Fifty Third Sovereign Debt News Update: Moody's Downgrades Nigeria's Sovereign Rating to B3 from B2, Placing it on Review for further Downgrade

By:

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On 21st October 2022, Moody's Investors Service (Moody's) downgraded Nigeria's local currency and foreign currency long-term issuer ratings, as well as its foreign currency senior unsecured debt ratings to B3 from B2 and placed them on review for downgrade. Shortly thereafter on 25th October 2022, Moody’s downgraded the long-term deposit ratings to B3 from B2, as well as senior unsecured debt ratings, where applicable, of all the Moody's rated banks in Nigeria: Access Bank Plc, Zenith Bank Plc, First Bank of Nigeria Limited, United Bank for Africa Plc, Guaranty Trust Bank Limited, Union Bank of Nigeria plc, Fidelity Bank plc, FCMB (First City Monument Bank) Limited and Sterling Bank Plc. Moody's also placed the long-term deposit ratings, as well as senior unsecured debt ratings, where applicable, of the nine Nigerian banks on review for further downgrade.

According to Moody’s, the October 21st rating downgrade was driven by the significant deterioration in Nigeria’s government finances as well as its external position, exerting increasing pressure on the sovereign credit profile despite a strong increase in international crude oil prices in 2022. Concurrently, Moody’s lowered Nigeria’s local currency and foreign currency country ceilings to B1 and B3 respectively, from Ba3 and B2 respectively. Moody's assessment was that these developments are partly the result of weak governance and are likely to last. According to the credit rating agency, ‘the steep fall in oil production in 2022 and the extension of the expensive oil subsidy have almost entirely eroded the boost to government revenue and exports that would otherwise have been anticipated from higher oil prices.’ It argued that the policy levers available to manage weaker oil revenue and rising borrowing costs amid monetary tightening in Nigeria and globally are limited, and that on the external front, the capacity of the Central Bank of Nigeria (CBN) to protect foreign exchange reserves from external outflows has its limits.

In its statement, Moody’s observed that the initiation of the review for downgrade was prompted by the risk that as the ongoing fiscal and external deterioration accelerates, this will further weaken the government's capacity to service debt and thereby increase its risk of default. Moody’s also noted that the review would focus on understanding the Nigerian authorities' strategy to address both domestic and external pressure and assessing the associated default risk for the government's private creditors. According to the statement, the downgrade also reflects how significant transfer and convertibility risks are given the track record of imposition of capital controls in times of low oil prices. As a justification to the downgrade, Moody’s noted that:

Nigeria's fiscal and external position hasn't benefited from higher oil prices in 2022, which have been 42% higher on average than in 2021. This is due to the 32% drop in oil production since the beginning of the year (recorded between January and September of 2022) and growing domestic consumption of petroleum products – a product of the country's stage of economic development further incentivized by the expensive oil subsidy. The constraints on oil production increasingly appear structural, caused by repeated theft and *lack of investment in infrastructure. While the oil sector is a relatively modest contributor to GDP, it is a primary source of revenue and foreign exchange generation.*

On the fiscal side, Moody's noted that the scope for the government to deliver on fiscal consolidation is constrained, with rating agency expecting government debt affordability to weaken further in the years to come from already very weak levels. Ultimately, according to the rating agency, as the government dedicates a growing share of its revenue to paying interest, the policy dilemma between servicing creditors and meeting the population's demand for social and economic development will intensify. Moody's also explained in the statement that Nigeria's Ministry of Finance has recognised the pressing need to remove the oil subsidy, but its removal from mid-2023 onwards would likely prove difficult politically and to implement in practice. Besides, according to Moody's, Nigeria's ESG Credit Impact Score is very highly negative (CIS-5), reflecting very high exposure to environmental risk and social risk and very weak governance that, with low wealth levels, leads to low resilience to E and S risks. In its words: "Management of oil revenue is particularly weak; absent fiscal stabilisers, the government runs pro-cyclical policy or worse fails to take advantage of high international oil prices. In 2021, the country's hydrocarbon exports amounted to $41 billion, the general government received only $5 billion in net oil revenue or 1 per cent of GDP.

The rating agency noted a few factors that could lead to an upgrade or downgrade of Nigeria's ratings. Particularly, it noted that it would likely downgrade Nigeria's rating if it concluded that fiscal and external pressure is likely to continue to intensify, with the government's funding options narrowing further. In essence, should Moody's assess that the likelihood of default, including through a distressed exchange, has increased, the rating may be downgraded by multiple notches. Furthermore, should Moody's conclude that a sizeable devaluation is highly likely, downward pressure on the rating would develop too. Conversely, according to the statement, Moody's would likely confirm Nigeria's rating at the current level if it expects that the fiscal and external pressure, including those arising from the oil sector, will ease. A clear, prudent medium-term funding plan would support Moody's view that the risk regarding debt service payments is consistent with the current rating.

Moody’s downward review comes months after JP Morgan similarly delisted Nigeria from the list of emerging market sovereign recommendations that investors should be ‘overweight’ in. The leading American investment bank also cited the country’s inability to convert the gains of bullish oil prices as subsidy payment weighs heavily on its fiscal stability.

Nigeria’s downgrade also comes after a number of Sub-Saharan African countries have faced a record number of downgrades since the COVID-19 crisis began. According to a UN study, 41 percent of sub-Saharan African rated sovereigns were downgraded at least once between February 2020 and March 2021, the highest regional average, compared to only 6 percent of advanced economies. The result was that not a single country in sub-Saharan Africa was able to issue a Eurobond for the vast majority of 2020. More recently, Moody’s downgraded Ghana to Caa2 from Caa1, citing sharp rise in interest rates, high inflation and a rapidly weakening currency exacerbate the government's debt challenges. Ghana’s downgrade sparked sharp criticism, with the country’s government saying that it was “gravely concerned” and that the ratings company left out key data to arrive at its decision. Ghana’s slam on Moody’s correctly echoes the common concerns that have been raised against credit rating agencies, which include potential conflicts of interest, unreliable methodologies, and a lack of understanding of African economies.

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