

Nigeria Strategy Report – H2 2017 Excerpts

Key Developments in Domestic Economic and Policy Environment

Economic Snapshot

June 2017 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	1.6%	16.1%	16.25%
Food	2.0%	19.9%	19.3%
All Items Less Farm	1.3%	12.5%	13.0%
Imported food	1.6%	14.2%	14.9%
Energy	0.75%	14.2%	16.3%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	305.8	0.0%	0.2%
EURNGN	367.2	-0.2%	13.6%
GBPNGN	410.8	0.3%	8.2%
JPYNGN	285.0	0.4%	8.7%

Monetary Aggregates – April 2017

	(₦'bn)	MoM	YoY
M2	21,713	-1.4%	4.8%
CPS	21,943	-1.5%	13.2%
NCG	5,592	7.5%	42.2%
NFA	7,262	-4.1%	43.2%
NDC	27,535	0.2%	18.1%

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)	30,323	0.95%	3.68%
Foreign Debt (\$'mn)	13,808	21.1%	23.3%

Growth Data – Q1 2017

	(₦'bn)	% of total	YoY
Real GDP	15,861	100%	-0.5%
Agriculture	3,385	21.3%	3.4%
Oil	1,411	8.9%	-11.6%
Services	5,975	37.7%	1.0%
Wholesale and Trade	2,819	17.8%	-3.1%
Manufacturing	1,543	9.7%	1.4%

Nigerian Fiscal: One Step Closer, Several More to go

FG banks bigger wallet on improved oil prices

After much congressional delays, the National Assembly finally passed the 2017 appropriation bill, more than four months after its submission by President Muhammadu Buhari, in May 2017. The approved document now reflects an increase in proposed fiscal expenditure to ₦7.44 trillion (vs. ₦7.298 trillion in the initial draft) primarily due to an upward review of proposed recurrent spend (+5% to ₦5.282 trillion) with proposed capital expenditure notably lower by the same margin. Crucially, it was the upward review of debt service to ₦181 billion (+11% from prior), perhaps to capture impact of elevated interest rate environment, that underpinned the increase in recurrent spend. On the revenue side, projected oil revenue of ₦2.08 trillion is also 9% higher than prior as the National Assembly raised crude oil price assumption to \$44.50/bbl. (vs. \$42.5/bbl. previously) while leaving target crude output unchanged at 2.2mbpd. On the other hand, overall non-oil revenue estimate was essentially left unchanged at ₦3.0 trillion, split into non-oil (₦1.4trillion), independent revenue (₦807billion) and other revenue (₦776billion). Thus, it was the upward revision in oil price assumption that primarily underpinned the rise in 2017 projected revenue to ₦5.08trillion (vs. ₦4.94 trillion previously and ₦3.86 trillion in 2016).

On balance, given the largely consistent changes on both the revenue and expenditure fronts, projected deficit is largely unchanged at ₦2.36 trillion

(vs. ₦2.20 trillion in 2016) still to be predominantly financed by borrowings (~98%) from local and foreign sources.

Table 1: Highlights of approved budget

	Approved 2017 budget	Proposed 2017 Budget	2016 Budget
Oil price (\$/bbl)	44	42.5	38
Oil production (mbpd)	2.2	2.2	2.2
Average Exchange rate (₦/\$)	305	305	197
FGN retained revenues (₦'trillion)	5.08	4.94	3.86
FGN expenditure (N'trillion)	7.44	7.3	6.06
Budget deficit (₦'trillion)	-2.36	-2.36	-2.2
Debt service (₦'trillion)	1.84	1.66	1.36

Source: Budget Speech, ARM Research

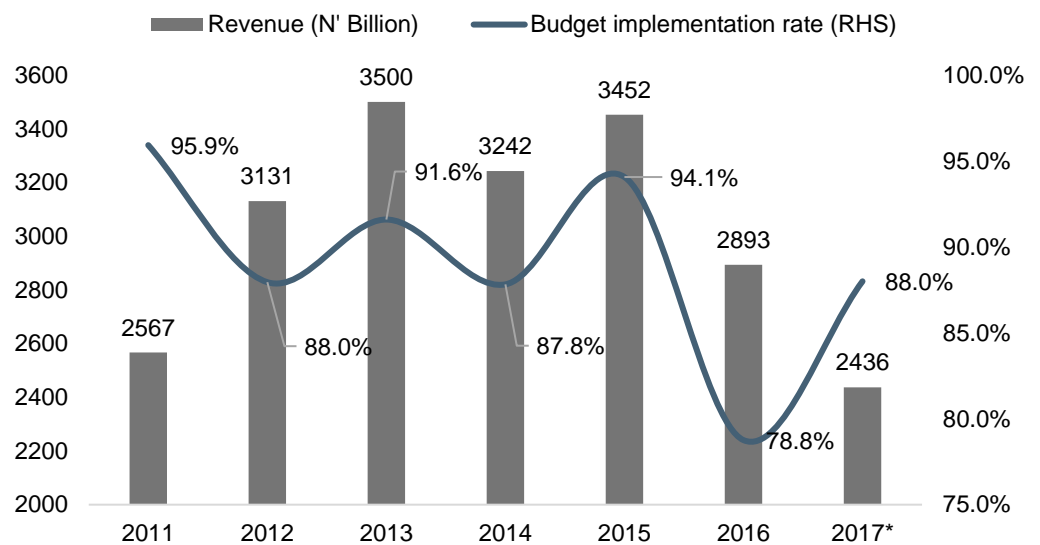
Budget implementation rises despite revenue slippages

Importantly, our earlier concerns about the overly optimistic nature of FG's revenue projections have already materialized with actual federally retained revenues over the first five months of 2017 sizably lower than budget target (-55% at ₦1.015 trillion). According to the CBN, subdued FG retained revenue was an outcome of lower than anticipated oil and non-oil receipts in the period. Specifically, oil receipts were lower than budgeted by 40% following subdued crude-oil and gas exports and PPT/Royalties while projections for non-oil was shy of actual by 49% in the period. In our view, the unimpressive oil and gas receipts corroborates earlier fears of sizable shortfall in crude production (~1.7mbpd over Q1 17) relative to a bullish budget expectation of 2.2mbpd. This drag was particularly occasioned by delayed re-opening of major oil export routes such as the *Trans Forcados* as well as emergency repair works at -Trans-Niger Pipeline (TNP) & Nembe Creek Trunk Line (NCTL). On the non-oil leg, CBN pinned nonperformance to overall slowdown in economic activities with corporate taxes, VAT, and independent revenues more than 50% below government's expectation for the period.

Even though FG's revenue receipts were well below expectations, budget implementation rose sizably January through May (+9.2pps YoY to 88%). In addition, further breakdowns suggest that a larger proportion of spending (i.e. north of 60%) went the way of recurrent expenditure with capital expenditure accounting for another 24%. Although allocations to capital expenditure still lagged FG's target by 5pps, recurrent disbursement is notably

within government's target. Overall, largely reflecting sizable revenue shortfalls amidst high budget implementation, Nigeria's fiscal deficit printed at ₦1.828 trillion (or ~77% of FG's fiscal deficit estimate for 2017) over the first five months of the year alone to provide strong support for our expectation of a far larger deficit for Nigeria in the current year. As stipulated in the budget, the deficit was funded via borrowing, with the FG raising about \$1.8 billion (₦549 billion) in foreign currency in addition to net borrowing of ₦717 billion from the local debt market.

Figure 2: Historical revenue and budget implementation rates



Source: CBN, ARM Research, 2017* estimate

Lingering revenue pressures to hamper states' budget implementation

Over the first four months of 2017, FAAC disbursements to state governments stood at ₦490.5 billion, 32% higher on YoY basis. The jump in FAAC allocation largely reflects gains in exchange rate relative to prior year following naira devaluation. Although, the robust numbers hint at improved outlook for the fiscal position of states, we note that on an annualized basis, actual statutory allocation to states accounted for a meagre 22% of cumulative state government budget for 2017 (vs. 26% in the prior year). These setbacks, in our view, make it difficult for states to pull out of the challenge of an ever-rising accumulation of unpaid salaries.

FG on course to raise borrowings

Despite well documented increases in crude prices (H1 17: +18.3% YoY to \$53.25/bbl) which had provided backing to Nigeria's recent oil benchmark price review, we retain a largely cautious stance on revenue expectation for the rest of the year. This is even as OPEC's attempt to rebalance the oil market via production cuts appears to be losing the fight to sizably tilt crude price northwards. Precisely, after hovering over \$50/bbl in the first four months of 2017, crude prices crashed to \$46.43 in July (-18% YTD) with concerns across OPEC wild cards (i.e. Nigeria, Libya, and Iraq) and US shale production obvious pointers that the current supply glut could extend for the rest of the year or even get worse. In view of these realities, we have reviewed our H2 17 target crude price to \$45/bbl (vs. \$55/bbl previously). This benchmark now implies 2017 weighted crude price of \$49.12/bbl. Although this estimate remains sizably higher than the budget benchmark price, it however represents sizable cutback compared to our previous expectation. Furthermore, developments on the production front have not been as pleasant as FG would have hoped for with average crude production of 1.73mbpd still shy of budget target by a whopping 21% according to NNPC's latest report. Going into the second half of 2017 though, increased budgetary allocations to amnesty and better conciliatory efforts, which have already reflected in the number of pipeline vandalized points and the late re-opening of Trans Forcados in May, speak to potential increase in crude production. Even then, the FG's projection for oil output of 2.2mbpd remains overly ambitious in view of limited investments into the sector which continues to reflect delays in passing the other tranches of the PIB addressing the fiscal aspect of oil and gas. Needless to mention, the trend of narrowing pipeline vandalized points was bucked in March as the Niger Delta offered timely reminder of how slender "tranquil" can be in the volatile oil-rich region. Thus, we have adopted a less sanguine target crude production of 1.9mbpd for 2017. Having combined this assumption to our weighted crude price target for 2017, we now project oil receipts at ₦1.8 trillion—11% below budgetary estimates.

On the non-oil leg, major components of non-oil revenue—VAT, CIT, and Customs—are yet to reflect improvements on the FX front that are slowly driving improvements in company performance and overall macro (as evidenced by the FX-led rebound in non-oil GDP in Q1 17). This is compounded by depressed discretionary income levels and pass-through from weaknesses on the oil side of things. That said, whilst current run rate of total

FG retained revenue receipts from January through May and an adjustment for our estimate for oil receipt would ordinarily have translated to non-oil revenue projection of ₦636 billion for 2017, we see scope for a relatively strong improvement in H2 17 in line with historical trend. Thus, we now forecast FG retained non-oil revenue at ₦1.4 trillion (vs. ₦1.6 trillion in previous estimate and ₦3.0 trillion in budget target). The foregoing, combined with oil revenue estimate of ₦1.8 trillion suggest an FGN retained revenue of ₦3.2 trillion (36% lower than in the proposed budget). Overall therefore, we project fiscal deficit at ₦4.3 trillion or 83% greater than government projection. For context, entire government borrowing has thus far met only 29% of our estimated deficit. Thus, assuming even a lower budget implementation of 80% (vs. 88% thus far in 2017), we see scope for sustained high FG issuances in the coming months.

Table 2: 2017 Federation budget vs. ARM estimates

	2017 Budget	Estimates		
		Bear	Base	Bull
Oil production (mbpd)	2.20	1.00	1.90	2.20
Oil price (\$/bbl)	42.50	30.00	45.00	60.00
Exchange rate (N/\$)	305.00	300.00	305.00	450.00
Oil and gas receipts (N' billion)	4,940	1,478	4,273	9,756
Deductions				
JV Cash calls (N' billion)	-	370	-	-
13% derivation (N' billion)	642	144	556	1,268
Net Oil Revenue (N' billion)	4,298	965	3,718	8,488
FG Share of oil revenue (N' billion)	2,084	468	1,803	4,117
FG share of non-Oil revenue (N' billion)	1,370	504	699	882
FG independent revenue (N' billion)	808	213	223	223
Other revenue (N' billion)	776	356	454	454
FG Total revenue (N' billion)	5,038	1,541	3,179	5,675
FGN Expenditure (N' billion)	7,444	7,444	7,444	7,444
Fiscal deficit (N' billion)	(2,406)	(5,903)	(4,265)	(1,769)

Source: Budget Speech, ARM Research

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