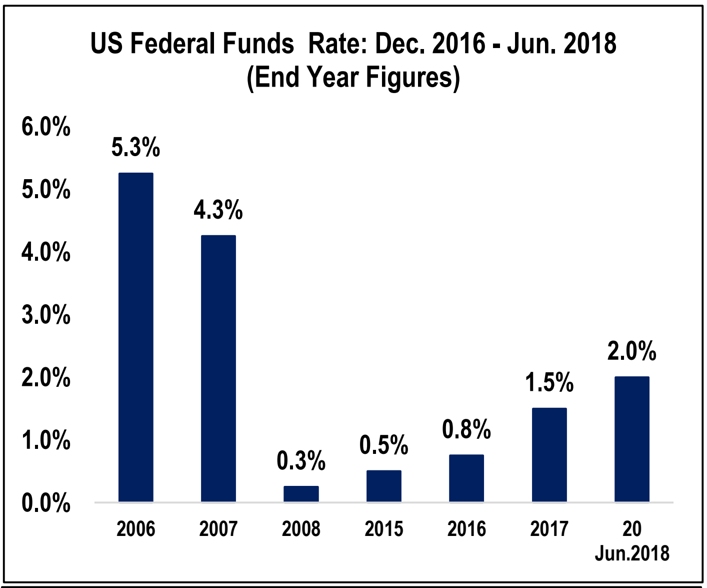
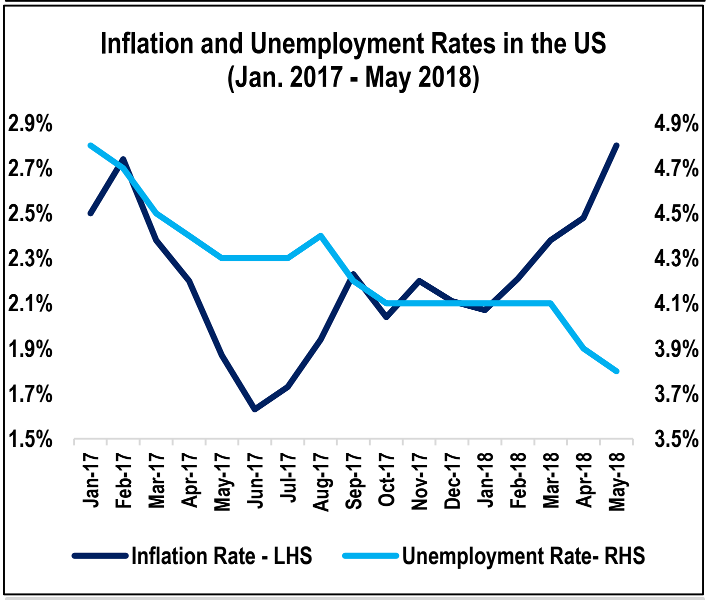
Borrowing Cost on External Debt to Increase

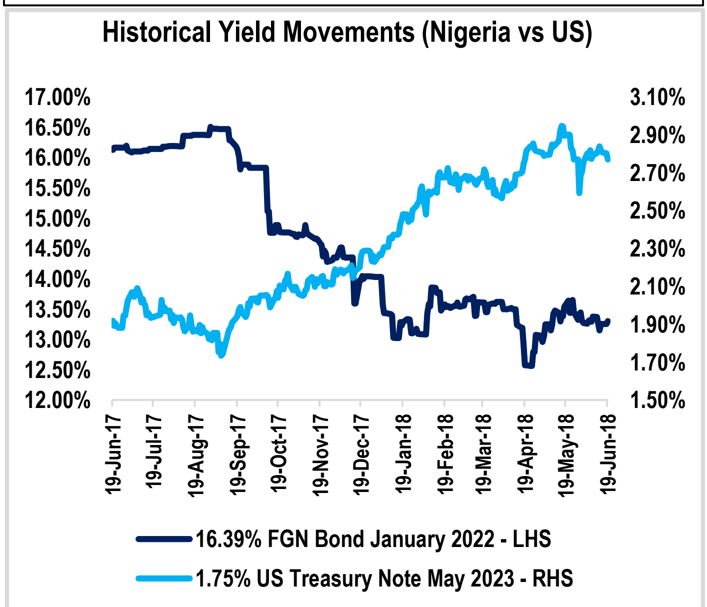
FSDH Research expects interest rates and yields in the global financial market to increase further as the normalization of monetary policy in advanced countries continues. This development has two major implications. Firstly, countries or corporates that plan to raise money from the international market may pay higher interest rates because of rising yields. Secondly, countries in emerging markets may adjust the yields on their fixed income securities to sustain the interests of investors, both local and foreign, in the instruments.



The Federal Open Market Committee (FOMC) of the United States Federal Reserve (The Fed) increased the Federal Funds Rate (Fed Rate) by 25 basis points to 1.75%-2.00% at its June 2018 meeting. The increase in the Fed Rate is in line with the expectation of FSDH Research. We expect two more rate hikes in 2018, possibly in September and December, as the fundamentals of the US economy improve.

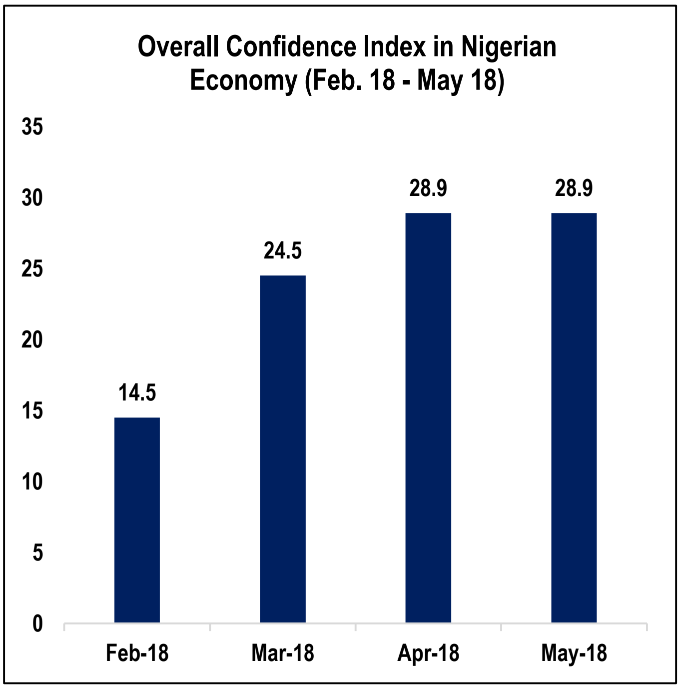


According to the US Bureau of Economic Analysis (BEA), the US economy grew by 2.2% quarter-on-quarter in Q1 2018. Inflation rate increased to 2.8% year-on-year in May 2018, from 2.5% in April. Unemployment rate dropped to 3.8% in May 2018, from 3.9% in April. The Fed's inflation rate and unemployment rate targets are 2.0% and 6.5% respectively.



FSDH Research observes an inverse relationship between the movements in yields on FGN Bonds and US Treasury Notes over the last twelve months. The strategy of the Debt Management Office (DMO) to issue more of long term debt than short term debt and to increase the proportion of the external debt in the total debt stock, was the major reason for the inverse yield movement. We expect the relationship to change as additional rate hikes are announced in the US and the Federal Government of Nigeria (FGN) starts to fund the 2018 budget deficit.

Meanwhile, the Business Expectations Survey (BES) for the month of May 2018, published by the Central Bank of Nigeria (CBN), shows that confidence of firms remains positive. The survey identified the major challenges facing businesses include: insufficient power supply, unfavourable economic climate, high interest rate, unclear economic laws, financial problems, unfavourable political climate, and insufficient demand. Deliberate policies to address the identified challenges will stimulate confidence and investments in Nigeria.



Sources: The US Federal Reserve, US Bureau of Labour Statistics, Bloomberg, Central Bank of Nigeria, and FSDH Research Analysis

RHS – Right Hand Side *LHS – Left Hand Side*

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