



**DEBT MANAGEMENT OFFICE  
NIGERIA**

**NIGERIA'S DEBT MANAGEMENT STRATEGY, 2016-2019**

June, 2016

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## **I. INTRODUCTION**

The imperatives for a formal debt management strategy for Nigeria are based on the expiration of the maiden Debt Management Strategy, 2012-2015, and more importantly, the fact that the country is currently under severe revenue pressure arising from a volatile macroeconomic environment and uncertain global economic outlook, which are due to the structural collapse in the international price of crude oil. Although the country currently has low debt levels relative to total output, the significant drop in revenue poses a substantial risk to the public debt portfolio, if measures are not taken to structure the portfolio in line with current economic realities. Yet the country needs additional resources (including debt resources) to fund economic recovery and diversification. Accordingly, the focus is to develop a debt management strategy that would ensure that in the face of macroeconomic and other financial constraints, the cost and risk profile of the public debt portfolio remains within acceptable limits over time.

It is against this background that the Debt Management Office (DMO), in collaboration with stakeholders<sup>1</sup>, prepared this Debt Management Strategy, 2016-2019, to guide the borrowing decisions of the Federal Government of Nigeria, going forward. The latest World Bank/IMF Debt Management Strategy Analytical Tool<sup>2</sup> was used to simulate and compare the cost and risk profile of alternative financing sources, debt compositions and cost-risk trade-offs with a view to identifying a robust debt management strategy.

## **II. OBJECTIVES OF PUBLIC DEBT MANAGEMENT**

The National Debt Management Framework, 2013-2017, outlines Nigeria's public debt management objectives to include the following:

- i. The efficient management of the nation's public debt in terms of well-diversified and sustainable debt portfolio, supportive of government and private sector needs;
- ii. Meeting Government's financing needs at minimal cost and with prudent degree of risk over the medium to long-term; and,
- iii. Ensuring the growth and development of the country's domestic and international securities markets.

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<sup>1</sup> These are the Federal Ministry of Finance (FMF), Federal Ministry of Budget & National Planning (FMBNP), Central Bank of Nigeria (CBN), Budget Office of the Federation (BOF), National Bureau of Statistics (NBS) and Office of the Accountant-General of the Federation (OAGF).

<sup>2</sup>A team of officials from The World Bank, IMF and WAIFEM were on hand to guide the DMO and the stakeholders on the application of the Debt Management Strategy Analytical Tool.

### III. SCOPE OF THE DEBT MANAGEMENT STRATEGY

The Strategy covers Federal and State Governments' external debts, and Federal Government's domestic debt and financing needs. The Strategy is primarily concerned with how to optimally fund Federal Government's primary balance (i.e., the difference between revenue and expenditure, excluding debt service – interest payment and principal repayments), taking into account likely changes in macroeconomic and market variables, such as interest and exchange rates, inflation level, output and external reserves. The Strategy does not cover the funding gap of State Governments as the States' take their domestic borrowing decisions based on their particular circumstances in terms of revenue and expenditure and financing options available to them.

### IV. COST AND RISK OF TOTAL FEDERAL GOVERNMENT DEBT AS AT END-DECEMBER, 2015

Table 1 presents the cost and risk profile of existing public debt of the Federal Government of Nigeria (FGN) as at the end of 2015. Figures 1 and 2 show the composition of domestic debt in terms of instruments and the sources of external financing and their respective percentage share as at the end of 2015.

**Table 1: Cost and Risk Indicators of FGN's Debt Portfolio as at end-2015**

Cost and Risk Indicators		External Debt	Domestic Debt	Total Debt
Nominal Amount (in millions of NGN) <sup>3</sup>		2,113,230.59	8,537,932.60	10,651,163.19
Nominal Amount (in millions of USD)		10,727.06	43,339.76	54,066.82
Nominal Debt as % GDP		2.20	8.91	11.11
NPV of Debt as % of GDP		1.44	8.91	10.35
Cost of Debt	Interest Payment as % GDP	0.04	1.16	1.20
	Weighted Av. IR (%)	1.74	13.00	10.77
Refinancing Risk	ATM (years)	14.39	5.35	7.15
	Debt Maturing in 1yr (% of Total)	1.16	36.08	29.15
	Debt Maturing in 1yr (% of GDP)	0.03	3.21	3.24
Interest Rate Risk	ATR (years)	13.86	5.35	7.04
	Debt Refixing in 1yr (% of Total)	6.40	36.08	30.19
	Fixed Rate Debt (% of Total)	94.77	100.00	98.96
FX Risk	FX Debt (% of Total Debt)			19.84
	ST FX Debt (% of Reserves)			0.44

<sup>3</sup>This debt stock is slightly lower than the published FGN's Total Debt stock of US\$55,576.28 million (₦10,948,526.57 million), because the Debt Management Strategy tool treats NTBs Stock based on the discount values and not on the face values, while for the external debt, the tool aggregates the debt by tranche & currency, and applies a common end-period exchange rate. These gave rise to the observed difference.

The implied interest rate (i.e., weighted average cost of debt) was high at 10.77 percent, due mainly to the higher interest cost on domestic debt. The portfolio is further characterized by a relatively high share of domestic debt falling due within the next one year. Interest rate risk is high, since maturing debt will have to be refinanced at market rates, which could be higher than interest rates on existing debt. The foreign exchange risk is relatively low given the predominance of domestic debt in the portfolio.

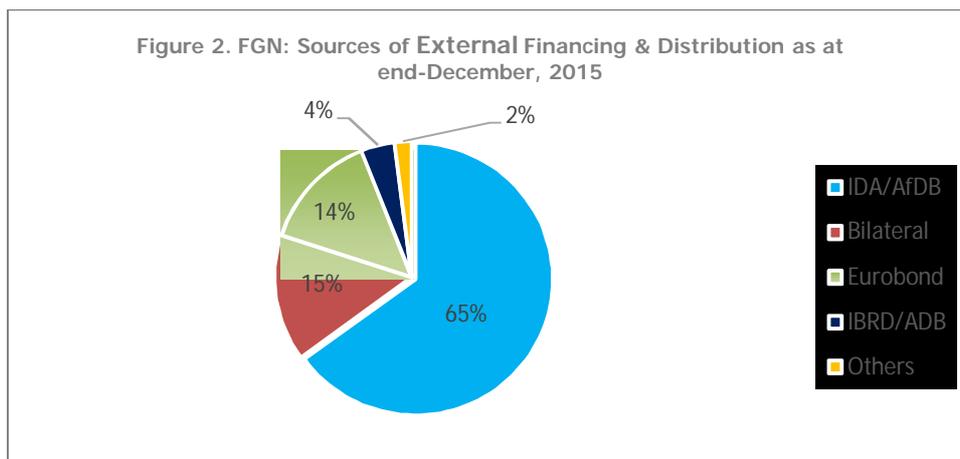
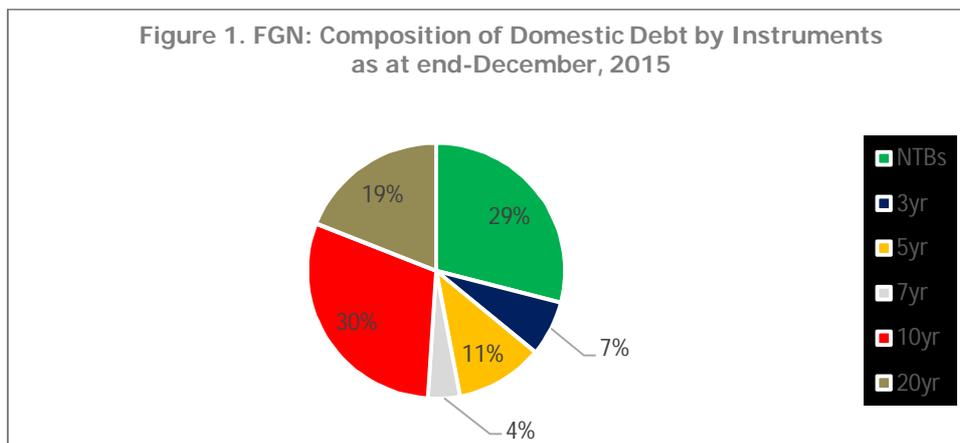
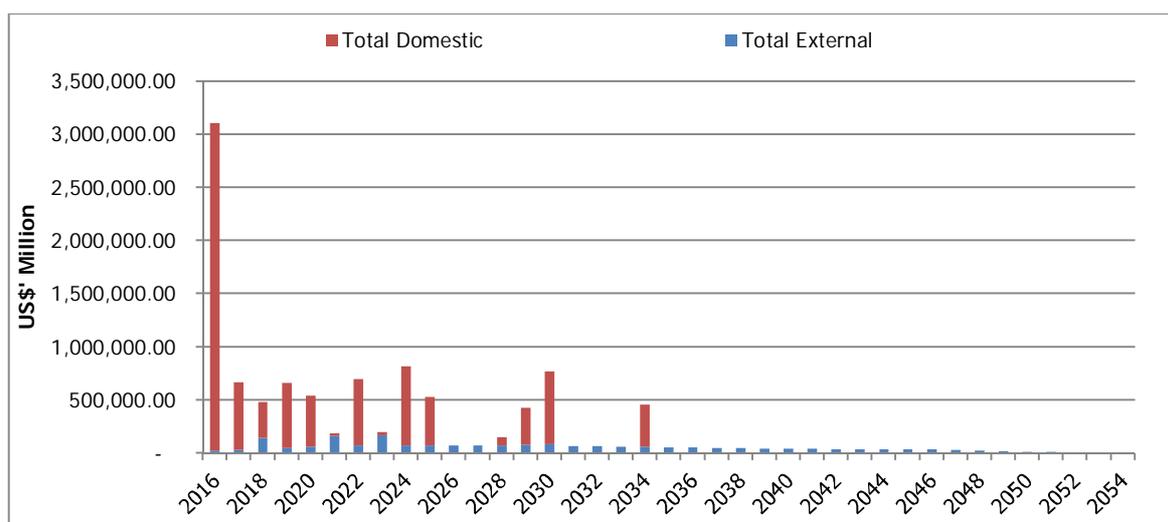


Figure 3 further shows the redemption profile of the total public debt portfolio of the FGN as at end-December, 2015. The dominance of NTBs in the portfolio accounts for the high refinancing risk in 2016.

**Figure 3. FGN: Redemption Profile of the Existing Debt as at end-2015**



In summary, the main risks to the existing public debt portfolio are:

- i. the high refinancing risk, given that more than 30 percent of the domestic debt matures within 1 year; and,
- ii. the high interest rate risk, arising from the high proportion of domestic debt due for refixing within the coming year, and therefore, exposed to changes in interest rates.

The direct exposure to exchange rate risk is limited due to the low share of debt denominated in foreign currencies and low interest rate at concessional terms that apply to most of external debt. Regarding domestic debt, the large amount of short-term securities in the portfolio implies a relatively higher exposure to an interest rate increase, and additional high refinancing risk.

## **V. MACROECONOMIC ENVIRONMENT FOR PUBLIC DEBT MANAGEMENT, 2016-2019**

After a decade of strong economic performance, real GDP growth weakened considerably to as low as 2.97 percent in 2015 compared to 6.22 percent in 2014, due to the structural collapse in the price of crude oil, which contributes about 90 percent of foreign exchange earnings and about 70 percent of Government's revenue. The collapse in oil prices has created high level of uncertainty in the global and domestic macroeconomic environment and volatility in market prices, especially in the domestic foreign exchange market. The primary balance has widened due to reduced revenues, while current account is also under pressure because of reduced exports.

The Federal Government has embarked on a number of sector reforms with a view to diversifying the economy away from crude oil and boosting productivity in agriculture and solid minerals. It has also committed to developing key infrastructure projects in power and

transportation (road, rail and aviation). The new policy focuses on the utilization of all the borrowed amounts to fund the budget deficit and the amounts would be specifically allocated to fund identified infrastructure projects. Efforts are also being made to improve governance and efficiency in fiscal operations of the Government so as to reduce wastages and leakages.

The Government, in its Medium-Term Expenditure Framework (MTEF), 2016-2019<sup>4</sup>, envisages generating a real GDP growth rate of about of 4.4 percent in 2016, with a gradual increase to 5.1 percent by 2019; while keeping the inflation level under control at slightly above 9 percent annually. Oil revenues and related foreign exchange proceeds are expected to show only a modest increase leading to a continued, but more gradual decline in international reserves. The MTEF, 2016-2019 and the 2016 Budget give room for fiscal expansion with conservative revenue estimates. This would create funding gaps much of which would have to be covered through debt. The purpose of the Debt Management Strategy analyses is to explore how to optimally fund the gap (i.e., the difference between the revenue and expenditure estimates), thus created in view of the several funding sources and debts instruments available to the Government.

## **VI. MARKET CONDITIONS**

Market risks arising from fluctuations in market rates and other macroeconomic variables are tilted to the downside as the fiscal and external positions of the economy remain vulnerable to both global and domestic sources of fiscal risks. A probable rise in short-term interest rates would increase the cost of domestic debt, while further pressure in the foreign exchange market (leading to foreign exchange restrictions) and the resultant volatility would threaten the prospects of external financing and capital inflows in the immediate term.

The pricing of Government's debt instruments would be determined by the prevailing market conditions. In the external front, deliberate efforts would be made to obtain fixed rate debts with relatively long tenors of 15 years and above. The country would access the International Capital Market (ICM), through the issuance of Eurobonds, Diaspora Bonds and International Sukuk, under market conditions that would ensure realistic cost and risk. The credit spread on Eurobonds to be issued by the FGN would be determined by both exogenous and endogenous factors prevailing at the time of issuance, including the yield on the comparable US Treasury Bonds (e.g. 10-yr), yields on other emerging market bonds with similar conditions to Nigeria and the market assessment of Nigeria's credit risk.

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<sup>4</sup> The projection provided by BOF for the Debt Management Strategy was up to 2019

## **VII. SOURCES OF FINANCING AND INSTRUMENTS**

The existing sources of financing and instruments are expected to be used going forward. In addition, the DMO plans to introduce new products with a view to further diversifying the investor-base, boost financial inclusion and national savings culture for increased gross capital formation, create more benchmarks and deepen the domestic and external markets for Government securities. The new debt instruments to be introduced, subject to market conditions, are as follows:

- i. Domestic Debt Market: Retail Bond, Inflation-Linked Bond and Domestic Sukuk.
- ii. International Capital Market: Diaspora Bonds (the process of issuance is on-going) and International Sukuk.

## **VIII. ANALYSES UNDERTAKEN**

In arriving at the preferred debt management strategy, the technical team considered combinations of various financing options and instruments relative to the existing financing structure and debt composition. Four financing strategies were formulated and tested through simulation against a variety of market shocks over a 4-year period. The results obtained, especially on the cost of debt were compared with the baseline and with each other with a view to selecting a preferred one that is in line with the key debt management objectives of the Government. The process of selecting a preferred strategy was a challenging one because of the cost-risk trade-offs, as well as the many constraints associated with each of the strategies, including the size and availability of funding from the various sources, estimation of the annual funding requirements and the need to maintain liquidity and depth in the domestic bond market. The outcome of the analyses supports the identification of a robust strategy that is expected to reduce the cost of debt and exposure to interest rates changes and refinancing risk, while at the same time maintaining liquidity in Government's securities markets.

## **IX. THE PREFERRED DEBT STRATEGY, 2016-2019**

The preferred debt management strategy based on current economic realities would require:

- i. An increase in external financing with a view to rebalancing the public debt portfolio in favour of long-term external financing in order to reduce the debt service cost and lengthen the maturity profile. To achieve a significant reduction in cost would require that the Government accesses relatively cheaper long-term external financing in such a way that it first maximizes the available funds from the concessional and semi-

concessional sources, taking into account what may be readily available within a given period, after which other external sources would be accessed.

- ii. Further lengthening of the maturity profile of the domestic debt portfolio through reduction in the issuance of new short-dated debt instruments or refinancing of maturing NTBs with external financing or both. Although the impact on cost of the introduction of new debt instruments into the domestic debt market is expected to be relatively small, the impact on maturity profile of total domestic debt could be significant, hence reducing the risk of bunching, roll-over risk, and the associated debt servicing costs.

The main constraints to the preferred strategy include:

- i. An increase in the foreign exchange risk, due to the rise in external debt relative to domestic debt; and,
- ii. The need to maintain liquidity in the short end of the Government domestic securities market.

In the case of foreign exchange risk, this would be mitigated by:

- i. The fact that the borrowings (both domestic and external) will be used to fund priority infrastructure projects, which will boost output and put the economy on the path of sustainable growth and competitiveness; and,
- ii. The fact that the loans are long-term (i.e., 15 years and above), which means that the economy would have been sufficiently diversified for increased export earnings for ease of debt service payments.

## **X. GUIDELINES AND TARGETS**

The main guidelines and targets of the preferred Debt Management Strategy, 2016-2019, are:

### **i. Debt Portfolio Composition**

- Targeting an optimal debt composition of **60:40** for domestic and external debt, respectively, as against the 84:16 as at end-2015, by progressively increasing the percentage share of external financing, taking into account the need to moderate foreign exchange risk in the short to medium-term.
- Targeting a domestic debt mix of **75:25** for long and short-term debts, respectively, (currently at 69:31 as at end-2015), so as to reduce the cost of debt service and roll-over risk.

## ii. Funding Sources

- Maximisation of available funding envelopes from concessional and semi-concessional external sources, taking into account what may be readily available within a given period, for the financing of key infrastructure projects.

## iii. Interest Rate and Refinancing Risks

- Keeping the share of debt maturing within 1 year, as a percentage of Total Debt Portfolio at not more than 20%, relative to 29.15% as at end-2015.
- Targeting an Average Time-to-Maturity (ATM) for the Total Debt Portfolio at a minimum of 10 years, as against 7.15 years as at end-2015.

The guidelines require reviewing, on an annual basis, the performance of the debt portfolio and making necessary adjustments based on the prevailing macroeconomic environment.

**DEBT MANAGEMENT OFFICE**  
**THE PRESIDENCY**  
Plot 447/448 Constitution Avenue,  
Central Business District,  
P.M.B. 532, Garki,  
Abuja, Nigeria.

Email: [enquiries@dmo.gov.ng](mailto:enquiries@dmo.gov.ng)  
Website: [www.dmo.gov.ng](http://www.dmo.gov.ng)

**JUNE, 2016**