PUBLIC DEBT AND EXCHANGE RATE IN NIGERIA

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Abstract: The purpose of this research is to find out the impact of public debt and exchange rate on the performance of firms in Nigeria. Proper understanding on how to investigate the importance of public debt in Nigeria and the degree of responsiveness of exchange rate to public debt in Nigeria. The study adopted a co-relational research design. The population of the study were Central Bank of Nigeria, Federal Ministry of Finance, among others that are listed on the floor of Nigerian Stock Exchange. The study adopted purposive sampling technique. This study covers the period interval from 2004-2022. The relationship between variables was determined using the Pearson Product Moment Correlation Coefficient (PPMCC) and Panel Data Analysis that involved the use of both the fixed and random effects analysis. Therefore, the study recommends that debt management should be linked to a clear macroeconomic framework which ensures that Nigeria Government will seek to ensure that public debt level and growth rate are sustainable.

Keywords: Public debt, Exchange rate, Performance, Firms, Macroeconomic, Government.

Background to the Study

Public debt, also known as government debt, refers to the amounts owed by different levels of government and used to finance public deficits resulting from a higher level of program spending to budgeted income. Debt can be acquired within the same country or abroad and usually takes the form of bonds, paper, and government securities; although in some cases the debt is acquired directly through a supranational body like the IMF (DMO 2022).

Public debt could be conceptualized as the resources sourced outside the shores of a country for investment projects. This is usually borrowed from foreign lenders such commercial banks, government, or international financial institutions etc. Meanwhile, one of the critical challenges facing developing economies, Nigeria inclusive in the last few decades is debt crisis. The issues of debt crisis among developing economies have become a subject of concern to the multilateral borrowers and advanced economies (UNDP, 2021). This is because most developing and emerging countries are constrained by savings, and this makes external debt an inevitable source of capital for economic development (Blessy & Lakshmi, 2020).

Exchange rate is a rate at which one currency will be exchanged for another currency and affects trade and the movement of money between countries. Exchange rates are impacted by both the domestic currency value and the foreign currency value. In July 2022, the exchange rate from U.S. Dollars to Naira was 414.72, meaning it takes ₦414.72 to buy $1. Exchange rate can be explained further as the rate at which one currency can be exchanged for another currency. When the exchange rate changes, prices of imported goods changes. It impacts the performance of investment, interest rates and inflation.

The government assumes an active role in the development of the economy by trying to put in place the infrastructure and institutional superstructure necessary for economic growth and development. The tendency of increasing public expenditure has been attributed to growing population and increasing urbanization, which requires increase in the sheer of scale of state services and traditional functions, including defense particularly where the country faces one form of crisis or the other Sanusi, (2014). For instance, the insurgences crisis and terrorism occurring in some states in the north-eastern part of Nigeria has forced the government to increase its spending on defense.

The relationship between public debt and exchange rate have been investigated and analyzed by different studies as stated earlier and also with Ogege & Ekpudu, (2020), Ijeoma, (2022) & Patrawimolporn, (2007) but no consensus has been reached. Therefore, this study examines public debt and exchange rate performance in Nigeria with other related macroeconomic fundamentals around the world. The study also examines how exchange rate responds to public debt in Nigeria and in other countries as public expenditure recorded a continuous increase over time.

Statement of the Problem

There have been fluctuations in the exchange rate over time and different literatures and series of sources show that the fluctuations in the exchange rate is due to series of macroeconomic fundamentals and variables which also results into changes in some other macroeconomic trends around the globe. With reference to public debt, Nigeria's public debt have been unstable over time (CBN 2022, Sene, 2004). Although under the Nigerian constitution, only the Federal Government could borrow abroad, many state governments, however, have successfully negotiated foreign loans and subsequently obtained Federal Government Guarantees.

Objectives of the Study

The objective of this study is to examine the effect of public debt and exchange rate in Nigeria with the view of enhancing exchange rate performance on debt service in Nigeria. The specific objectives are to:

i. examine the trend in public debt and exchange rate in Nigeria.
ii. analyse the direction of causality between public debt and exchange rate in Nigeria.
iii. evaluate the effect of public debt on exchange rate in Nigeria.

Research hypothesis

The research hypothesis is formulated.

H_o: Public debt has significant effect on exchange rate in Nigeria.
H_1: Public debt has no significant effect on exchange rate in Nigeria.

Scope of the Study

This study seeks to analyse the effect of public debt and exchange rate in Nigeria, and a thorough empirical investigation was conducted with data covering 22years i.e. 2000-2022. Also, this study attempts to expand the data coverage to recent years. Data on public debt and exchange rate from different data sources such as Central Bank of Nigeria, Statistical Bulletin and World Development Indicators was used.

Concept of Public Debt

According to Bamidele & Joseph, (2022) debt has to do with the resource used in an organization that is not being contributed by the owner and doesn't belong to or owned by the organization. Public debt can be of two types which is internal or external debt. World Bank (2000) explains that external debt as the amount and liabilities at a particular time of a country to a nonresident to repay the capital or principal, which is with interest or without interest. There are some liabilities which fall in this category of liabilities as of this case and the liabilities include long term loans, short term bills, bonds, transferable deposits and currency, advances, and trade credit. The external debt is supposed to be meant to supplement for natural resources coupled with not an immediate decrease in the local resource use either for capital formation or consumption.

The internal debts in this case include treasury certificate, development stocks, treasury bills and ways and means advances. According to Sanusi, (2012) there is a distinction between

different stocks and flows that has to do with debt. However, debt is classified into deadweight debt and productive debt. Whenever a loan is obtained to be used for enabling a nation or state to purchase some needed assets it is called productive debt e.g. electricity, refinery, money borrowed for acquiring factories etc. A deadweight debt has

to do with the debt that is being undertaken to finance expenses on current expenditure and finance war. An obligation is owned to a foreign institution or government and the interest servicing is done in foreign exchange, and this tends to influence the exchange rate.

Exchange Rate

Exchange rate is the rate at which the currency of a country can be exchanged for the currency of another country. According to Ajayi, (2002), foreign exchange is the price of a domestic currency in terms of the price of a foreign currency. Thus, it is a fact to know that foreign currency is the price of a local currency in terms of the foreign one. Exchange rate plays a role in every free market economy around the world and for this reason; exchange rate is one of the most analyzed macroeconomic variables which are being analyzed as one of the economic measures.
According to Ijeoma, (2022) there are two types of exchange rate regimes which are fixed or pegged and floating or flexible exchange rates. For the fixed exchange rate, this is the case in which the exchange is being predetermined by the government, but the exchange rate value of the country is being allowed to fluctuate with that currency to which they are fixed. Also,

Theoretical Review - Ricardo Theory of Public Debt

Robert, (2012) the primary burden of any community was derived from the waste of public expenditure by the community rather than from the methods that are adopted or employed to finance such an expenditure. Ricardo viewed that the funds will be gotten from the liquid resources present in the community and that in the point of the economy and it would make no difference if such funds were raised from loans or taxes.

The Mint Parity Theory

The earliest theory of foreign exchange was the mint parity theory by Austav, (2000). This theory was applicable for those countries which had the same metallic standard (gold or silver). Under the gold standard, countries had their standard currency unit either of gold or it was freely convertible into gold of a given purity. The value of currency unit under gold standard was defined in terms of weight of gold of a specified purity contained in it. The central bank of the country was always willing to buy and sell gold up to an unlimited extent at the given price. The price at which the standard currency unit of the country was convertible into gold was called the mint price. This rate of exchange determined on weight-to-weight basis of the metallic contents of currencies of the two countries was called mint par of exchange or the mint parity. So, the mint par values of the two currencies determined the basic rate of exchange between them.

Empirical Review in Developed Countries

Robin, (2011) observed public debt and how exchange rate changes in relation to financial meltdown. The scope is the United States of America which covered between 1990 and 2010. An exchange rate model was developed to analyze the objective of the study and the study reveals that the country should try to avert further damage from exchange rate liquidity shock by ensuring that profit activities in financial industries are regulated.

Noer (2010) studied the effect of exchange rate on inflation in France. The year scope of the study is 1980 to 2009. The variables used in the study are external debt, domestic debt, inflation, exchange rate and gross domestic product. The methodology used in the study is the Vector Autoregressive (VAR) Model and GARCH model for the analysis of volatility in exchange rate. The study finds that the regime of exchange rate policy of a country plays a key role in reducing the fluctuations risk in the real exchange rate, which has a significant effect on inflation level and the entire economy.

Empirical Review in Developing Countries

Governments in many developing countries, because of the continuous increase in public expenditures, and low capital formation have resorted into borrowing either or both within and outside the country. However, most borrowings come with interest attached, which results in debt servicing. Serving external debt may involve demand for foreign currency which tends to affect the exchange rate of the country. Bunescu, (2014) evaluates the impact of

external debt on exchange rate variation. The scope of the study covered Romania from 1990 to 2014. The variables used in the study are exchange rate, nominal exchange rate and external debt. The methodology used in the study is the ordinary least square. The study reveals that all independent variables are deterministic factors of exchange rates.

Odera, (2015) studied the effect of external debt on exchange rate volatility. The study focuses on Kenya as a case study and used data covering 1985 to 2014. The study used real exchange rate, nominal exchange rate and public debt. The study finds that exchange rates in real and nominal terms have a significant impact on exchange rate volatility.

Masaku, (2021) explored the link between external borrowing and exchange rate movements in Kenya in-between 2000-2020 applying ordinary least squares method. The empirical findings revealed that external borrowing had positive and significant influence on exchange rate. However, the study failed to recognize the different exchange rate regimes that characterized the country. In addition, the study focused on a single currency only despite the fact that Kenya is an open economy with multiple trading partners.

Empirical Review in Nigeria

The fluctuating exchange rate and massive debt burden of Nigeria necessitates a thorough investigation of trends in her foreign debt levels, its underlying causes, and implications for economic growth. This study, therefore, investigated the impact of rising external debt on the exchange rate in Nigeria with annual data from 1980 to 2021. The data obtained were analyzed using the Augmented Dickey-Fuller (ADF) unit root test, Autoregressive Distributed Lag (ARDL) technique, and the stability and diagnostic test in the analysis. Based on the outcomes of the preliminary test analysis, the results show that external debt has a negative but insignificant effect on the exchange rate in Nigeria. Also, external debt has a positive and significant effect on the inflation rate in Nigeria. In light of these findings, the study concluded and recommended that the Nigerian government and/ or Central Bank of Nigeria should ensure that all borrowed funds are effectively channeled into viable projects that will yield returns to service the debts as well as pay up the debt at maturity, which puts pressure on the foreign exchange market in the short term. study is secondary data and the major source of data is the Statistical Bulletin published annually by the Central Bank of Nigeria (CBN) December, 2018.The study used Ordinary Least Squares (OLS) and Error Correction Model (ECM) tools of analysis in the investigation of the impact and relationship among the economic variables. The long and short run results confirmed that public external debt has impact on exchange rate in Nigeria. However, based on the probability value at the short run all independent variables were statistically significant in explaining variation in Exchange Rate in Nigeria except Foreign Reserve in Nigeria (FRN) at 5 percent level of significance. While, at the long run the External Debt in Nigeria (EXDTN), Debt Service Payment in Nigeria (DSPN) and Foreign Reserve in Nigeria (FRN) Foreign Reserve in Nigeria (FRN) was statistically significant in explaining the variation in Exchange Rate in Nigeria (EXCHR) at 5 percent level of significant. Therefore, the study recommends that Government should increase the mechanism to check and control the allocation and implementation of public funds in Nigeria to reduce deficit budget and exchange rate.

Adeyemi & Fagbola, (2022) observed the effect of external debt on exchange rate performance. The country scope of the study is Nigeria between 1980 and 2019. The variables used in the study are inflation rate, exchange rate, external debt and gross domestic product. Then the methodology used in the study is an autoregressive distributed lag model. The study finds that external debt has a positive and significant effect on the exchange rate.

Jimo, (2022) employed ordinary least square (OLS) multiple regression and co-integration test to investigate the relationship between external public debt servicing and exchange rate fluctuations in Nigeria from 2000-2022. The variables used include external public debt receipts, external public debt servicing and the exchange rate. The findings showed that external debt receipts and external debt servicing have positive short and long-run relationships with the naira exchange rate fluctuations.

Furthermore, Ezeanyeji, Okeke, & Usifoh, (2022) adopted the Error Correction model (ECM) estimation to examine the effect of external debt management on the exchange rate in Nigeria from 2000 to 2024. The research findings showed that the external debt stock does not affect the exchange rate of Nigeria. However, Nigeria's external service payment negatively affected the average official exchange rate in Nigeria.

Gaps in the Study

A series of studies as found in the empirical literature, effect of public debt and exchange rate, but our major concern is the extent at which public debt influences exchange rate. Most studies in Nigeria, developing and developed economies such has Robin (2011), Aderemi & Fagbola, (2022), Benigno, (2019), Saheeed, (2022) only focused on the effect of public debt and exchange rate but failed to investigate the direction of causality between public debt and exchange rate, to be able to determine if public debt and exchange rate can cause each other or one of the two can cause the other.

This study shall however fill the gap in literature by empirically analyzing the direction of causality between public debt and exchange rate in Nigeria.

Methodology

The study being quantitative research based adopted a co relational research design. This research design involves relating two or more variables with the aim of explaining and predicting the relationship between variables. The population of this study was Central Bank of Nigeria, Federal Ministry of Finance, among others that are listed on the floor of Nigerian Stock Exchange. The sample technique that was adopted for this study was a non-random sampling technique. Variables are exchanging rate, external debt, domestic debt, money supply and foreign reserve. Data was collected from secondary source. Descriptive statistics was employed to explain the effect of public debt and exchange rate in Nigeria using tables, ratios, and percentages to measure each of the variables, while formulated hypotheses was tested using inferential statistics techniques.

Results and Discussion

Descriptive Statistics

On table 1, the variables: exchange rate, domestic debt, debt service payment, external debt, foreign reserve, money supply are represented. Their averages within the period measured by the study are 94.14346, 28700, 28600, 28600, 17900 and 70500 respectively. The standard deviation shows the extent at which the observations are distributed around their respective mean. The maximum values for EXR, DOD, EXD, FR, MS, and DSP are 306.9210, 14300, 54800, 5300, 34900, and 17400 respectively while their minimum values are 0.617708, 1200, 11400, 65100, 15200 and 15200 respectively.

Table 1: Descriptive Statistics of the variables

	Exchange Rate	Domestic Debt	Debt Service Payment	External Debt	Foreign Reserve	Money Supply
Mean	94.143	287000	286000	28600	17900	70500
Median	101.697	898000	115000	29100	73300	10400
Maximum	306.921	143000	174000	54800	53000	34900
Minimum	0.618	112000	152000	11400	65100	15200
Standard Deviation	92.822	412000	442000	10100	18300	16500
Skewness	0.810	1.524	2.139	0.405	0.601	1.381
Kurtosis	2.855	4.051	6.663	3.066	1.699	3.571
Jacque-Bera	4.301	16.889	51.534	1.071	5.096	12.921
Probability	0.116431	0.000215	0.0000	0.585410	0.078236	0.001564

Observations	39	39	39	39	39	39

Source: author's computation, (2024)

Graphical illustration of Exchange Rate

Figure 1, showed the trend of exchange rate for Nigeria, it can be seen from the graph that the exchange rate has been on the rise over the years.

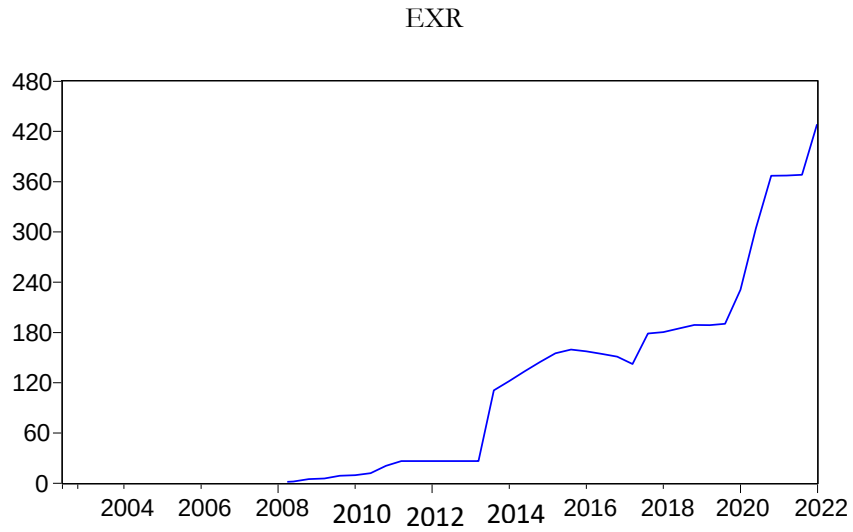

Figure 1: Trend of Exchange Rate

Graphical illustration of Domestic Debt

Figure 2, showed the trend of domestic debt of Nigeria, from the chart it was observed that domestic debt increased over the years.

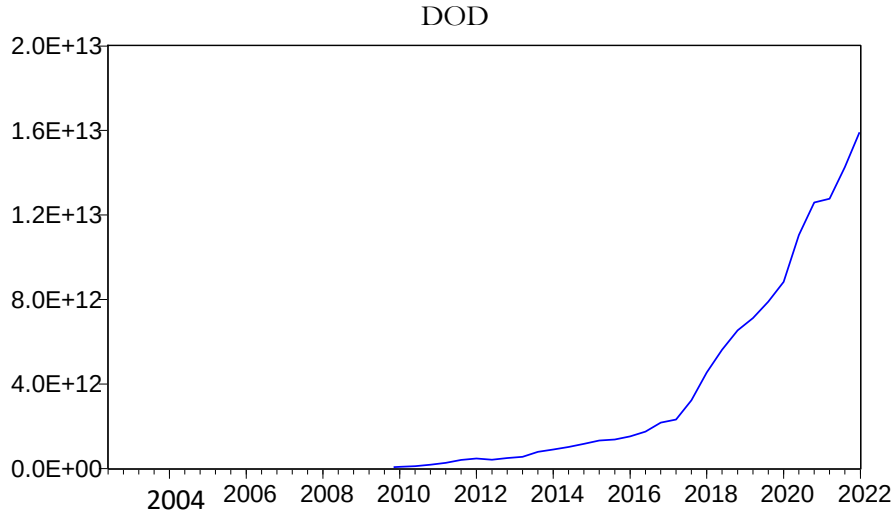

Figure 2: Trend of Domestic Debt

Graphical illustration of Debt Service Payment

Figure 3, represents the trend of debt service payment of Nigeria and it can be observed that debt service payment has maintained an upward trend over the years.

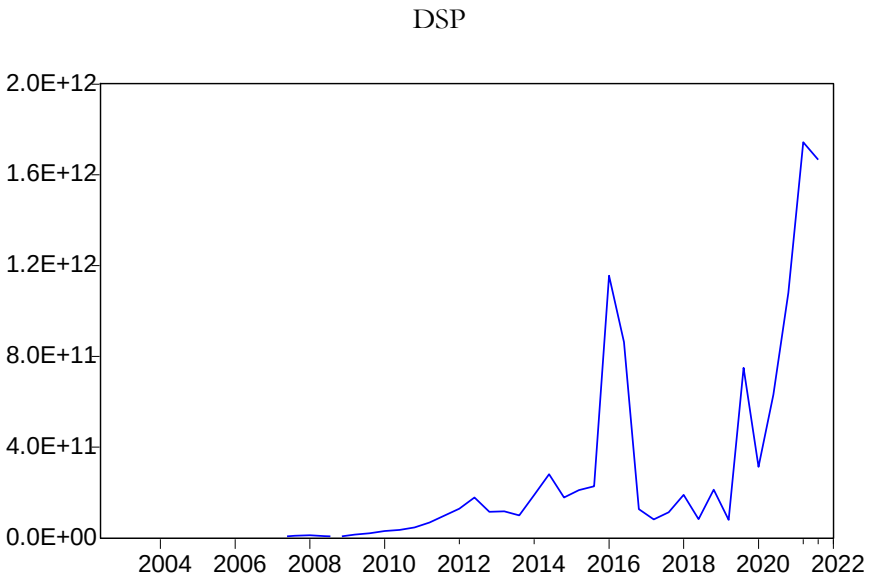

Figure 3: Trend of Debt Service Payment

Graphical illustration of External Debt

Figure 4, represents the trend of external debt of Nigeria and it can be observed that external debt has maintained an upward trend over the years.

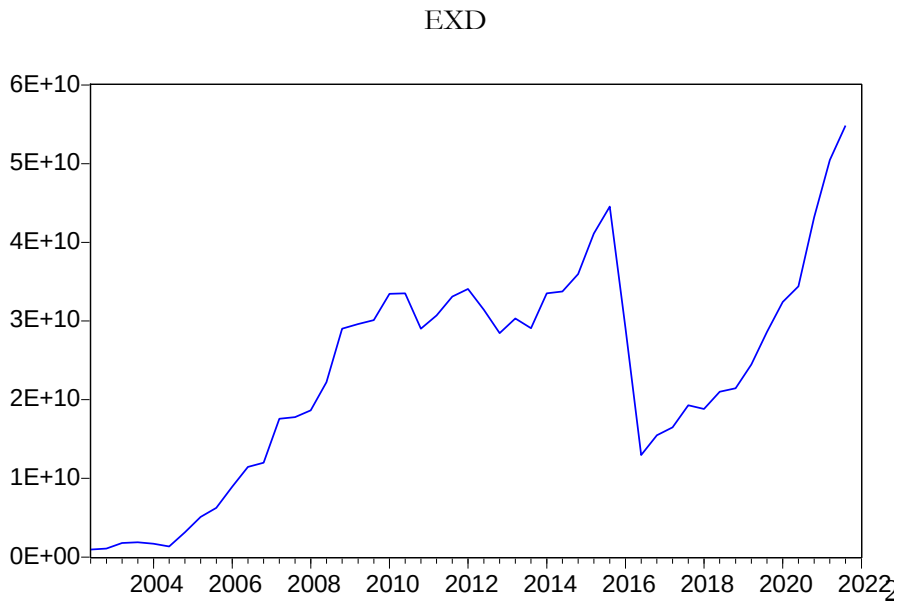

Figure 4: Trend of External Debt

Graphical illustration of Money Supply

Figure 5, represents the trend of money supply in Nigeria and it can be observed that money supply has maintained an upward trend over the years.

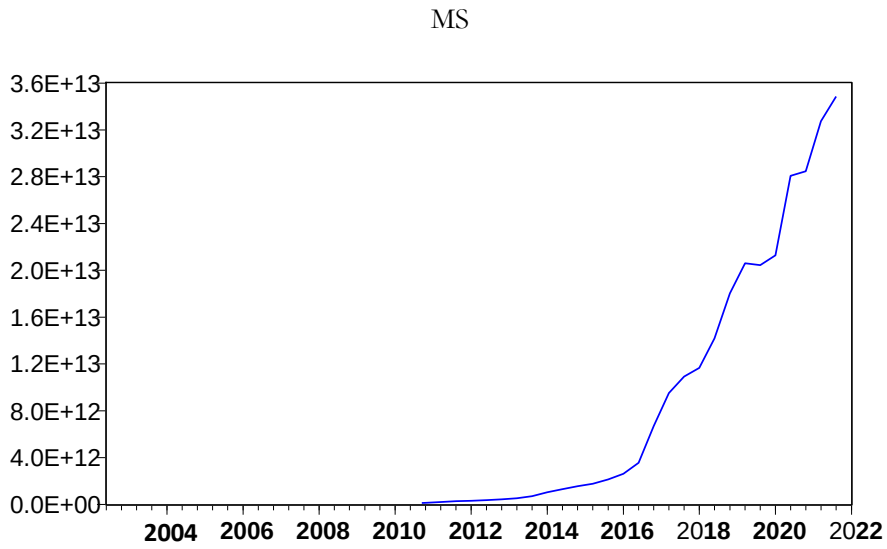

Figure 5: Trend of Money Supply

Graphical illustration of Foreign Reserve

Figure 6, represents the trend of foreign reserves of Nigeria over the years.

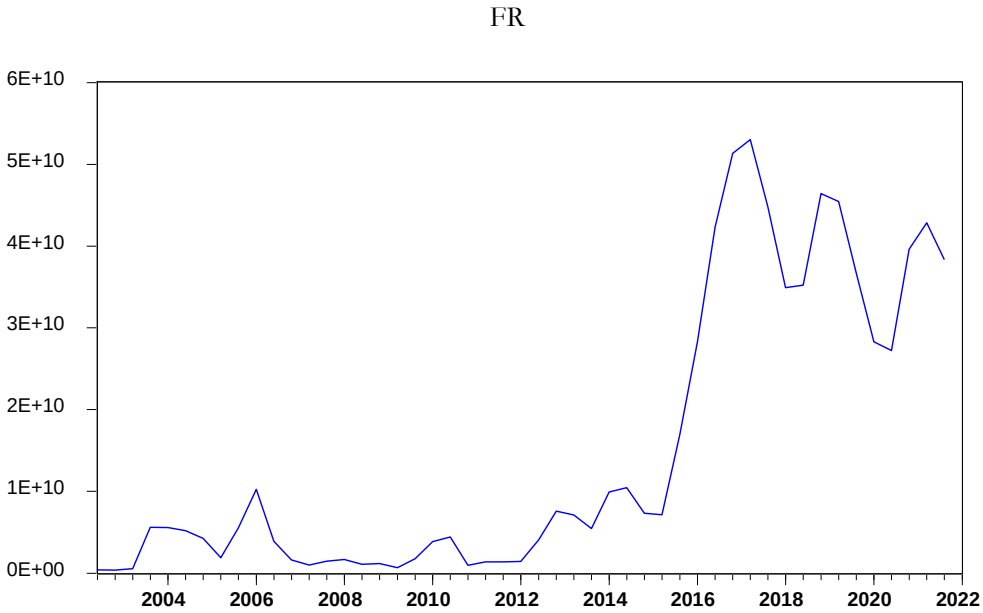

Figure 6: Trend of Foreign Reserve

Correlation Analysis

This analysis is carried out to ensure that the variables do not have a perfect or exact linear relationship or representation of one another, in essence no multicollinearity. The table (Table 2) below showed the result of the correlation analysis and from the table it can be deduced that there is no perfect correlation among the variables.

Table 2: Correlation Analysis of the study variables

	Exchange Rate	Domestic Debt	Debt Service Payment	External Debt	Foreign Reserve	Money Supply
Exchange Rate	1.00					
Domestic Debt	0.47	1.00				
Debt Service Payment	0.78	0.55	1.00			
External Debt	0.92	0.46	0.76	1.00		
Foreign Reserve	0.78	-0.03	0.51	0.69	1.00	
Money Supply	0.9	0.39	0.72	0.99	0.74	1.00

Source: Author's computation, (2024)

Table 3: Augmented Dickey Fuller

Variables	**Level**			**First Difference**			**I(d)**
	None	**Intercept**	**Trend & Intercept**	**None**	**Intercept**	**Trend & Intercept**	
EXR	4.3039	2.8951	0.2216	-3.8215***	-4.4418***	-5.2704***	I(1)
DOD	3.2787	-1.5605	-1.5489	-2.5766**	-4.6112***	-4.8491***	I(1)
EXD	2.3420	-2.8633*	-2.3747				I(0)
MS	3.1364	-1.361	-2.3229	-2.2405**	-4.3483***	-4.4975***	I(1)
FR	0.9486	-1.7741	-2.5428	-5.98125***	-6.0558***	-5.9812***	I(1)
DSP	1.8294	-1.2797	-2.1966	7.6691***	-8.4358***	-8.4236***	I(1)

Source: author's computation, (2024)

*** Significant at 10% ** significant at 5% *** significant at 1%**

Table 4 below shows the result of unit root test at level form and first difference form of the variables using Phillip-Pheron (PP) test. The order of integration I(d) shows the number of times each variable was differentiated before it is stationary. The result shows that not all the series of the included variables are stationary at level, the result discloses that only EXD is stationary at level while EXR, FR, DOD, DSP, and MS are stationary at first difference.

Table 4: Phillips-Pheron

Variables	**Level**			**First Difference**			**I(d)**
	None	**Intercept**	**Trend & Intercept**	**None**	**Intercept**	**Trend & Intercept**	
EXR	4.8079	2.8951	0.2216	-3.8215***	-4.467***	-5.0605***	I(1)
DOD	5.9705	-1.9412	-1.3898	-2.3626**	-4.6118***	-4.8399***	I(1)
EXD	2.0298	-2.7935*	-2.1359				I(0)
MS	6.9535	-1.3004	-1.647	-1.948**	-	-4.4998***	I(1)

					4.3593***		
FR	1.6415	-1.7647	-2.5444	-5.9546***	-6.4949***	-6.198***	I(1)
DSP	2.836	-1.5668	-2.139	-7.6451***	-8.898***	-9.9137***	I(1)

Source: author's computation, (2024)

*** Significant at 10% ** significant at 5% *** significant at 1%**

Table 5: ARDL Bounds test result

Test Statistic	Value	K
F-statistic	2.091957	5
Critical Value Bounds		
Significance	I0 Bound	I1 Bound
10%	2.26	3.35
5%	2.62	3.79
2.50%	2.96	4.18
1%	3.41	4.68

Source: author's computation, (2024)

Short run result discussion

The result in table 6 below shows the short run results. It can be observed that LNDSP has a significant effect on EXR. This implies that debt service payment has a significant effect on exchange rate in the short run i.e. the impact of the variables are evident in the short run, it also shows that an increase in the debt service payment will result in a reduction in exchange rate, specifically, a 1% increase in debt service payment will decrease exchange rate by 0.19%, this effect was statistically significant at 10%. This finding is expected as debt servicing as well as repayment put a lot of pressure on the foreign exchange market in the short run resulting in exchange rate fluctuations. is in agreement with Ajayi (1992) and Ezirim and Muoghalu (2006) both also found external debt to have no significant effect on exchange rate, but contrary to the findings of Aderemi and Fagbola (2020). It also showed that a 1% increase in the previous value of the domestic debt will reduce exchange rate by 0.996%, while a 1% increase in the previous value of foreign reserve will reduce exchange rate by 0.381%. This implies that both the current domestic debt and foreign reserve do not impact the exchange rate but their previous value does.

Furthermore, the Adjusted R^2 as shown in the table was 0.981 which revealed that the independent variables (DOD, DSP, EXD, FR, and MS) can conveniently explain or account for the variations in EXR with about 98.8% while the remaining 1.2% would be explained by other factors affecting exchange rate which were not included in the model estimated.

The F-statistic result indicated that regression model used in the study was good and fit for predictive purposes. F-statistics was 148.3532, significant at 1 percent indicating that the overall model applied can statistically predict the dependent variable.

The short run error correction term (ECT) is negative, less than one and significant. The ECT result shows the speed of adjustment of exchange rate to its long run equilibrium after a short run disequilibrium. The coefficient for adjustment of exchange rate is -0.2467, this implies that more than 24 percent of the total short run disequilibrium converges back to equilibrium in the long run. In other words, more than 24% of the disequilibrium is adjusted annually.

Table 6: Short run results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LNDOD)	0.65464	0.39331	1.66443	0.1096
D(LNDOD(-1))	-0.9958**	0.36539	-2.7253	0.0121
D(LNDSP)	-0.1907*	0.0976	-1.9536	0.063
D(LNEXD)	-0.151	0.28582	-0.5285	0.6022
D(LNFR)	0.08523	0.12839	0.6638	0.5134
D(LNFR(-1))	-0.3811***	0.12867	-2.9622	0.007
D(LNMS)	-0.1079	0.55366	-0.1949	0.8472
D(LNMS(-1))	0.56405	0.42494	1.32736	0.1974
CointEq(-1)	-0.2467*	0.12284	-2.0085	0.0565
R-Squared	**Adjusted R-Squared**	**F-statistics**	**Durbin Watson**	**Prob (F-statistics)**
0.988215	0.981554	148.3532	1.874416	0.000

Source: author's computation, 2024

*** Significant at 10% ** significant at 5% *** significant at 1%**

Post Estimation

Post estimation test are conducted to ensure that all assumptions of the classical linear regression mode; were not violated. The result of the post estimation test is presented in table 8. The result indicated that the error series of the model estimated has time invariant variance, as the null hypothesis of homoscedasticity cannot be rejected at 5% significance level. Jarque-Bera Test showed that the null hypothesis of the series being normally distributed was rejected at 5% significant level. Breusch- Godfrey LM test was adopted to determine if the error term exhibits auto correlation. The test's null hypothesis was that no auto correlation existed and the null hypothesis was accepted at 5% level of significance. Ramsey RESET Test was adopted to conduct linearity test on the model to test how well fitted the model is, with null hypothesis that the model was linear. The null hypothesis was accepted at 5% level of significance. Thus, the linearity of the model was confirmed.

Table 7: Post Estimation Diagnostics

Test	Result	
	F-Statistics	Probability
Jarque-Bera	12.52448	0.001907
Breush-Godfrey LM	0.597535	0.5593

Breush-Godfrey Pagan	1.929001	0.815
Ramsey RESET	2.327909	0.1413

Conclusion and Recommendations

Exchange rate is one of the most important macroeconomic variables particularly for an emerging economy like Nigeria, it affects import, exports and economic activity, thus the ability of the monetary authority to manage it can be of great benefits to the nation's economy. Based on the findings of this study, this study concludes that the external debt has an insignificant effect on the exchange rate while domestic debt only affects the exchange rate through its previous values and is partly responsible along with debt service payment and foreign reserve for the state of the exchange rate.

Recommendations

Based on the findings of this study, Debt management should be linked to a clear macroeconomic framework which ensures that Nigeria Government will seek to ensure that public debt level and growth rate is sustainable. It is also crucial to ensure that the borrowed funds are invested in projects with high rate of returns.

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