

July 25, 2019



## Nigeria Strategy Report

H2 2019

Domestic Economy and Policy Environment

# Nigerian Fiscal: CBN backdoor financing will constrain local borrowing

### Executive Summary

In our H1 19 strategy report, we had estimated fiscal deficit over 2019 to print at ₦2.9 trillion – from our revenue expectation of ₦4.4 trillion and expenditure of ₦7.2 trillion – which basically formed our domestic borrowing expectation of ₦1.4 trillion after adjusting for CBN part funding of 34% of the projected domestic borrowing ₦2.1 trillion. Coming into 2019, actual fiscal deficit in the first five months of 2019 printed at ₦825 billion (-50% YoY) Reflecting the lag in FG's retained revenue relative to budget implementation. However, FG borrowed just ₦371.8 between January and May, representing 45.1% of the total deficit, with no foreign borrowings over the period. For us, we believe the excess deficit of ₦426.8 billion was funded by the CBN similar to the prior year. To clarify, total overdraft claims on FGN increased by ₦615.1 billion between December 2018 and April 2019 – which translates to 15.8% of 2018 actual FGN revenue. That said, total overdraft claims on FG now prints at ₦6.0 trillion as at April.

Over 2019, we expect federally collected revenue to print at ₦4.2 trillion (53% lower than budget projections), which is 6% higher than the prior year. Our estimate is based on expected average crude oil price of \$62.31/bbl. and our forecast crude oil production of 2.04mbpd, which resulted in oil revenue of ₦1.8 trillion (budget estimate of ₦3.7 trillion). On non-oil revenue, following the kick-off of the divestment process of FG's equity stake in JV oil assets in 2018, we see some room for completion during the year, albeit at a lower valuation. With our modelled budget implementation of 89%, we estimate that fiscal deficit could range between ₦3.0 trillion and ₦4.8 trillion with our base case of ₦3.7 trillion. In terms of financing, on the sale & privatization of government assets where FG expects ₦210 billion, we forecast no sale and project foreign borrowing of \$2.2 billion (₦803 billion) over the second half of the year. With the balance of ₦1.8 funded by the CBN as in the prior year.

***In this report, we focus on developments in the fiscal space over H1 2019. We also delineate our view on the feasibility of FG's 2019 Budget projections and implications for government borrowing farther out.***

*Approved 2019 Budget: Much of the same*

In a less confrontational exercise than usual, the National Assembly passed the 2019 budget in May with the President assenting to the appropriation bill the same month. Compared to the proposed outlay of ₦8.83 trillion submitted to the National Assembly in December 2018, the approved budget was increased by ₦80.3 billion to ₦8.91 trillion due to an upward review of recurrent non-debt expenditure by ₦17.4 billion, capital spending by ₦63.3 billion, statutory transfers by ₦9.7 billion. However, we saw a ₦10 billion cutback in provision for sinking fund. Clearly, the increase in capital expenditure largely emanated from adjustments made on capital allocations to top 12 MDAs and increase related constituency projects. On statutory transfer, the breakdown reveals an increase of ₦5 billion to NDDC<sup>1</sup>, ₦1.5 billion to UBE, ₦3 billion to the National Assembly and ₦0.199 billion to the Public Complaints Commission.

On revenue, compared to prior years, National Assembly left all oil revenue assumptions unchanged, translating to a projected revenue of ₦3.7 trillion. On the other hand, overall non-oil revenue estimate was increased by ₦31.5 billion to ₦3.3 trillion essentially reflecting upward adjustments to receipts from Company Income Tax (₦14 billion to ₦813.4 billion) and Custom Revenue (₦8.3 billion to ₦310.9 billion). Furthermore, estimates for independent revenue was also increased by ₦6.5 billion to ₦631 billion, while the Federation account levies and special accounts was increased by ₦2.82 billion to ₦64 billion. On balance, reflecting the higher adjustments to expenditure compared to the revenue estimates, fiscal deficit increased by ₦58.9 billion to ₦1.92 trillion. However, reflecting inconsistency on the part of the legislature on the financing of the deficit, planned borrowings was revised lower by ₦44 billion to ₦1.61 trillion, which coupled with the ₦210 billion projected privatization proceeds, left the approved budget with a financing gap of ₦102.8 billion.

**Table 1: Key highlights of the 2019 approved budget and 2018 Actual**

	Approved 2019 budget	Proposed 2019 budget	2018 Budget	2018 Actual
<i>Oil production (mbpd)</i>	<i>2.3</i>	<i>2.3</i>	<i>2.3</i>	<i>1.96</i>
<i>Oil price (\$/bbl.)</i>	<i>60</i>	<i>60</i>	<i>51</i>	<i>71.3</i>
<i>Exchange rate (₦/\$)</i>	<i>305</i>	<i>305</i>	<i>305</i>	<i>305.95</i>
FG Share of oil revenue (₦' billion)	3,688	3,688	2,988	2,320
Total Non-Oil revenue (₦' billion)	3,310	3,279	4,177	1,640
<b>FG Total revenue (₦' billion)</b>	<b>6,999</b>	<b>6,967</b>	<b>7,165</b>	<b>3,960</b>
FGN Expenditure (₦' billion)	8,917	8,827	9,120	6,940
<b>Fiscal deficit (₦' billion)</b>	<b>-1,918</b>	<b>-1,860</b>	<b>-1,955</b>	<b>-2,357</b>

Source: Budget office, CBN, ARM Research

<sup>1</sup> Niger Delta Development Commission

*Lower oil prices underpin drag FG receipts*

In our H1 2019 Nigeria Strategy Report (See Report: Nigerian Fiscal: More strain on FG finances), we had expressed concerns about the overly optimistic nature of FG's revenue projections, which was little changed from the approved appropriation bill. Over the first five months of 2019, actual federally retained revenue of ₦1.5 trillion fell short of prorated budget estimate by 49% and below same period in the prior year by 11.3%. The shortfall emanated largely from lower than projected oil and non-oil receipts. On oil revenue, provided breakdown by CBN showed actual oil receipts fell short of expectation by 28% due to lower than anticipated crude-oil and gas exports, domestic crude oil and gas sales, and PPT/Royalties. Relative to FG's projections, the slow-down in constituents of oil receipt largely reflects sizable shortfall in crude oil production (~1.94mbpd average) as prices were higher over the review period. However, when compared to the prior year, the decline in oil receipts largely reflects lower prices over 2019, which averaged \$67.20/barrel compared to average over the same period of 2018 of \$70.20/barrel. On the non-oil leg, the decline relative to the prior year (and prorated budget estimate) emanated from shortfalls in receipt from independent revenue, corporate income tax and other revenue.

On expenditure, reflecting the lower receipts relative to the prior year, budget implementation printed at 62.6% (vs. 88.3% in 5M 18). FGN's spend over the review period printed at ₦2.3 trillion with recurrent expenditure (₦1.63 trillion) accounting for 70% of total spend, 26% was disbursed to meet capital expenditure (₦607 billion), while the balance of ₦90 billion was allocated to statutory transfers. Notably, the CAPEX spend reflects funds allocated to the completion of outstanding 2018 capital projects as the 2019 capital spend commenced after the assent of the appropriation bill.

Reflecting the lag in FG's retained revenue relative to budget implementation, fiscal deficit amounted to ₦825 billion (-50% YoY) above ₦799 billion allotted in the budget for the period. However, FG borrowed just ₦371.8 between January and May, representing 45.1% of the total deficit, with no foreign borrowings over the period. For us, we believe the excess deficit of ₦426.8 billion was funded by the CBN similar to what was done in the prior year. To clarify, the law allows FG to fund its expenses through unorthodox sources, such as overdraft from the CBN which gives room for the government to receive up to 5% of the prior years' actual revenue. Going by CBN's data, total overdraft claims on FGN increased by ₦615.1 billion between December 2018 and April 2019 – which translates to 15.8% of 2018 actual FGN revenue. That said, total overdraft claims on FG now prints at ₦6.0 trillion as at April.

**Table 2: Implementation of the 2019 budget approved between January - May**

(₦' billion)	FY 19 Budget	Prorated Jan - May	Actual Jan - May 19	Actual Jan - May 18
<b>Retained Revenue</b>	<b>6,999</b>	<b>2,916</b>	<b>1,499</b>	<b>1,690</b>
Federation Account	4,572	1,905	1,157	1,257
VAT pool account	229	96	71	64
FGN Independent Revenue	848	354	228	210
Others	1,349	562	44	160
<b>Expenditure</b>	<b>8,917</b>	<b>3,715</b>	<b>2,325</b>	<b>3,354</b>
Recurrent	6,630	2,762	1,628	2,339
Capital	2,095	873	607	825
<b>Surplus (+)/Deficit (-)</b>	<b>1,918</b>	<b>799</b>	<b>825</b>	<b>1,664</b>
Borrowings	1,606	669	372	N/A

Source: CBN, ARM Research

***Improved FGN receipt, but short of projection***

Coming into 2019, the free fall in crude oil prices amidst global idiosyncrasies had informed our expectation of average crude oil price of \$55.95/bbl. and production of 2.07mbpd, guiding our projected oil receipts of ₦2 trillion (Budget estimate: ₦3.69trillion). While crude oil prices over the first half of the year came ahead of our estimate at \$66.06/bbl., average crude oil production fell short of estimate at 1.96mbpd to offset the impact of higher prices. Going into the rest of the year, we have adjusted our base FGN oil revenue estimate slightly lower to ₦1.8 trillion, reflecting a downward adjustment to production and FG's share of overall oil revenue. However, we increased our estimate for average crude oil prices to \$62.3/bbl.

**Table 3: 2019 Federation revenue budget vs. ARM estimates**

	2019 Budget	Estimates		
(₦' billion)		Bear	Base	Bull
<b>Oil production (mbpd)</b>	<b>2.30</b>	<b>1.84</b>	<b>2.04</b>	<b>2.21</b>
<b>Oil price (\$/bbl)</b>	<b>60</b>	<b>61.06</b>	<b>62.31</b>	<b>71.06</b>
<b>Exchange rate (₦/\$)</b>	<b>305</b>	<b>305.87</b>	<b>305.87</b>	<b>305.87</b>
Oil and gas receipts	7,682	4,506	5,111	6,311
Net Oil Revenue	5,706	3,347	3,796	4,687
FG Share of oil revenue	3,688	1,547	1,755	2,166
Non-Oil revenue	1,418	1,089	1,210	1,271
FG independent revenue	644	477	454	545
Other revenue	1,247	33	746	932
<b>FG Total revenue</b>	<b>6,997</b>	<b>3,146</b>	<b>4,165</b>	<b>4,914</b>
FGN Expenditure	8,917	7,907	7,907	7,907
<b>Fiscal deficit</b>	<b>-1,920</b>	<b>-4,761</b>	<b>-3,741</b>	<b>-2,993</b>

Source: Budget Office, ARM Research

In line with historical trend, we expect non-oil receipts to grossly underperform budget estimates over 2019 due to ambitious targets set by the FG and the National Assembly. However, relative to our estimate earlier in the year, total non-oil receipt is expected to come in slightly higher at ₦2.41 trillion (previously: ₦2.32 trillion). The adjustment emanated largely from the increase in our projected receipts from custom/excise duties following the increase in exchange rate for Customs duty from ₦306/\$ to ₦326/\$ earlier in June. Albeit, the impact was muted by the downward revision of our projected Other Revenue estimate to ₦746 billion which includes the ₦500 billion estimated income from divestment of FG's equity stake in JV oil assets. While we maintain our bullishness on CIT following our expectation of improved performance of the non-oil sector and higher consumption in 2019, the upward review by the National Assembly suggests shortfall of 16.1% compared to our estimates. Combined with oil receipts, we estimate federally collected revenue to print at ₦4.2 trillion for 2019 (53% lower than budget projections), which is 6% higher than the prior year.

Elsewhere on expenditure, assuming 100% implementation of recurrent expenditure, which typically runs January – December and much lower capital expenditure of 58% (5-year average of 59%, and FY 18 of 57%), which runs one year from the month of budget approval, we assume 89% budget implementation. Thus, we estimate total expenditure of ₦7.91 trillion in 2019, which overlaid on our projected revenue scenarios suggests that the fiscal deficit could range between ₦3.0 trillion and ₦4.8 trillion.

### ***CBN backdoor financing will constrain local borrowing***

In financing its proposed fiscal deficit of ₦1.9 trillion, the FG plans to improve on its optimal debt mix. The expectation is to fund the sum of ₦1.6 trillion via domestic and foreign borrowing in the ratio mix of 50:50, while the excess of ₦210 billion would be funded from the privatization of some non-oil assets by the Bureau of Public Enterprises (BPE). However, we believe the balance of ₦1.8 trillion in our estimate will largely be funded by the CBN considering the increase in CBN overdraft to the FGN over the first five months of the year. Recall, following the meager borrowings over 2018 of ₦290 billion, total overdraft extended by the apex bank amounted to ₦2.1 trillion, which helped support overall deficit (₦3.8 trillion) during the year. While actual guidance on the drawdown from the CBN wallet is not provided, we assumed two scenarios; 1) we annualized the overdraft from the CBN between the first five months which summed to ₦1.8 trillion, and 2) we assumed the same level over 2018. Overall, we believe actual borrowings from the capital market could be much lower than approved in the 2019 budget. Additionally, we played out different scenarios in the table below to forecast the potential size of domestic paper issue using our estimated fiscal deficit. Overall, we estimate that to finance the budget, the net debt issue could range between ₦622

billion and ₦1.1 trillion with the range sizably higher than 2018 net issuance of ₦90 billion. In sum, our scenario analysis guides to a higher domestic borrowing relative to 2018.

**Table 4: Scenario analysis of 2019 proposed borrowings**

₦'billion	Asset sale + \$2.2bn debt + Annualised Ways & Means	50% sale + \$2.2bn debt + Annualised Ways & Means	No sale + \$2.2bn debt + Annualised Ways & Means	Asset sale + \$2.2bn debt + FY 18 Ways & Means	50% asset sale + \$2.2bn debt + FY 18 Ways & Means	No asset sale + \$2.2bn debt + FY 18 Ways & Means
<b>Projected deficit</b>	<b>3,741</b>	<b>3,741</b>	<b>3,741</b>	<b>3,741</b>	<b>3,741</b>	<b>3,741</b>
Sale of Assets	210	105		210	105	
Foreign Borrowings	803	803	803	803	803	803
Domestic Borrowings	2,728	2,833	2,938	2,728	2,833	2,938
CBN ways and means	1,845	1,845	1,845	2,107	2,107	2,107
<b>Borrowings from capital market</b>	<b>883</b>	<b>988</b>	<b>1,093</b>	<b>622</b>	<b>727</b>	<b>832</b>
2018 net issuance	290	290	290	290	290	290
2017 net issuance	1,277	1,277	1,277	1,277	1,277	1,277
2019 YoY increase ((₦ billion)	594	699	804	332	437	542
<b>Total Borrowing</b>	<b>1,686</b>	<b>1,791</b>	<b>1,896</b>	<b>1,425</b>	<b>1,530</b>	<b>1,635</b>

Source: Bloomberg, ARM Research

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