billion part **funding of the budget deficit for the year**; the ~~₦~~25 billion NTBs in FGN's support to the TINAPA project, which the Cross-River State Government (CRSG) is repaying according to an operating schedule; as well as, ~~₦~~5 billion new NTBs issued by CBN for Open Market Operations (OMO). These explanations are summarized in Table 2.

2.8 From the foregoing it could be safely deduced that the increase in the level of the domestic debt stock between 2005 and 2007 was largely due to financing of: budget deficit; capital projects; bonds meant for supporting development finance institutions; as well as final settlement of local contractors' debts and pension arrears. These are clearly productive, necessary and desirable objectives which are consistent with the generation of sustainable growth, shared prosperity and poverty reduction.

***Table 2: Yearly Analysis of Change in FGN Domestic Debt Portfolio  
2005- End March 2007***

<b>Year of Issue</b>	<b>Amount of Debt Stock (₦'bn)</b>	<b>Change in Debt Stock (₦'bn)</b>	<b>Type of Instrument</b>	<b>Purpose of Change in Stock</b>
2005	1,525,906	155,581	FGN BONDS & NTBs	*2 <sup>nd</sup> FGN Bonds of ₦178.27 bn broken down as: *Funding of ₦108.27 bn capital expenditure *₦70 bn for 2005 budget deficit *OMO of CBN NTBs (₦ 16 bn), Dev. St. (₦ 0.27 bn), T-Bonds (₦ 5bn)
2006	1,753,259	227,353	FGN BONDS & NTB's	*₦45bn to part finance budget deficit *Agency Bonds for 3 DFI's (₦15 bn) *Local Contractors (₦91.6 bn) & Pension Arrears (₦75 bn)
2007 (End-March)	1,863,768	110,509	FGN BONDS & NTB's	*Part financing FGN budget deficit (₦80 bn) so far *Tinapa Bonds (₦25 bn) in NTBs *OMO CBN (₦ 5 bn)

2.9 In the process, the DMO has also achieved the objective of changing the maturity profile of about 42% of the component of the domestic debt stock from the predominantly short-term instruments of less than one year to long-term ones, extending from 3 years to 10 years. The restructuring exercise is still on-going. This long-termization of the portfolio is in itself, a goal worth pursuing because it provides the basis for developing a market for funds that could be accessed by the private sector to develop agriculture, manufacturing, power, housing, etc.

**2.10 It is important to note that much of the domestic debt (currently about ₦1.8 trillion) is active investment by various economic agents, including individuals and firms. These investors are assured of a steady and reliable income from it, while being guaranteed of repayment at maturity. As the secondary market for**

**government bonds has been introduced and is being developed by the DMO with the support of other stakeholders, those investors that wish to realise liquidity before the bonds mature can easily do so. It is, therefore, clear that the domestic debt portfolio is not overdue debt owed to local contractors and other groups, which need to be paid, as has been misconstrued in some quarters. As such the issue of paying off the debt does not arise. It is neither necessary, desirable, nor appropriate.**

### **3.0 STRUCTURE OF THE DOMESTIC DEBT PORTFOLIO**

*3.1 Composition:* The domestic debt of Nigeria is comprised of securitized and non-securitized debts. The securitised debts include: NTBs, Treasury Bonds, FGN Development Stocks and the FGN Bonds, whereas the unsecuritised ones are mainly the outstanding liabilities of government such as contractor debts and pensions arrears. A preponderant share of the domestic public debt before DMO's initiatives was concentrated in short-dated instruments, held in the forms of 91-day NTBs. As at end-December 2002, 91-day NTBs accounted for about 63 per cent of the domestic debt portfolio. This situation has improved significantly. As at end-March 2007, the proportion of 91-day NTBs had declined to 37 per cent, while long-term bonds of 3 years and above had risen from virtually zero to 40 percent.

*3.2 Holding:* As at end-December 2003, CBN accounted for ₦686.80 billion or 51.65 percent of the total outstanding, whereas the remaining 48.45 percent was taken by the Non-Bank Public, the Commercial Banks and the Discount Houses. This meant that the structure of holdings of the debt

instruments was disproportionately tilted towards holdings by the CBN. In the past, the practice was for the CBN to take in the residuals from under-subscribed offerings. This situation has changed significantly as a consequence of DMO's efforts towards broadening the investor base of domestic debt holders. As at 2006, CBN holding was 19.14 percent, Banks and Discount Houses, 50.36 percent, and Non-Bank Public, 30.51 percent.

*3.3 Problems with the Structure of the Debt Portfolio:* The first problem relates to the composition of the domestic debt. Until 2005, the domestic debt portfolio was dominated by the 91-day Nigerian Treasury Bills (NTBs). From ₦556.0 million or 50.0 percent of the total debt in 1970, the share of NTBs rose to ₦825 billion or 63 percent of the total domestic debt in 2003. The lopsided nature of the domestic debt created interest rate and rollover risks, as well as bunching problems. The effects of these were high inflation and interest rate volatility.

3.4 The second problem before DMO's intervention is related to the issue of the pattern of holding of the debt, in which holding by the non-bank public of this portfolio was very small (less than 10 per cent), while the financial system alone held more than 80 per cent. The financial system consists of the Central Bank of Nigeria (CBN) and the Deposit Money Banks.

3.5 A number of problems were associated with this situation. The first is that over the years, the CBN has been a major holder of the domestic public debt. As at December 2003, CBN accounted for ₦686.8 billion or 51.56 percent of the total outstanding. The preponderant holdings of these

instruments by CBN led to a depressed and below-market pricing of these instruments as well as the absence of a virile, deep and resilient securities market. It had also complicated monetary policy management. Secondly, the very insignificant holding by the non-bank public implies that ordinary people and the corporate sector were scarcely active in the financial system, which was dominated by the banks. Thirdly, the preponderance of treasury bills meant the underdevelopment of the government bond market and the absence of a credible vehicle for long-term resource mobilization for the execution of infrastructure and social programmes.

*3.6 Efforts to Address the Defects in the Domestic Debt Portfolio:* With the creation of the Debt Management Office (DMO) in 2000, efforts were made to address these problems. First, in terms of the overall domestic debt portfolio, the DMO adopted a strategy of restructuring of the existing 91-day NTBs, which amounted to ~~N~~850 billion into long-term bonds. This was initiated in 2003, with the issuance of the ~~N~~150 billion 1st FGN Bonds. Based on the lessons that were learnt from that outing after 17 years of absence from the market by the government, the DMO had taken other initiatives, in conjunction with other stakeholders, particularly the Central Bank of Nigeria (CBN) in 2004. These initiatives entailed the smoothening exercise, as well as lengthening the maturity structure of the FGN's debt profile. The objective was not just to restructure the existing domestic debt portfolio, but to ensure a balanced maturity and holding structure, as well as making it compatible with macroeconomic stability.

3.7 The smoothening process envisaged that the amount the CBN issued each week was approximately the same. This has brought some stability to

the system. In addition, the CBN has gone forward to issue 6 months and one year NTBs. In the past, these bills were issued in varying amounts which led to high volatility and instability in the system. In line with this development, the DMO started issuing 2 and 3 year bonds on a regular monthly basis in the second part of 2005, for the purposes of restructuring part of the existing 91-day NTBs to longer term tenor. Currently, a significant portion of the portfolio (about 40 per cent) is in the form of long-term securities of 3-10 year tenor. The holding of the debt by the non-bank public has also improved from less than 10 per cent before DMO's intervention to about 30 per cent by December 2006.

*3.8 The Impact of DMO's Intervention:* First, there has been a significant decline in the amount of domestic debt being held by the CBN over the past 4 to 5 years. In many respect this was salutary, as it tended to "liberate" the CBN from the contradictions of playing the role of a monetary authority, as well as that of government's fiscal agent, all at once. Secondly, there has been a significant improvement in liquidity in the financial system. Thirdly, in addition to improving liquidity it has put a downward pressure on the interest rates. As the DMO continues to refinance the maturing short-term NTBs with longer-term bonds, the 91-day securities became scarce and the demand for it relative to its supply became higher, putting a downward pressure on short term interest rates. This is salutary for the economy and particularly the real sector whose growth is easily assured under a regime of low interest rates.

3.9 The DMO has taken further steps to consolidate the gains of the

restructuring exercise by putting in place a framework for the development of the Federal Government bond market. Of particular importance is the introduction of the Primary Dealing/ Market Making System. The DMO has empanelled 20 Primary Dealers/Market Makers (PDMMs); these are institutions, with appropriate resource base and skills that make two-way quotes and are always ready to buy or sell government bonds. The objective includes not just funding government deficits in a non-inflationary manner, but creating the desirable yield curve that will serve as benchmarks for pricing other securities as well as the revitalization of the capital market in order to encourage the private sector to begin to access long term funds for development.

#### **4.0 ROLE AND USES OF GOVERNMENT DEBT MARKET IN GENERATING GROWTH AND DEVELOPMENT**

4.1 Domestic debt plays an important role in the development of both advanced and emerging market economies such as Nigeria. Domestic borrowing is desirable as long as it is targeted at developing the productive base of the economy and is within sustainable levels. Compared to its peers in the emerging markets of South East Asia, Nigeria's domestic debt market is very far behind. For example, the size of local currency bond market as percentage of GDP in Korea, Malaysia and Singapore is 25, 39 and 40 percent, respectively, while in Nigeria it is barely 2 percent. Countries with similar developmental aspirations such as Nigeria maintain a sizeable stock of domestic debt which they use for the purpose of generating growth and development.

Table 3 details the level of total indebtedness (both domestic and external), as a percentage of GDP, for countries of similar credit standing as Nigeria, as well as some of the most developed countries in the world.

**Table 3: Total Public Debt as % of GDP**

<b>Country</b>	<b>%</b>	<b>S &amp; P Rating</b>
Lebanon	209.0	BB-
Japan	176.2	AA
Jordan	72.2	BB-
Morocco	70.9	BB
Germany	66.8	AAA
France	64.7	AAA
Turkey	64.7	BA3
US	64.7	AAA
Argentina	61.0	B-
India	52.8	BB+
Brazil	50.0	BB-
Vietnam	47.5	BA3
UK	42.2	AAA
South Africa	32.9	BB+
Korea	31.9	A2
China	22.1	A-
Romania	21.4	BBB-
<b>Nigeria</b>	<b>10.4</b>	<b>BB-</b>
Russia	8.0	BB-

*Source: The World Fact Book, 2007*

4.2 It should be noted that Nigeria ranks second from the bottom of the list at a very low level of indebtedness. Given Nigeria's infrastructure needs and high level of unemployment, along side huge unexploited natural resource base, the future funding of projects (both public and private) using the domestic debt market can be fully justified.

4.3 Advanced economies like the United States of America (USA) have historically used domestic debt to propel their economies out of depression and recession, and have continued to use domestic debt to deepen their financial markets. In these economies, funding of investments in public projects is made possible not just by investing tax revenues but by borrowing domestically to augment the already constrained available resources.

4.4 Nigeria is currently set to embark upon an ambitious effort to modernise the economy, rebuild infrastructure and expand the scope of economic opportunities for the private sector. The nature of investments that the changing need of the economy would require is bound to be great in magnitude and will require long-term financing. Prudent financial management that will inevitably come with privatization will ensure that new investments are financed more rationally with better tenor matching.

4.5 The domestic debt market is bound to play a crucial role in this process, hence the imperative for the government to actively encourage the development of the government debt market through a prudent domestic borrowing framework. There are immense economic benefits to be gained from using the government debt market as platform for resource mobilization that will be deployed for generating growth and development.

4.6 Currently, funding sources of the Federal Government are too skewed towards oil export receipts, underscoring the huge over-dependence on oil as a source of revenue to the Government. This tends to make Government projected revenue highly vulnerable to fluctuations as a result of volatility in

international oil prices. Development and broadening of the non-oil sector of the economy is a primary goal. The development of the Nigerian bond market is essential to private sector capital formation. Borrowing domestically through the government bond market would definitely avail the Federal Government with the opportunity to leverage its commitment to development within a prudent degree of risk.

4.7 In essence, the role which the debt market would play in the rejuvenation of the Nigerian economy could be delineated in at least seven key areas, namely:

- (a) Developing the financial sector;
- (b) Mobilizing long-term funds for long-term projects in the development of the real sector of the economy, particularly by the private sector;
- (c) Financing economic infrastructure;
- (d) Providing an alternative to reliance on external sources of finance;
- (e) Fostering savings culture amongst the citizens;
- (f) Resolving special problems like settlement of contractor arrears and pensions arrears; and,
- (g) Improving the Welfare of Nigerians.

*4.7.1 Developing the Financial Sector and the Capital Market:* Government securities contribute to the development and functioning of financial markets, in part because of their liquidity. They also play an important hedging and pricing role. Even in highly developed markets, Governments, reflecting their taxation power, provide securities with no (or a negligible) credit risk. The financial markets in turn use sovereign government debt as a benchmark from which they can evaluate and price other debt and derivative instruments. Such benchmarking is considered to be important for the development of a corporate bond market.

4.7.2 Government debt is often a critical component of strategies aimed at reducing overall portfolio risk. For example, short positions in government bonds can be used to hedge interest-rate risk from holding other fixed-income securities. More generally, government debt is part of bank regulatory capital. In many countries, including Nigeria, guidelines and/or direct quantitative regulations of private pension funds specify minimum compulsory investment shares in government securities.

4.7.3 The importance of the government debt market towards the development of the financial sector and the capital market in particular is underscored by the fact that **countries running budget surpluses such as Botswana and Singapore, for instance, still borrow domestically to achieve the objective of developing the capital market.**

*4.7.4 Mobilizing Long-term Funds to Develop the Real Sector of the Economy:* The importance of the real sector in accelerating economic growth and development in a mono-cultural economy like Nigeria cannot be

overemphasized. Bonds market which structurally provides funding for long term projects are best suited for developing the real sector considering the long term nature that characterizes projects in sector. Projects like Real Estate and Mining, Agriculture, etc which requires huge capital outlay could conveniently leverage on the bond market to source long term funds at relatively cheaper cost.

*4.7.5 Financing Economic Infrastructure:* Bond markets create platforms for financing not only the government budgets but specific social and economic projects, such as, power, roads, bridges, railways, and housing. Governments at Federal, State and Local Government levels if they are to meet the aspirations of the citizenry are bound to rapidly expand investments in these areas, not only to restore capacity but to meet current demand. With constraints in short-term revenue generation, they are bound to turn to the bond market for funding. They would, therefore, need to access the bond markets to finance their projects. In the United States and the United Kingdom, for instance, municipal governments issue project-based bonds in the bond market on a regular basis. These are typically repaid by cash flows emanating from the projects.

*4.7.6 Alternative to Reliance on External Sources of Finance:* The bond market typically allows the government to borrow in domestic currency and thus avoids build up of foreign currency denominated debt by providing vital access to a large pool of relatively affordable funds. In recent years, a major issue associated with borrowing from external sources is the element

of currency risk. Adverse currency and exchange rates movements expose the economy to huge financial losses. To mitigate this, domestic bond markets, serve to insulate the economy from exchange rate risks. In addition, bond markets assist to reduce the external political control of a sovereign country, which is usually associated with high level of external indebtedness or total dependence on external aid.

*4.7.7 Fostering Savings Culture amongst the Citizens:* The bonds market provides a good avenue for promoting savings culture among Nigerians especially at the retail end. Considering that the economy has a large informal sector whose income is largely untapped for economic growth, the bonds market provides a relatively risk-free, fixed income investment outlet for the citizenry hence promoting a healthy savings culture that would ultimately positively impact economic growth and development.

*4.7.8 Resolving Special Problems such as Settlement of Contractors and Pensions Arrears:* The lingering problem of local contractors liability which the government has been grappling with since the military era, and that of pension arrears of Federal Government employees were conveniently addressed and resolved in a non-inflationary manner by the issuance of Local Contractors' and Pension Arrears Bonds worth ₦103 billion and ₦75 billion respectively. The use of the instrument provided government with an avenue to securitize the liability and thereby deferred the payments of the debts to periods between 2009 to 2011.

*4.7.9 Improving the Welfare of Nigerians:* The welfare of the average Nigerian is partly hinged on his ability to acquire decent housing. Mortgage financing in most developed economies is available as a matter of course for up to 30 years tenor. In Nigeria, five-year mortgage tenors are hardly known outside the limited government driven but grossly inadequate National Housing Fund Scheme. A virile government bond market can transform mortgage financing and guarantee its sustenance outside of government-driven schemes. By providing liquidity to mortgage obligations, savings from various sectors can be voluntarily, as against compulsorily, channeled in to the mortgage sector. Indeed, mortgage finance market can also be placed on a self-sustaining platform by a vibrant bond market. In the United States, easily accessible mortgage financing has resulted in 70% home ownership. The housing market and related activities – home building, furnishings, appliances, etc. - accounts for 25% of economic activity. The development of the mortgage market in Nigeria can be a great engine of growth for the economy, but it is largely hinged on the development of the bond market.

## **5.0 CONCLUSION**

5.1 Contrary to the commonly held view, the current size of the domestic debt does not constitute a problem, particularly when viewed from the point of view of resource endowment of the country and its potentials. It is safe to say, therefore, that as at the moment, Nigeria's domestic debt is within sustainable thresholds and the DMO is committed to keeping it within sustainable limits. In some instances, the domestic debt has been used as a

mechanism to resolve lingering debt problems such as the pension arrears and contractor debts, as well as recognise these debts formally as part of government's liabilities, which needed to be addressed one way or the other. The securitization of these debts meant that government needed not strain its constrained revenues to repay these debts, while at the same time reviving many firms that had gone comatose so that they could continue to generate economic activities and create jobs in the economy.

5.2 The role of debt instruments in the economic development of a country cannot be overemphasized. Apart from providing a platform for financial mobilization, it ensures efficient allocation of resources. It is planned that the initiative of DMO would help develop the bond market to maturity, provide a sustainable and cheaper source of funds, as well as ensures prudent management of financial resources, especially by the federal government. In particular, the development of the bond market will provide a reliable source of funds for the private sector. Long term money would be required if we are to grow the economy at a minimum of 7 per cent per annum, to generate employment and reduce poverty on a sustainable level. The efforts of DMO to develop the government bond market, therefore, ties into the current vision of President Umaru Musa Yar'adua's administration to build the Nigerian economy to be among the top 20 economies in the world by the year 2020.

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