

February 8, 2022



Nigeria Strategy Report

H1 2022

Domestic Economy and Policy Environment

Nigerian Fiscal: Revenue Estimates Still Elusive?

Executive Summary

As reported by the budget office as of the end of November 2021, FG's pro-rated aggregate revenue for the 11-month period underperformed the pro-rated budget by 26.0% at ₦5.51tn. The underwhelming revenue is an offshoot of oil revenue that settled at ₦970.33bn (Variance: 47.4%), a far-cry from the ₦1.84tn that was budgeted for the period and premised on an average oil price of \$40/bbl. Although oil price averaged \$70.22/bbl. in the period, oil revenue remained under water due to many concerns including production shutdown at the Forcados terminal which dragged oil production to an average of 1.38mbpd (vs budgeted 1.86mbpd) despite improved quota from the OPEC+ alliance. On the flip side, non-oil revenue took the shine, surpassing the budget in an unusual fashion by 118.8% to print at ₦1.62tn riding on the wheels of increased CIT collections (+115.0%) due to improved corporate performance and higher VAT revenue (+165.0%) as consumption recovers and the economy fully reopened following the downturn in 2020.

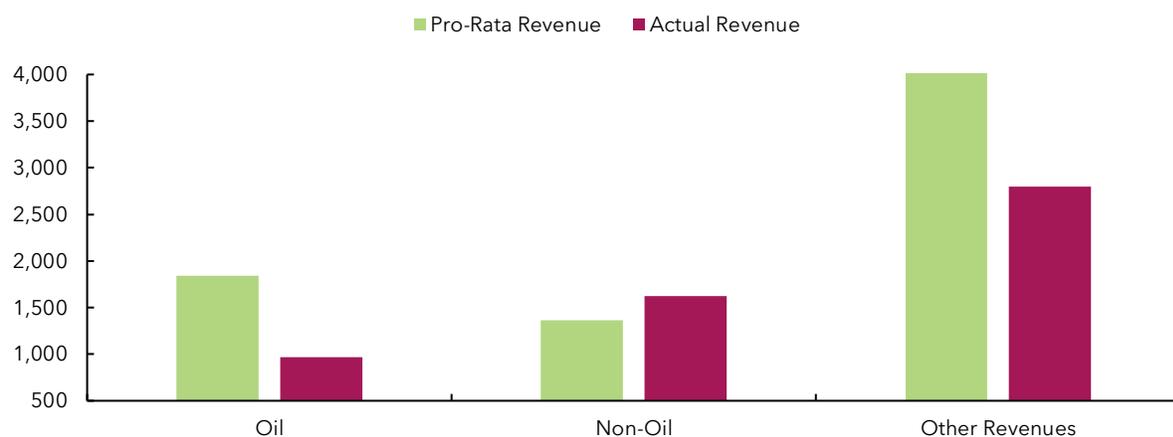
We assessed the budget assumptions for their reasonableness in the light of current realities. The adjusted oil price benchmark at \$62/bbl. is higher than the \$40/bbl. for 2021 but lower compared with 2021 actual average of \$70.92/bbl and EIA forecast for 2022 (\$74.95/bbl), representing prudent estimate. Although, the price appears conservative when juxtaposed with current oil price levels and EIA forecast of \$80/bbl. and \$70.05/bbl. respectively, the recently discovered Omicron variant and its speedy spread, defiance to vaccines, and attendant effect on aggregate output suppresses optimism for the oil market in 2022. On the flip side, oil production estimate at 1.88mbpd appears optimistic given that oil production has only averaged 1.38mbpd in 2021 despite OPEC+ easing supply cuts. We are also comfortable with exchange rate estimate of ₦410.15/\$1.00 in line with the adjustments this year and we do not see an imminent devaluation in the offing.

***In this report,
we focus on
developments
in the fiscal
space over
2021 and
outline our view
for the 2022.***

2021 Budget Implementation for Jan - Nov 2021: Lower Revenues, Burgeoning Expenditure

As reported by the budget office as of the end of November 2021, FG's pro-rated aggregate revenue for the 11-month period underperformed the pro-rated budget by 26.0% at ₦5.51tn. The underwhelming revenue is an offshoot of oil revenue that settled at ₦970.33bn (Variance: 47.4%), a far-cry from the ₦1.84tn that was budgeted for the period and premised on an average oil price of \$40/bbl. Although oil price averaged \$70.22/bbl. in the period, oil revenue remained under water due to many concerns including production shutdown at the Forcados terminal which dragged oil production to an average of 1.38mbpd (vs budgeted 1.86mbpd) despite improved quota from the OPEC+ alliance. On the flip side, non-oil revenue took the shine, surpassing the budget in an unusual fashion by 118.8% to print at ₦1.62tn riding on the wheels of increased CIT collections (+115.0%) due to improved corporate performance and higher VAT revenue (+165.0%) as consumption recovers and the economy fully reopened following the downturn in 2020. Contrary to the experience in 2020 where customs revenue fell short of target by 12.4% due to downturn in trade, it exceeded the budgeted amount of ₦465.91bn by 8.1% in 2021. Inflows from 'Other revenue' amounted to ₦2.80tn, 30.8% lower than the budget level for the period as inflows from Special Accounts/Levies underperformed by 75.4%.

Figure 1: Actual Vs Budgeted Revenue Performance Jan - Nov 2021 (NGN'bn)

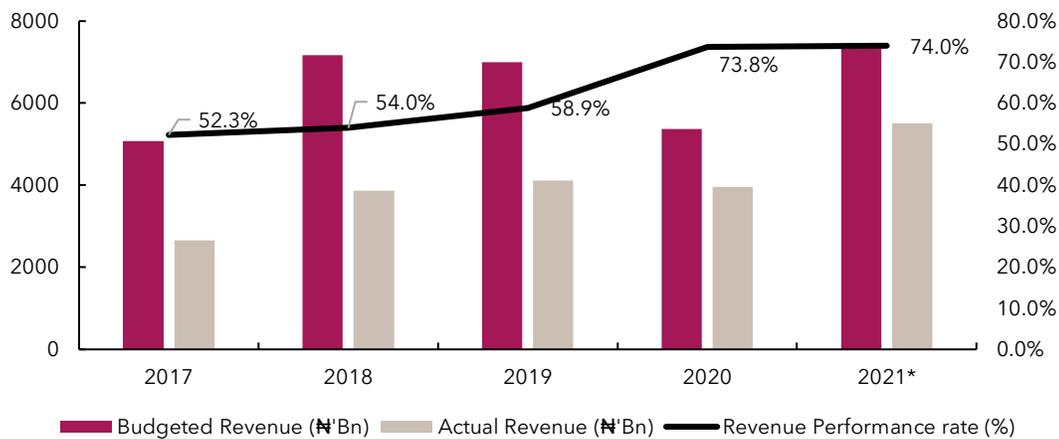


Source: ARM Research, Budget Office

For the expenditure leg, 94.1% (₦12.56tn) of the pro-rated expenditure (incl. GoEs and project-tied loans) was disbursed in the period under review, higher compared to an average actual-budget ratio of 89.5% over the last 5 years. As recorded over the previous years, recurrent expenditure subsumes 69.3% of total disbursement in the period. Capital spending implementation over budget matched 2020 levels at 74.4% (2020: 74.3%) as ₦3.40tn was disbursed out of the budgeted ₦4.57tn.

Debt service costs, however, soared 37.9% above the planned amount to ₦4.20tn as debt service charges on foreign and domestic debt outweighed budget. We suspect that currency adjustments in the period is responsible for the rise in external debt costs. On a similar note, FG paid an extra-budgetary ₦1.1tn interest on its 'Ways & Means' backdoor funding from the CBN which had summed up to ₦16.6tn as of September 2021.

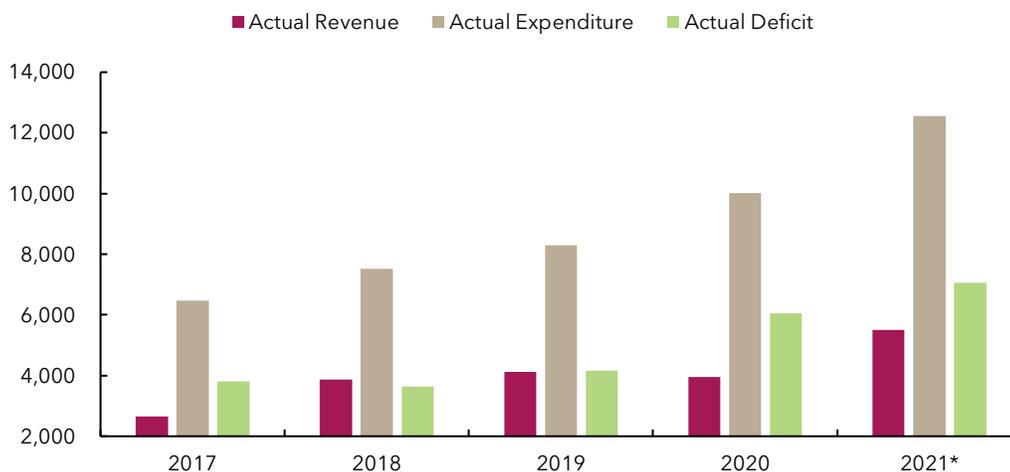
Figure 2: Revenue Performance Rate 2017 - 2021



Source: ARM Research, Budget Office

Consequently, budget deficit widened than planned by 19.3% to ₦7.05tn (vs ₦5.91tn) on the back of a faster decline in revenue compared to outflows. The deficit was plugged through new domestic - both in the fixed income market and through CBN 'Ways & Means' funding - and external borrowings as the FG tapped the Eurobonds market in September, raising \$4bn (₦1.62tn) to plug its fiscal deficit.

Figure 3: Actual Budget Performance Jan - Nov 2021 (NGN' bn)



Source: ARM Research, Budget Office

For FY 2021 as we expect full-year implementation report, we project a revenue performance of 74% (₦6.0tn), higher than current 5-year average performance of 63.1% as the rebound in economic activities continue to support the already-conservative non-oil revenue budget. Oil revenue is projected to print at ₦1.06tn with oil production and prices at an average 1.4mbpd and \$70.92/bbl. in 2021. On the expenditure side, we project an actual-budget ratio of 95% as stiff recurrent expenditure and exchange rate pressures elevate expenditure. Also, we expect a 73:27 split between recurrent and capital expenditure. Hence, the budget deficit should widen to c.₦7.83tn in 2021 which is funded primarily through borrowings. Furthermore, given that the FG tapped the Eurobonds market in September, we expect total borrowings to close at ₦7.83tn for 2021, constituting the risk of elevated debt servicing cost in subsequent years.

Figure 4: Key Highlights of the 2021 and 2022 Budgets

| | 2021 Budget+ Suppl. Budget | Jan-Nov prorated | Jan-Nov actual | 2022 Approved Budget |
|----------------------------------------|-------------------------------------|---------------------|-------------------|----------------------------|
| Oil production (mbpd) | 1.86 | 1.86 | 1.57 | 1.88 |
| Oil price (\$/bbl) | 40 | 40 | 65 | 62 |
| Exchange rate (₦/\$) | 379 | 379 | 410.15 | 410.15 |
| FGN Share of oil revenue (N'billion) | 2,011.02 | 1,843.43 | 754.16 | 3362.01 |
| Total non-oil revenue (N'billion) | 6,110.39 | 5,601.20 | 4,755.69 | 7,378.80 |
| FGN's Total revenue (N'billion) | 8,121.41 | 7,444.63 | 5,509.85 | 10,740.80 |
| FGN Expenditure (N'billion) | 14,570.76 | 13,356.53 | 12,562.25 | 17,126.87 |
| Fiscal Deficit (N'billion) | 6,449.35 | 5,911.90 | 7,052.40 | 6,386.07 |

Source: Budget Office, ARM Research

2022 Budget of Economic Growth and Sustainability: Revenue Estimates Still Elusive?

We assessed the budget assumptions for their reasonableness in the light of current realities. The adjusted oil price benchmark at \$62/bbl. is higher than the \$40/bbl. for 2021 but lower compared with 2021 actual average of \$70.92/bbl and EIA forecast for 2022 (\$74.95/bbl), representing prudent estimate. Although, the price appears conservative when juxtaposed with current oil price levels and EIA forecast of \$80/bbl. and \$70.05/bbl. respectively, the recently discovered Omicron variant and its speedy spread, defiance to vaccines, and attendant effect on aggregate output suppresses optimism for the oil market in 2022. On the flip side, oil production estimate at 1.88mbpd appears optimistic given that oil production has only averaged 1.38mbpd in 2021 despite OPEC+ easing supply cuts. We are also comfortable with exchange rate estimate of ₦410.15/\$1.00 in line with the adjustments this year and we do not see an imminent devaluation in the offing.

The budget projects an audacious total revenue of ₦10.13tn (incl. of revenue from GOEs), 24.74% and 68.5% higher than the budgeted and annualized actual revenues, respectively, for 2021. Excluding GOE revenue, FG's projected revenue for 2022 stands at ₦8.4tn, higher by 24.09% and 39.77% respectively compared to budgeted and actual revenue amounts for 2021. An audacious ₦3.36tn (37.3% of FG's revenue) is expected from oil revenue for FY2022 and in our view, this is overly bullish especially with 2021 annualized amounts suggesting an oil revenue of ₦1.06tn and considering the threat of the Omicron variant to oil prices. Similarly, technical bottlenecks in oil production have kept oil volumes below par and we are not optimistic of significant improvement in 2022 that could spur higher revenue. For non-oil revenue, CIT and Customs revenue take the lead with expected revenues of ₦909.3bn and ₦834.1bn respectively in 2022. Revenue from VAT collections and Federal account levies are budgeted at higher amounts than 2021 levels at ₦316.70bn and ₦71.97bn.

On the expenditure leg, the budget proposes a record-level ₦17.13tn for fiscal year 2022. Capital expenditure is set at ₦5.47tn or 32% of total expenditure exceeding 2021 capex budget of ₦4.98tn in absolute and relative terms as the ratio of capex to total expenditure exceeds last 5 years average of 28%. Recurrent Non-debt and Debt-servicing costs remain sky-high at ₦6.91tn and ₦3.61tn respectively, representing 61.41% (Recurrent Non-debt:40.34% and Debt-servicing:21.07%) of planned expenditure.

For projections, we expect actual revenue collection at ₦6.72tn (62.6% of budget) with oil revenue at ₦1.80tn while non-oil revenue maintains strong recovery pace. As recorded over the past 3 years, we see actual expenditure at close par with the budget at 92% as recurrent expenditure consist mainly of personnel and debt-servicing costs which are inevitable. Although, fiscal deficit is set at ₦6.26tn for FY2022, we see a widening in the deficit to about ₦9.0tn due to expected underperformance in stated revenue numbers.

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